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Four Myths About Investing in Presidential Election Years

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Earlier this month, we celebrated the declaration of our country's independence. This is also the month that both our major political parties will hold their national conventions, perhaps making this the perfect time to examine what we, as a nation, do to ourselves financially every four years as we exercise the electoral system our forefathers created.

Specific to investors, and to the financial services industry as a whole, is a question that hasn't gone away and never will: What effect will the process and result of electing a new president have on our investment portfolios?

That's a tough nut to crack. The most important place to start, however, is with an understanding of just how often statements of "fact" (whether they appear in the financial media or simply exist in the "conventional wisdom") are really just myths that continually need busting.

Myth #1: Presidential election years are a bad time to invest because the markets are too volatile.

Actually, during presidential election years in which the incumbent is not running for re-election, the Dow Jones Industrial Average (DJIA) tends to gain about 13 percent, roughly double what it would in a typical year. And there have been some impressive election-year leaps in the DJIA that far exceed its average. When Herbert Hoover was elected in 1928, the Dow rose 48.22 percent.

Of course, this dramatic performance was quickly forgotten when the nation plunged shortly thereafter into the Great Depression. But it begs the question: Does a down year inevitably follow an election year?

Myth #2: Sell high-risk stocks before the general election because markets are more likely to decline after the winner is announced.

True … if you're talking about the first half of last century. Yale Hirsh's "Presidential Election Cycle Theory" asserts that markets are weakest in the first year of a new president's term and then steadily improve until a new president is elected.

This trend hasn't been the case for decades. The presidencies of George H.W. Bush and Bill Clinton both showed very strong performance in their first year, for example. It just goes to show that any observed correlation between the market and election cycles is neither a viable investment strategy nor predictive of the future.

Myth #3: A Republican in the White House will be best for market performance.

Surely markets will react more positively to seeing the more "business-friendly" party in power, right? While this belief can affect the behavior of individual investors sensitive to the political climate, whether a Democrat or Republican is in the White House actually has "no statistically significant impact on U.S. equity markets."

The research shows that the political climate and investors' political beliefs not only can affect their view of the economy and the stock market, but also may impact their investment behavior (usually with negative results). Specifically, their returns tend to improve when the political regime favors the same party they do. Being aware of how your beliefs can affect your investment decisions is the first step to avoiding mistakes.

While the uncertainty or hopefulness inspired by presidential elections almost certainly has had some historical effect on markets, to what degree should we factor them into our decision-making process when investing?

Myth #4: Historical data for market performance in presidential election years is *the best* indicator of what to expect this cycle.

We certainly hope you don't believe this myth! Whatever data appears to justify an election-year stock strategy, there is always another interpretation to contest it. For instance, while the preceding data does seem to indicate a trend in which the DJIA rises in presidential election years, there doesn't appear to be any similar election-cycle trend on the S&P 500.

Better indicators of stock market performance may include economic conditions, but those are understandably less popular harbingers. Assessing the state of the economy is a lot more complicated than betting on a president or political party.

Fact: The best bet you can make is on the will of the markets to sustain themselves and grow over the long term.

Focus on monitoring your portfolio performance over years and decades, not election cycles, and certainly not single election years.

And whatever happens this fall, remember that as far as your portfolio is concerned, the results won't matter nearly as much as you think. However, having a broadly diversified and evidenced-based portfolio will certainly shift the odds of financial success in your favor over the long term.

About Joe Delaney, Managing Director, Lifeguard Wealth, San Rafael, CA

Joe Delaney founded Lifeguard Wealth to help others realize their goals and dreams. As a fee-only financial advisor, he is dedicated to putting clients first. Joe has more than 30 years of financial-industry experience as a CPA and CFO; he has held senior positions with institutional investment and wealth management firms. Since 2001, he has focused his career on creating and executing wealth management strategies for individuals and families. He is licensed to provide investment advisory services, and he holds a BA in economics from Stanford University and an MBA in finance from UCLA Anderson.

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