It Is the Economy, Not the Election

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With one week away from one of the most "interesting" elections in recent history, the two candidates, Hillary Clinton and Donald Trump, are running a tight race. There remains a great deal of uncertainty about who will win and what it will mean for the stock market.

Conventional wisdom often says that Republicans are more pro-business than Democrats, and therefore a Republican president would be better for the stock market. However, historical evidence paints a different picture. Table 1 summarizes stock market performance under Democratic and Republican presidents since 1896. Over the last 120 years, Democrats and Republicans occupied the White House for almost the same amount of time. A Democratic president was in the White House for 720 months and a Republican for 722 months. The average monthly stock market return measured by the price return of the Dow Jones Industrial Average Index under a Democratic president was 0.68%, but the average monthly return under a Republican president was 0.46%. On the surface, it looks that a Democratic president was better for the stock market, but when we dig deeper, we have found **the stock market performance was more related to economic performance and the business cycle than to which party occupied the White House.**

During the periods of a Republican presidency, there were 243 months when the US economy experienced recession. The average monthly return in those months was -0.79%. On the other hand, during the periods when a Democratic president was in the office, there were only 125 months when the economy was in recession, and the average monthly return was -0.40%, much less severe than that under a Republican president. The underperformance of the stock market under the Republican presidents had more to do with the "unlucky" timing. The two worst recessions in our history - the Great Depression in the 1930s and the Great Recession in 2008 - both happened to occur at the time when a Republican president was in the office. During the periods of economic expansion, the stock market performed better under a Republican president than under a Democratic president. From these mixed results, it is hard to say whether the Democrat or the Republican is better at managing the economy. Most of the time, the economy and business cycles follow their own paths. Public policies can only smooth the cycles to a certain degree. **Therefore, positioning your portfolio based on a prediction on which political party wins will often prove to be fruitless.**

Table 1: Stock Market Performance under Democratic and Republican Presidents

May, 1896 – September, 2016	Number of months in Oval Office	Number of Months in Recession	Average Monthly Return	Average Monthly Return During Expansion	Average Monthly Return During Recession
Democrat	720	125	0.68%	0.91%	-0.40%
Republican	722	243	0.46%	1.09%	-0.79%

Data Source: S& P Dow Jones, Julex Capital Management

This election may not be the same as a traditional Democrat vs. Republican race. Trump is an outsider who does not align with the Republican establishment. Clinton is an establishment candidate on the Democratic side. They and their supporters have starkly different views about America and its standing in the world. Since the stock market's performance is highly correlated to economic growth, we will examine both candidates' economic plans to find a clue on how the stock market may perform in the next few years.

Table 2 summarizes the key points of the Clinton's and Trump's economic plans, though both candidates still flip-flop their positions. Some parts of their plans may favor economic growth, while others may support income redistribution. The Clinton plan calls for raising taxes on the wealthy, increasing spending on job training, offering free college education, increasing infrastructure spending, and raising minimum wages. The Trump plan is all about reducing taxes, renegotiating trade deals and imposing tariffs on Mexican and Chinese imports as well as increasing infrastructure spending. On the surface, the Trump plan sounds to have more pro-growth elements than Clinton plan. However, Trump never addressed how to pay for the tax cuts and spending. Given the current political environment, those proposals would be hard to get passed by the Congress who is more in favor of balancing the budget. The protectionist trade policies proposed by Trump are likely to create more low-skilled jobs at the expense of high-skilled job losses, but lead to higher prices for consumers, retaliation from other countries and thus slow economic growth. On the other hand, the Clinton plan on job training and free college education may help improve productivity and economic growth in the long run, but not give us much near term economic stimulus. **Overall, it is hard to determine whose plan will be more beneficial for economic growth despite all the rhetorics we have heard during the campaign.**

Table 2: Clinton and Trump Economic Plans: Pro-Growth or Pro-Redistribution

	Clinton			Trump		
	Economic Policies	**Pro-growth**	**Pro-redistribution**	**Economic Policies**	**Pro-growth**	**Pro-redistribution**
Tax	Raising Taxes on the wealthy; Offering tax credits to firms that keep jobs in the US.	No.	Yes	Reduce taxes for all, especially the wealthy; Reducing corporate tax from 35% to 15%.	Yes	No
Trade	Opposing TPP; More Status Quote	Yes	No	Opposing TPP; Tariffs on Mexican and Chinese imports	No	Yes
Spending	Raising spending on job training and supporting free college education; Proposing \$275 billion spending in infrastructure	Yes	No.	Calling for twice as much as \$275 billion in infrastructure spending	Yes	No.
Family and Wage	Raising minimum wage to \$12; Child care tax credit	No.	Yes.	Raising minimum wage to \$10; Tax deduction for child care	No.	Yes.

In conclusion, **investing based upon the prediction of which party, or which candidate will win the White House will prove to be futile.** Given the uncertainty of a tight race and future direction of economic policies, we expect to see short-term volatility in the stock market increase. However, the economy is likely to continue the path of low growth and low inflation in the near future regardless of who is elected. The Fed may hike interest rates by another 25 basis points in December, but the monetary policies across the globe remain ultra-loose. We still believe equities and other risk assets have the potential to outperform in the current economic environment.

About Julex Capital Management

Founded by industry veterans in 2012, Julex Capital Management, LLC is a tactical investment management firm dedicated to creating innovative solutions for institutions, investment advisors and individuals. Julex offers a variety of dynamic risk-managed/flexible investment strategies that are designed to deliver consistent returns with low volatility and drawdowns in both bull and bear markets. Its current strategies include equity sector rotation, multi asset, income, real asset, international equity and absolute return.

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