Economic and Market Insights

Aug. 22, 2016

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Revealing commentary on what impact a Democratic or Republican administration could have on the economy

At a recent client teleconference, Commerce Director of Investment Strategies Joe Williams and Chief Economist Scott Colbert were asked how November's upcoming presidential election might affect the U.S. stock markets and economy in general. Their answers give readers a look at how election cycles of the past have impacted the markets and a list of possible presidential appointees at the Federal Reserve.

Q. Moderator: Joe, what would you say about how the elections might affect the stock market?

A. When we look at all the four-year presidential cycles going back to 1900, the third year of the presidential cycle is the best of the four regarding the stock market. The election year is the second best, where the market typically rises around 7%. While this year so far has been anything but normal in terms of the political election, generally what happens is that the market ends up being essentially flat or only up marginally the first six months of the year. There is volatility as we sort through the candidates, but by the end of June -- and this year was no different -- there was little increase in stock prices.

What's interesting, though, is the next two months of a normal presidential cycle. July to the end of August is the strongest period of the election year with stocks on average up 4%-5%. This year is tracking right along with that, and as we now know our two candidates, the market has reached new highs.

By the time we reach September, and we see the market moving up, then we start becoming concerned again about what actually could happen in the election. Prices then start to trend down 2%-3% into October. By the end of October we start getting a little more confident about who might be elected and the market rallies until the end of the year. That's what has happened for the average election cycle since 1900. It doesn't look that much different so far this year.

What's interesting is one of the worst times for the market is the first four or five months in the next year, because whoever gets elected may have four to five months to try to implement any of what he or she thinks is the mandate from the voters. Then the new president tries to get that through Congress. If the president doesn't get it through the first four or five months, then we start the presidential election cycle all over again, and wait another four years.

Q. Moderator: Scott, what ramifications do you foresee at this time for a Democrat or Republican administration?

A. When it comes to the bond market, I can't tell you whether bond markets historically have done better or worse under Republican or Democratic administrations. However, we can make some suppositions about key economic appointments for each party. You have to think in terms of who they're hinting could possibly be the next Janet Yellen, the chair of the Federal Reserve (Fed).

If Hillary Clinton wins the election, I think you could see someone like Lael Brainard appointed as a Yellen replacement. She is a member of the Federal Reserve Board of Governors and sits at the left-hand side of Janet Yellen. She is very much a dove leaning in favor of relatively loose monetary policy, and a staunch Democrat who would largely maintain a status quo operation at the Fed.

Publicly, though, Gary Gensler, who is operating as Clinton's CFO for her campaign, might also have a shot. However, he is a former executive at Goldman, and getting a Goldman nominee through the Congressional approval process is probably a tough task. Some think he'd be very pro-Wall Street, which would be opposite of the other person who is also rumored as a possible candidate, Elizabeth Warren, U.S. Senator from Massachusetts. I do think all three of them, though, would largely lean on the easier monetary policy side.

On the Republican ticket, nominee Donald Trump has thrown out a number of names, including Carl Icahn, Henry Kravis, Jack Welch, and John Taylor. The key name was Carl Icahn early on. But even Icahn has said he has little desire for that role. Kravis is an accomplished businessman and one thing we could say about him is that he'd probably be interested in keeping interest rates low.

Of course, Jack Welch, former head of General Electric (GE), was the king of leverage at GE years ago. While he was widely regarded as having created the GE colossus that was there, I will tell you that the GE he left behind for Jeff Immelt, the current CEO, was not the same powerful company. Jeff has largely spent a decade and a half unwinding Welch's legacy.

Meanwhile, John Taylor, a Stanford economist whose economic theories have profoundly affected the way the Fed historically targeted short-term interest rates, is very much a hawk and would like to see higher rates. I think any new Fed chair will have to come in with a rather accommodative policy to start. I'm in the dovish camp when it comes to near-term Federal Reserve policy until inflation ticks up, or employment gets to the point where salaries and wages are growing strongly. That's when you really do need to take some of the punch bowl away from our economy.

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