

Market Thoughts: Midterm Elections 2022

Yesterday, November 8, American voters once again took to the polls for midterm elections that will decide the balance of power in both houses of Congress. This year, all 435 seats in the House of Representatives and 35 seats in the Senate were up for grabs.

At the time of writingâ??mid-morning on November 9â??neither of the major political parties has a clear majority, and many races are still too close to call. Although ballots are still being counted, the most likely outcome is a divided government, which may result in more short-term market fluctuation and increased political congestion.

It is important to remember that short-term market fluctuations are a normal part of market cycles. Although congestion resulting from a divided government can be frustrating, in general, markets respond well to legislative gridlock because it creates a slower and more predictable pace of change.

Of course, historical patterns do not guarantee future events or provide a crystal ball through which investors can predict the next two years. Still, being aware of past market reactions to midterm elections can help investors understand the potential impact on both the economy and individual investment portfolios.

Hereâ??s what history tells us. First, stock prices are typically volatile in the days and months before a midterm election. 2022 has certainly fit the mold, although the post-pandemic circumstances of recent volatility are unique.

Second, the S&P 500 Index generally underperforms its average in the months before a midterm election. In fact, over the first ten months of midterm election years, the average return for the S&P 500 was a modest 3.8 percent, and 40 percent of the time, those returns were negative. But following midterm elections, the S&P 500 historically reverses course to outperform, with an average return of 19.6 percent over 12 months. The only time this outperformance did not happen was amid the Great Depression, in 1930.

Whatâ??s most important to highlight here is that these market trends are not connected with a particular political party gaining or maintaining power, nor do they correlate with a divided government, a unified government, or any other political-party dynamic. In other words, the markets do not prefer one result over another.

What does seem to have influence on the markets is the health of the economy. Stocks tend to do well after elections because elections clarify some of the questions that have been swirling over the previous ten months. Across the current investment landscape with heightened economic and geopolitical uncertainty, any clarifying information is welcome.

We anticipate the outcomes of yesterdayâ??s vote will influence the federal legislative agenda. This could result in shifting taxation rules, spending priorities, or fiscal policy, among other things. Overall, the impact of yesterdayâ??s election on any of these is likely to be modest or minimal.

The takeaway: While we are likely to see continued short-term market volatility, tried-and-true investment principles still apply. Maintain a diversified portfolio, avoid emotional decisions, and harness the long-term compounding power of time.

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