Nationwide®
is on your side

October 2018

Could midterm elections rattle the market?

Investors have focused more on fundamentals than headlines for most of 2018, even with the recent spike in volatility. But the approaching midterm elections provide the potential for unnecessary distraction.

From an investing standpoint, election results tend to matter much less than some investors may think. Stocks are positioned to enjoy seasonal strength once the uncertainty around the election passes.

Strong fundamentals support the market going into Q4.

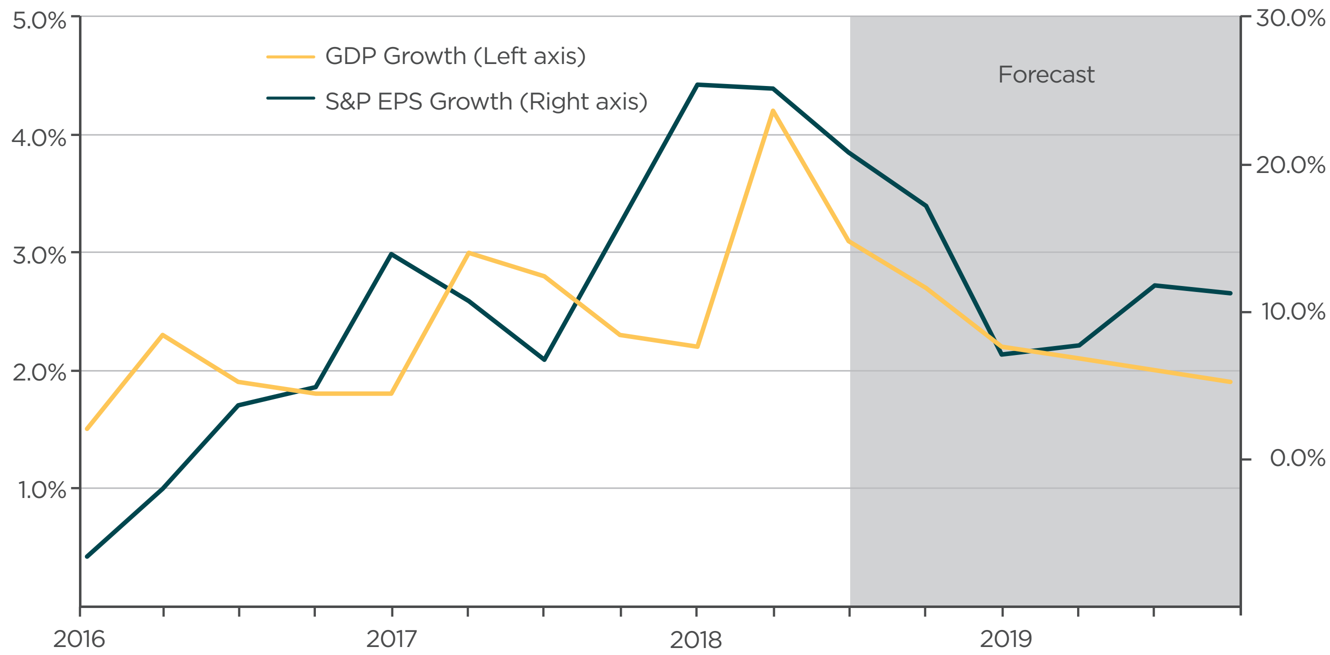
Volatility may rise as the election nears but should settle down by year-end.

There's no real correlation between Washington and Wall Street.

Strong fundamentals support the market going into Q4.

- Stocks have historically performed well in the 4th Quarter — October, November and December have been three of the four top-performing months for stocks in calendar years going back to 1990.
- As Q4 begins this year, momentum in the U.S. economy should help stocks continue this trend of outperformance (see chart below).
  - GDP growth spiked to an annual rate of 4.2% in Q2 and is expected to remain above-trend going into next year — although at a slightly more moderate pace.
  - Corporate earnings also accelerated in Q2 to a year-over-year growth rate of 25%; Q3 earnings are forecast to come in at around 20%.

Chart 1: Good fundamentals are supporting market growth

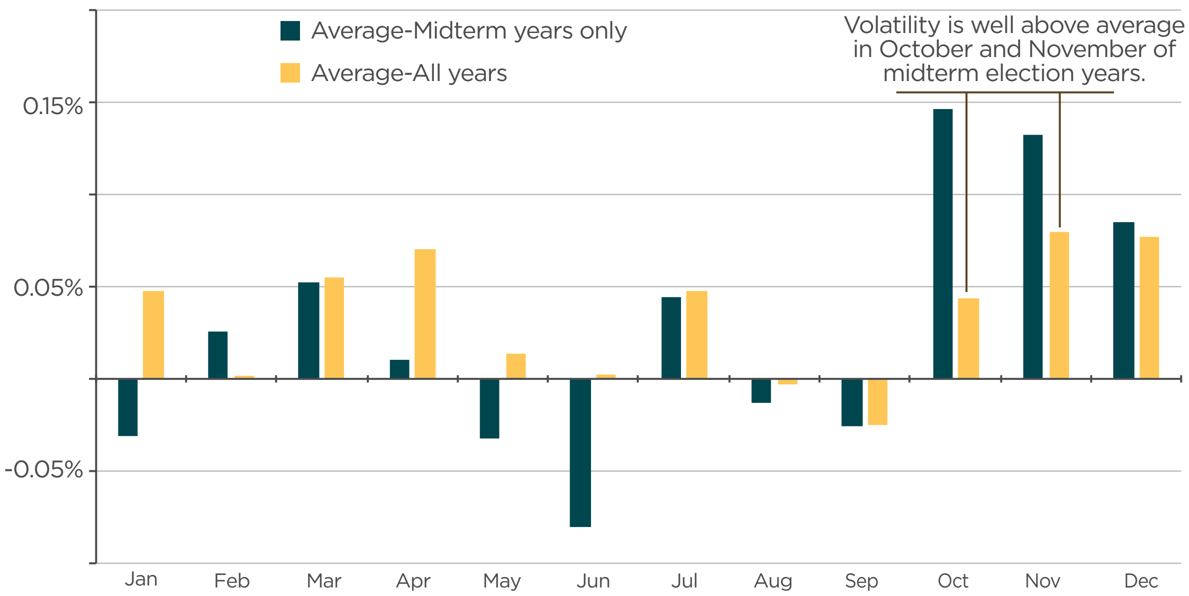


Source for chart data: FactSet

Volatility may rise before the election but should settle down by year-end.

- During previous midterm election years, stocks have historically been volatile in the summer and fall months leading up to Election Day.
  - Volatility prior to midterm elections is typically based on the uncertainty around the outcome and how future fiscal and regulatory policies may be affected.
  - Midterm election volatility in October and November is usually more on the positive side, as investors gain clarity and confidence about the future with the conclusion of the midterm campaigns.
- Stocks have been most volatile in September, October and November in midterm election years going back to 1950 (see chart below).
  - Daily changes in stock market values were around 25% more volatile than average in the months leading up to and including past midterm elections.
  - In October and November of midterm election years, daily price changes can exceed the average for all years by 0.5 to 1.0 percentage points.

Chart 2: S&P 500 average daily changes by month, 1950-2017

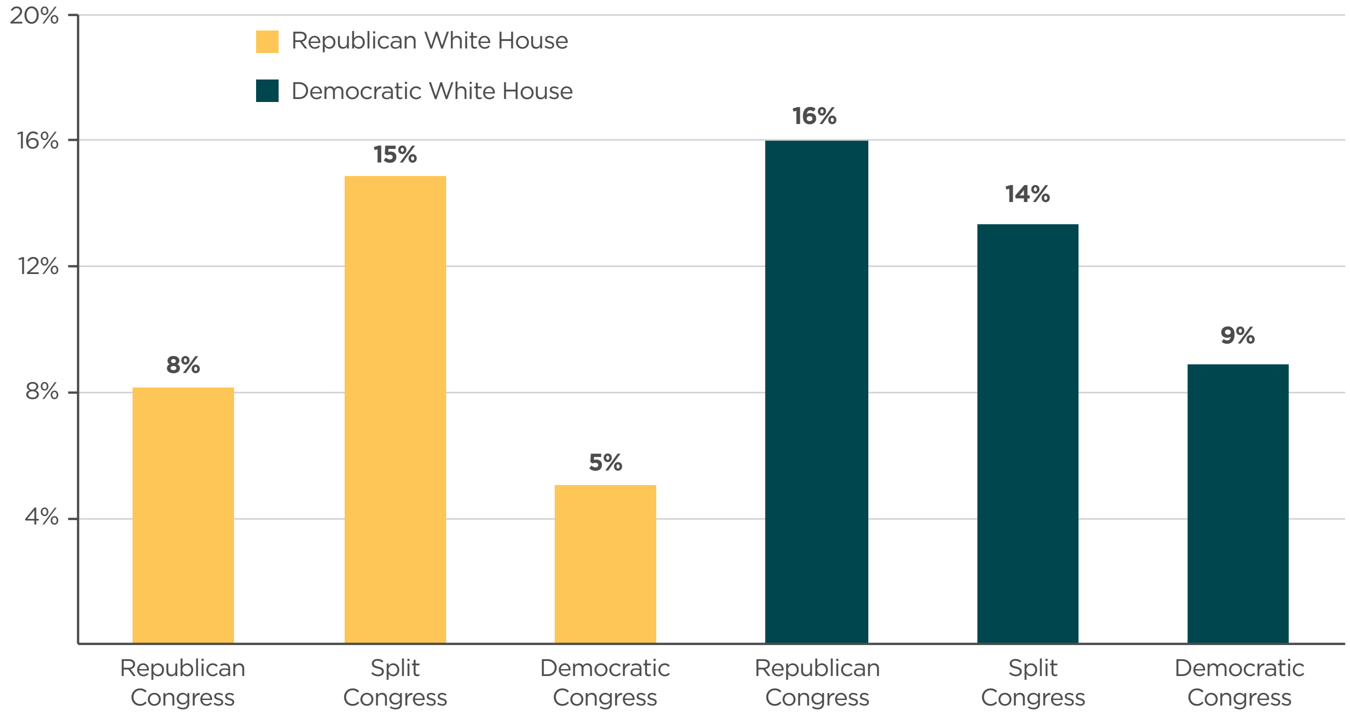


Source for chart data: FactSet

There's no real correlation between Washington and Wall Street.

- Investors may grow concerned about the impact of elections on the market, but past history shows stocks reflect no significant performance difference under rule by either political party.
  - Since 1950, stocks show the worst annual performance under a Republican White House with a Democratic Congress (a potential outcome of the upcoming midterm elections) but even this lowest average annual return of 5% is a respectable return for the S&P 500 (see chart below).
  - While government leadership certainly plays a role in the economy and by extension the stock market, the performance of stocks is in fact more idiosyncratic than the impact the government can have.
- If the midterm elections result in legislative gridlock between the House and Senate, it probably will not spell bad news for stocks — gridlock can be good with the opposing parties providing welcome checks-and-balances against political excesses.

Chart 3: S&P 500 average annual total return by White House and Congress control, 1950-2017



Source for chart data: FactSet

Key takeaways

Election years tend to offer plenty of opportunities for investors to get distracted from the fundamental drivers of market performance. While the upcoming midterm elections may be no different, investors can stay focused on their own investment plans by recognizing the weak link between election results and market performance and positioning their portfolios for the likelihood of a seasonally strong 4th Quarter.

- Stay focused on market fundamentals as the election season progresses.
- Maintain your stock allocations designed to take advantage of potential market gains during the historically strong 4th Quarter.
- Don't worry too much about the consequences of election outcomes on your investments—even Washington gridlock may be beneficial to investors.

For more help or information, contact your financial advisor.

Nationwide®
is on your side

NFM-17927AO (10/18)