

Musings from the Chief Economist

Election 2008

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OCTOBER 16, 2007

As the 2008 election approaches, debate over potential changes in fiscal and foreign policy is likely to increase investor anxiety. The vote is still more than a year in the future. Although not an overarching concern yet, the election is definitely something on the minds of investors. Moving forward, it is reasonable to assume that election uncertainty may cause some bumps between now and next November. The size of the bumps will likely depend on what the candidates are saying, what the media is

reporting and what other factors are driving the investment markets.

Historical presidential cycle

Since 1888, the tendency has been for stocks to trade up in the fourth quarter of the year prior to the election, turn volatile in the first half of the election year and then move higher after the election. The chart below shows historic stock price changes under different election scenarios.

“History does not repeat itself, but it rhymes”

Historical perspectives like this are interesting but can be misleading. The historical record is more an accident of history than a reason to invest or not invest in stocks. As Mark Twain once quipped, “History does not repeat itself, but it often rhymes.” Historically, election years have tended to be more volatile. However, when the incumbent party won, the stock market typically did very well. Continuity is usually perceived as a

Four-Year Presidential Stock Cycle 12/31/1888-12/31/2006

PARTY	Price Change Year-to-Year*			
	ELECTION YEAR	POST-ELECTION YEAR	MID-TERM YEAR	PRE-ELECTION YEAR
All Presidents	8.4%	2.9%	3.7%	11.2%
Republicans (17)	10.6%	3.7%	3.7%	6.5%
Democrats (13)	5.6%	1.9%	3.7%	16.5%
Incumbent Party Wins	13.9%	4.4%	4.5%	5.3%
Incumbent Party Loses	1.6%	0.9%	3.9%	18.5%
INCUMBENT REPUBLICAN PARTY				
Wins	17.5%	8.0%	-0.0%	14.3%
Loses	1.7%	5.2%	-4.9%	22.7%
INCUMBENT DEMOCRATIC PARTY				
Wins	8.9%	-0.9%	11.0%	12.0%
Loses	1.4%	-3.4%	12.0%	14.3%

*Before 1919, Cowles Commission Report. After 1919, S&P 500.

Source: Ned Davis Research

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good thing, since it reduces the chance of radical change that creates uncertainty.

Ultimately economic and market fundamentals drive the market

Stock prices are typically driven not so much by political affiliation but by the underlying policies that are pursued. Punitive high taxes, excessive government spending, overregulation and rampant protectionism are usually anathema to investors. However, extreme policies rarely get through the American political process. Our political system of checks and balances, for better or worse, usually assures glacial rather than radical change. Investors often overreact in the face of potential change, but such overreactions can create investment opportunities. The U.S. economy has shown a remarkable ability to adjust to political changes, proving its resilience time and time again.

It is also important not to fixate solely on the election. The stock market's behavior over the next year will be shaped not only by election uncertainty but by economic and market fundamentals, among other things. Fortunately, current stock market fundamentals remain healthy. Stock valuations are attractive, inflation and interest rates are low, the Fed is accommodative, taxes are low, and the global economy is strong. These are the types of factors that should drive stock prices in the long run.

In setting our investment strategy, we will continue to monitor any policy changes for how they might impact the fundamentals, avoid emotional overreaction and remain true to our disciplines.

We believe the election is too far off and the outcome too uncertain to be actionable at this point

It is too soon to be concerned about the possibility of radical changes. Rarely do radical policies get implemented, and the U.S. economy has shown itself to be resilient regardless of who occupies the White House. Given the historic volatility of the market during election years, some short-term tactical adjustments are likely, but our long-term strategy will continue to be driven by market fundamentals and the trend of the market.

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