The upcoming federal contests will affect policy — and, therefore, the conditions for business and investing — for at least the next four years.

It’s too soon to make predictions about what’s in store for investors during the next presidential term. However, review of current conditions and past patterns makes it likely that investors could see quite a bit of market volatility for the near term.

“This election seems particularly uncertain versus the past,” says Thom Melcher, chief investment officer for PNC Asset Management Group. “We’re seeing a high level of drama on both sides — and uncertainty of any kind, be it political or economic, is typically not helpful for upward market momentum.”

Looking To The Past For Guidance

Some market watchers look to what is called the presidential election cycle for a clue as to what to expect from equities. Researchers have indeed found a relationship between a president’s year of tenure in the White House and market performance, which has tended to create a four-year pattern.

“For example, in recent presidential election cycles, the third year of a presidential term has historically resulted in the strongest market performance,” Melcher notes. (See chart on right.) “This could be the result of spending to stimulate the economy and painting as positive a picture as possible by a candidate facing re-election, but it is a notable pattern.” However, he adds, 2011 was an exception to the rule.

And while this cycle may bode well for 2019, it reinforces the likelihood that markets may face pressure during the next 6–12 months. Melcher points out, “Presidential election years in the post-WWII era have historically shown to be the weakest for domestic equity markets. And open election years, that is, those in which there is no incumbent candidate, have underperformed the S&P 500 index.” According to research from the Ned Davis Research Group, S&P 500 returns average 9% in incumbent years vs. -6.6% in open years.

While not necessarily encouraging, these trends make sense to us. Consider that federal policies surrounding issues such as the economy, the federal deficit, health care, immigration and foreign policy depend to a significant degree on the outcome of both the presidential election and congressional seats. In the first year of an incumbent president’s term, exactly how much of the agenda will get through is unknown. This would seem to be doubly true when no incumbent is running and the markets have a full year to anticipate the potential degree of change on key issues.
Assessing The Prospects For This Election Cycle

But during this year in particular, it has been difficult to predict just how much election-year uncertainty may influence market performance. The decline in oil prices and global political unrest aren’t creating a stable backdrop for investors. The result? A dramatic first-quarter drop in the S&P 500 — at its worst, down 10% for the year, in mid-February. And while only six election years since 1896 have experienced declines of more than 5%, the last two of those occurred recently, in 2000 and 2008.

Melcher takes that as a cue for continued significant overall market volatility through 2016. “Despite the unsettling environment, we maintain our recommended allocations and our emphasis on quality, while carefully monitoring the markets, global economic data, and geopolitical events,” he says.

Watching and waiting is also Thom’s suggestion for those hoping to at least discern the prospects for various market sectors from the presidential contest. Those who aren’t convinced should keep in mind that congressional races have a role to play as well: “If the Republican party does take the White House and maintains control of both houses of Congress, it may be easier to make policy changes that will affect business conditions for some market sectors. But if the executive and legislative branches are not aligned, the country could end up with the same political stalemate that exists today.”

The nation has months to go before answers to these questions will become apparent, and even after the winners are known, we won’t know how effective they will be at getting their programs through. Prudent watchfulness seems a wise plan of action for the time being, and perhaps longer, in our view.

Learn how to manage the impact of market volatility on your portfolio.

Contact your PNC Relationship Manager or a PNC Wealth Management professional today.