

# On The Mark

## Midterms & Markets

September 2022

### Key Takeaways

- Historically, midterm elections have cost the incumbent presidential party seats in the House of Representatives.
- During midterm election years, market returns tend to be range-bound and volatility remains elevated compared to non-election years.
- Over the long-term, however, markets don't see red or blue but simply green and have gone up regardless of the party in power.

Midterm elections are around the corner, and the outcome will determine which party has control of the House of Representatives and the Senate. The result can also be a signal for the next presidential election. Midterm elections are important as they can have significant potential impact on policy and laws. In this edition, we look at how the balance of power has historically shifted during midterms and what, if any, impact it has had on the stock market.

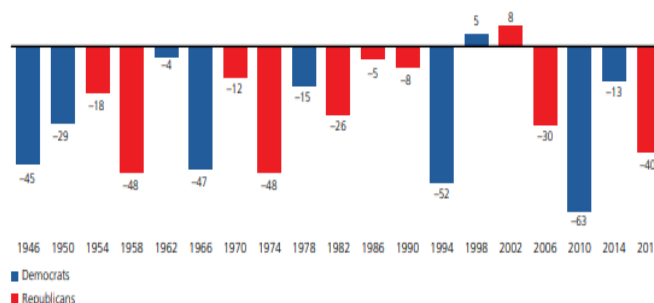
### How Midterms Impact the Control in Congress

Midterm elections have historically been challenging for the incumbent president's party. The impact has been clear in the House of Representatives, while the Senate has shown mixed results. Since 1946, the president's party has lost an average of 25 seats in the House of Representatives in 17 of the 19 midterm elections<sup>1</sup>. The consistency in losses can be attributed to a myriad of reasons, including higher motivation for voters of the opposing party who view the midterms as a referendum on the administration and general dissatisfaction with the state of the economy. The exceptions in 1998 and 2002 were tied to unique circumstances. In 1998 a strong economy helped, while in 2002, voters rallied around the incumbent president post the 9/11 attacks. In 2022, record-high inflation and concerns about the state of the

economy will likely play critical roles in the upcoming elections.

House seats gained or lost by president's party

Midterm elections, 1946-2018

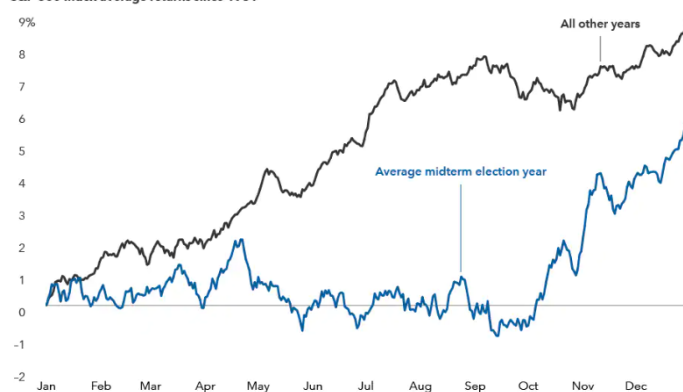


Source: UBS

### Stock Market & Midterm Election

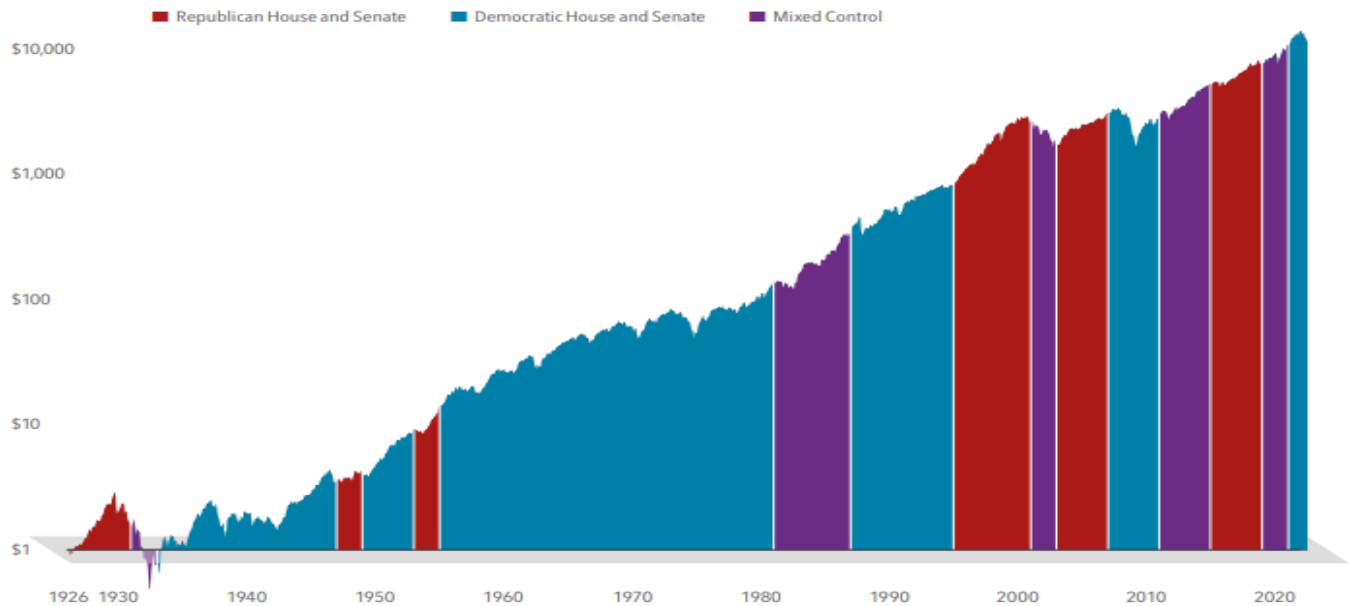
During midterm election years, market returns tend to be range-bound, and volatility remains elevated compared to non-election years<sup>2</sup>. While markets are impacted by a variety of forces, such as inflation, the direction of interest rates or the state of the job market, the subdued returns prior to elections and generally higher volatility are likely explained by the fact that markets don't like the uncertainty from potential policy changes.

S&P 500 Index average returns since 1931



Sources: Capital Group, RIMES, Standard & Poor's. The chart shows the average trajectory of equity returns throughout midterm election years compared to non-midterm election years. Each point on the lines represents the average year-to-date return as of that particular month and day and is calculated using daily price returns from 1/1/31-12/31/21.

HYPOTHETICAL GROWTH OF \$1 INVESTED IN S&P 500 INDEX.



Source: Dimensional Funds. Data from 1/1/26-6/30/22

Regardless of the outcome of the elections, market returns for the one year following midterms and over the long term have historically been strong. Since 1930, the average return for the 12-month period after a midterm election is 13% compared with 5.5% for other years<sup>3</sup>. Only in two instances did the market have negative returns for the 12-month period after midterm election years: in 1930-31 and 1938-39. Each of these periods were aligned with the economic challenges of the Great Depression and the early onset of WWII.

Finally, data over the last nearly 100 years shows that investors who remained disciplined and invested in the S&P 500 from January 1, 1926, through June 30, 2022, would have seen growth in their equity portfolio

regardless of whether Democrats or Republicans controlled the House and Senate or whether control was mixed<sup>4</sup> as seen in the final chart.

Many may think that's all in the past, and this time is different. Indeed, there are many important issues facing our country today; however, markets don't see red or blue, only green. The factors that will dictate the markets include interest rates set by the Federal Reserve, continued innovation, and ongoing consumer spending, not simply elections. Nearly a century's worth of data has shown using elections alone to make investment decisions is likely to lead to unreliable investment results.

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<sup>1</sup> UBS. 2022 Election Watch.

<sup>2</sup> Capital Group: Can midterm elections move markets? 5 charts to watch

<sup>3</sup> UBS. 2022 Election Watch.

<sup>4</sup> Dimensional Funds. What History Tells Us C22-about the Market and Control of US Congress

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