

# Midterms and the Markets

By Don McArthur, CFA®, Senior Investment Strategist and Director of Equity Research

With so much uncertainty facing investors this year — inflation surging to the highest levels in 40 years, the ongoing and intensifying war in Ukraine, an extremely volatile bear market and evolving economic conditions — the U.S. midterm elections have almost become an afterthought. However, with Election Day 2022 just days away, Commerce Trust examines the potential impact the midterms could have on the equity market.

Midterm elections historically have served as a referendum on the political party that controls the White House, with the president's party often losing ground in Congress. Since the end of World War II, the president's party lost House seats in 17 out of 19 midterm elections and Senate seats in 13 out of 19, with an average loss of 27 seats in the House and four seats in the Senate.<sup>1</sup> Based on this track record, it appears voters prefer a divided government.

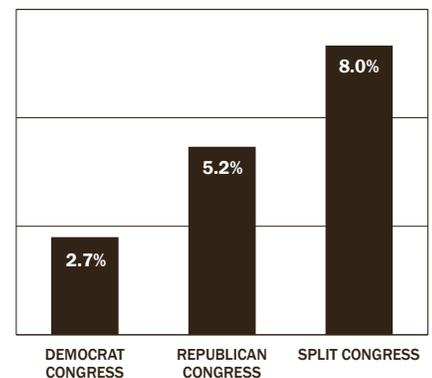
What does that mean from an investor's perspective? We looked at the historical market returns under the three likely scenarios facing the 2022 midterm elections of a sitting Democratic president combined with: 1) Democrat control of Congress, 2) Republican control of Congress, 3) split Congress. (Figure 1)

Looking at the performance of the Dow Jones Industrial Average dating back to 1900, the strongest returns came during periods of divided government, with the scenario of a Democratic president and split Congress delivering real annual returns of 8.0% followed by the Democratic White House and Republican Congress delivering 5.2% in real returns. In contrast, single party control where Democrats controlled both the White House and Congress produced a 2.7% real annual return. So, it appears the markets also prefer a divided government.

There's an adage that markets don't like uncertainty. Elections tend to bring clarity to the markets even if the result is political gridlock. Since 1950, the average one-year returns of the S&P 500 Index following a midterm election has been about 15%. (Figure 2)

### Dow Jones Industrial Average Real Returns, 1900-2018

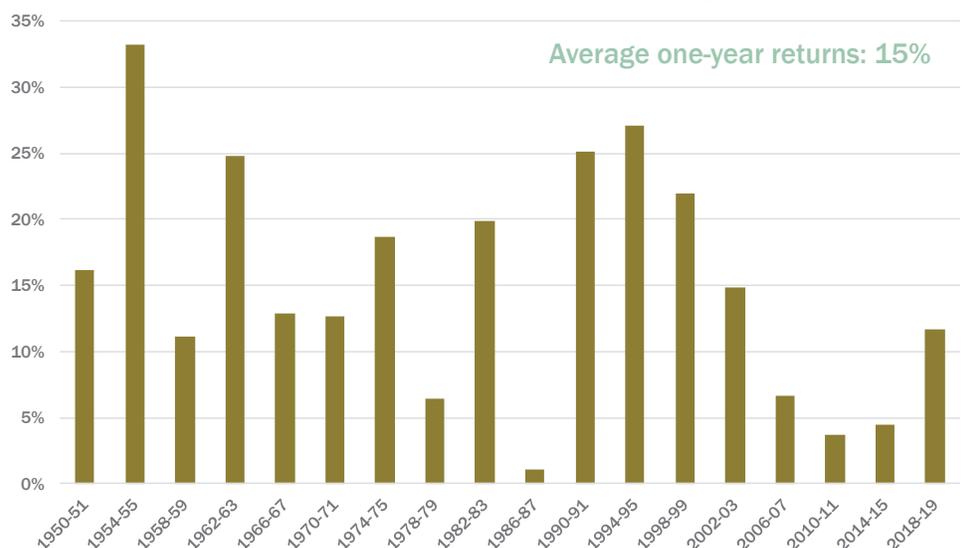
Figure 1



Source: Commerce Trust and Ned Davis

### S&P 500 Index One-Year Returns Following Midterm Elections Since 1950

Figure 2



Source: Commerce Trust, S&P Global Ratings.



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However, we believe the current economic cycle is more impactful to the capital markets than the outcome of November's midterm elections. History shows that patient investors who remain focused on long-term financial goals may be better positioned to withstand headwinds like political uncertainty than those who let short-term volatility dictate their investment decisions.

If you have questions about the potential impact of the midterm elections on your portfolio, contact a Commerce Trust advisor to be sure your investments are properly aligned with your goals.

<sup>4</sup>The American Presidency Project, University of California-Santa Barbara, "The 2022 Midterm Elections: What the historical data suggest," August 30, 2022.

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Don serves as a Senior Vice President, Senior Investment Strategist & Director of Equity Research with Commerce Trust in Kansas City and manages the Fundamental S&P 500 Equity Strategy. Prior to joining Commerce in 2006, Don was employed by Stifel Nicolaus and Company as a senior equity analyst and worked as a commercial lending officer at UMB Bank. Don earned his accounting degree and business administration degree with economics from University of Kansas in 1995. He also earned his master of business administration degree from the University of Missouri-Kansas City in 2000 and holds the Chartered Financial Analyst® designation.



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