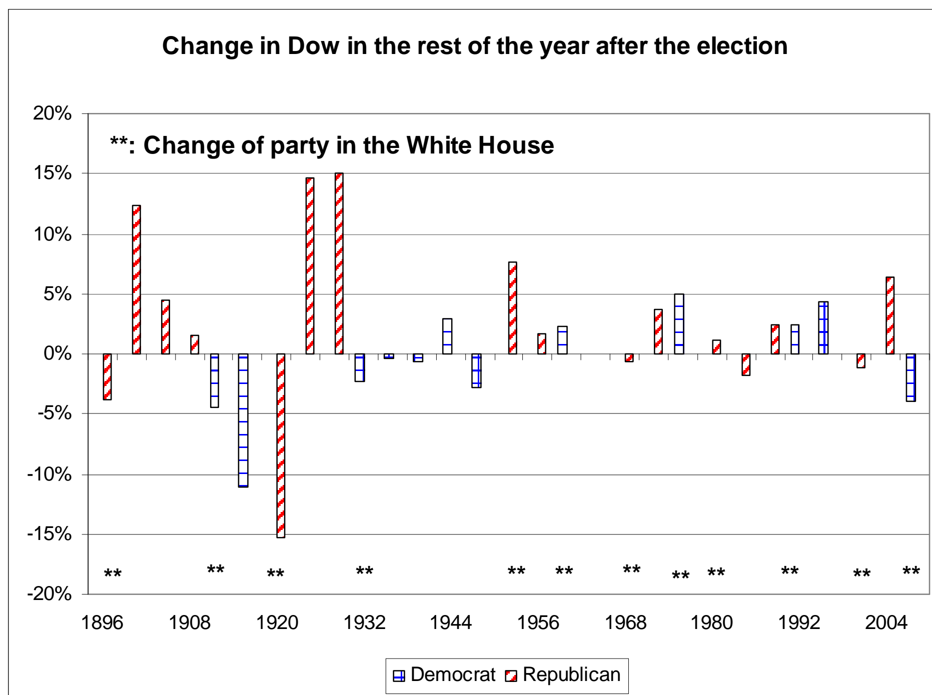
Stock Market Perspective: Is a Romney Win Good For Stocks?

"Conventional wisdom" often believes that Republicans are more likely to have policies that are favorable to business than are Democrats. If so, then one might think that stocks are more likely to do better under a GOP administration. The Dow Jones Industrial Average began in May of 1896, so we can use it as a measure of the performance of stocks following the elections from that year through 2008, a total of 29. Once the data are divided by winning party and by whether or not there was a change of party, we won't have enough observations for anything close to statistical significance. However, the numbers should be fun to look at and may provide some insights.

We will look at the percent change in the Dow over two periods following the election. One is how it did for the rest of the year. Since the stock market was closed on election day before 1968, I looked at the percent change from the day after until the end of the year. The other period is the four years following the election year (through September 30 of this year).

The first graph shows the changes for the rest of the year after the election. The red or "candy cane stripe" bars are after the Republicans won the White House, and the blue or horizontal striped ones are, not surprisingly, for the times the Democrats won. The years with "**" above them are the ones when there was a change in the winning party. Note that the moves tended to be larger in the earlier years, particularly the 1920s, than they have been in the more recent past.



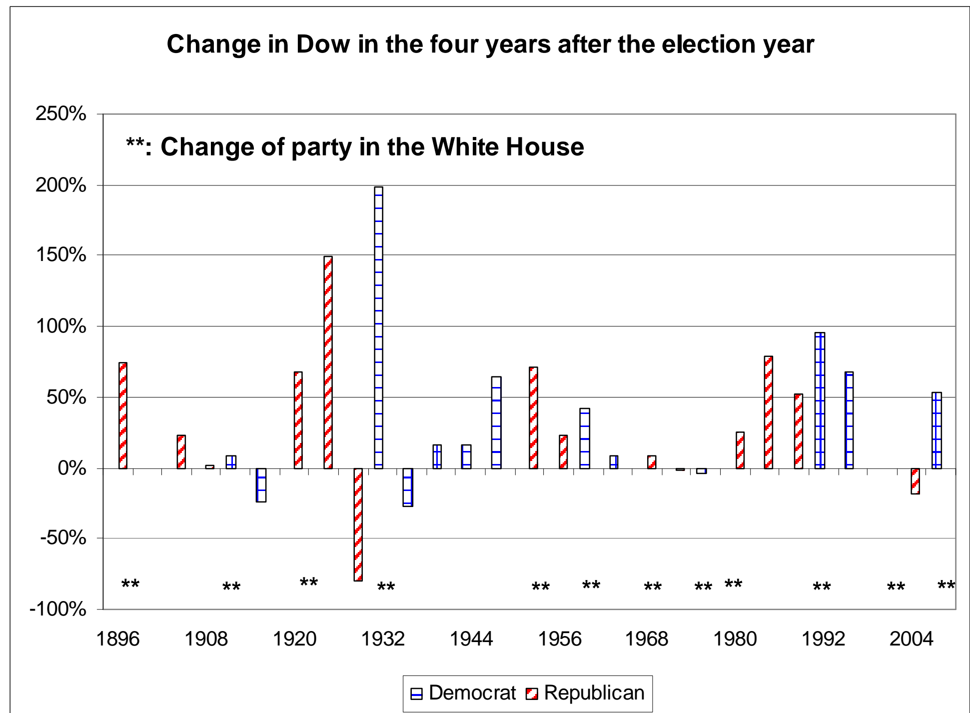
The Republicans have been elected 16 of the 29 times. In the remainder of the years after they have won, the Dow has gone up 11 times (69% of the time) for an overall average gain of 3.0%. In contrast, only 6 (46%) of the 13 Democratic victory years have seen the Dow rise in the rest of the year, and the total average change has been a loss of 0.7%. In the short term, the market seems to prefer a Republican victory.

In the 29 elections, 17 times the party in office retained power. In 12 (71%) of the years the Dow rose right after the election with an average change of 3.1%. In the 12 years when there was a change of party, only five (42%) saw the Dow rise, an overall average loss of 1.1%.

Those figures provide a mixed view about how the upcoming election result is likely to affect the remainder of the year. There were six years when a Republican took over from a Democrat and seven when the Democrats were kept in office. Those are too few cases to draw any meaningful inferences, so I won't try.

Perhaps of greater interest is how stocks did the four years following the

elections. The graph on this page shows the results. The layout is the same as in the first graph although the percent changes being over a much longer period are considerably larger.



There are far more rising four-year periods than falling ones, which is consistent with the long-term tendency of stocks to increase in value. As in the first graph, the 1920s are an extreme period with strong gains until the crash in 1929, which led to the deepest plunge ever in the Dow. The four years starting in 1933 saw the largest increase as stocks rebounded from the depths of the great depression.

There were ten up periods after each party won[1], so that is 77% of the 13 after Democrats won and 63% of the 16 Republican victories. The overall average gains were 39.5% for the four years after a Democratic win and 29.7% when the GOP had the White House.

When there was no change of party, 11 of the 17 times (65%) saw the Dow rise an average of 20.5%. When the other party took over, 9 of the 12 (75%) of the following four year periods were up with an average gain of 53.3%.

Republican are good for stocks and Democrats are bad for them? The data show that is not the case.

That leaves us with mixed results. It looks like the markets prefer a Republican winner in the short term and a Democrat in office for the following four years. On the other hand, the markets seem to be happier in the short-term when the party in power retains office, but does better over the following four years when there is a change. However, the four year results may be distorted due to the periods following the 1928 and 1932 elections. That illustrates one of the problems due to working with a relatively small number of cases, particularly when they have taken place over a very long time.

▶**Predicting the Winner:** Although the above does not really provide any useful "market timing" insight since returns in both periods are inconsistent based on party and whether there is a change, it is still interesting to see what markets and a non-pundit analytical method say about the likely outcome of the election. I am writing this before the first debate between Obama and Romney, and will update after it.

The first predictor is the Iowa Political Markets at "http://www.biz.uiowa.edu/iem/". I have written about these frequently, so I won't repeat the explanations and will go right to the latest readings.

[1] The Dow is up 53% for 2009 through Sept. 30, so it is a virtually certainty that the current period will be up.

As of mid-day on October 2, the markets are saying Obama will get 54% of the popular, not necessarily Electoral College, vote and Romney will get 46% with any votes for others ignored. The probability that Obama will get the most popular votes according to the market is about 75%. The graph of the vote shares shows a fairly steady "trend" for the past few months with perhaps a slight increase for the President. On the other hand, the probability of winning increased substantially for Obama after the conventions. It has gotten up to 80% before retreating a little in the past few days.

On October 10, a week after the first debate, the markets, like the opinion polls, have increased their assessments of Romney's chances. The popular vote market moved to 52.5% to 47.5% in favor of Obama, and the chances of winning the popular vote market had dropped to 62% for the President.

The second method doesn't care about the debates or the campaigns, but is based for the most part on domestic and foreign events during the current term. It was developed by Allan Lichtman, a history professor at American University in Washington, DC, based on statistical pattern recognition methods that have been used in various fields including predicting when earthquakes were the most likely. He developed it after the 1984 election, and it has correctly predicted the winner of the popular vote (i.e. Gore in 2000) in every election since then. It was written about in the latest issue of Analytics, a publication of the Institute for Operations Research and the Management Sciences (INFORMS), a professional society promoting research and practical applications of quantitative methods: (http://viewer.zmags.com/publication/577682e8#/577682e8/31).

Lichtman's model has 13 "keys" to the election. If six or more of them are negative for the party in power, the other party will win the popular vote. So far only three of the thirteen are negative for Obama—loss of seats in the House in the midterm election, slower economic growth than in the previous two presidential terms, and his not being charismatic or a national hero. Although not likely at this point, one or two more could turn negative (the economy appears to be in a recession, the recent events in Libya and the Middle East are considered to be a foreign policy failure). Even if they do, the model says Obama would win the popular vote. Some of the positives are Obama is the sitting president, there is no serious third-party candidate, Romney is neither charismatic nor a national hero, there has been a foreign policy success (the killing of bin Laden), and a major policy change (the health care act, which has been upheld by the Supreme Court).

As trading of stocks and mutual funds as well as markets moving to unsustainable extreme levels show, neither of the two predictors is likely to be a perfect crystal ball. Moreover, as the history of the Dow after elections illustrates, knowing the winner of the election is unlikely to provide a useful forecast for the direction of stock prices.