2018 U.S. Mid-Term Elections

October, 2018

SUMMARY

- **Mid-Term Elections in the U.S. are set for November 6th**
- **Each of the 435 House of Representative seats are up for re-election; in the Senate, 33 seats will be contested**
- **History suggests that, the party of newly elected Presidents lose, on average, approximately 27 seats in Congress**

HISTORY & BACKGROUND

Midterm elections in the U.S. occur mid-way through a President's term in office. Every four years, all 435 seats in the House of Representatives and typically 33 or 34 of the 100 seats in the Senate are up for re-election. History has shown that mid-term elections have not been kind to the incumbent President's political party. Specific to the upcoming mid-term elections, changes in the political landscape are expected, but it's the magnitude of those changes that could ultimately impact asset prices.

INSIGHTS & PORTFOLIO IMPLICATIONS

Mid-Term Elections and Financial Markets

Going into the 2018 mid-term elections, the balance of power sits with the Republican Party. Currently, there is a unified Republican Congress operating alongside President Trump. If history is a good predictor, it would not be surprising to see the Republicans lose some of their political influence in Congress.

From 1934 through 2014, there have been 13 mid-term elections for first time presidents. In those mid-term elections, the President's political party lost an average of 27 seats between the House and Senate. The market implications for those losses are varied, but on average, the S&P 500 Index advanced +5.4% in the last two months of the year, following the elections, suggesting that political losses are not necessarily bad for the markets.

Forecasting the impact of an election outcome is challenging as non-political factors can still have a significant influence on markets. While the economy and monetary conditions historically have carried greater weight than politics in the minds of voters, the former two have only been shown to be true factors when either was considered a headwind. Today, the U.S. economy continues on a path of moderate growth, unemployment is low and while the Federal Reserve is in tightening mode, most agree it is a necessary prescription to normalize the interest rate environment. As a result, we believe the upcoming mid-term elections will be more of a referendum on the President's social, fiscal and foreign policies, than on the economy.

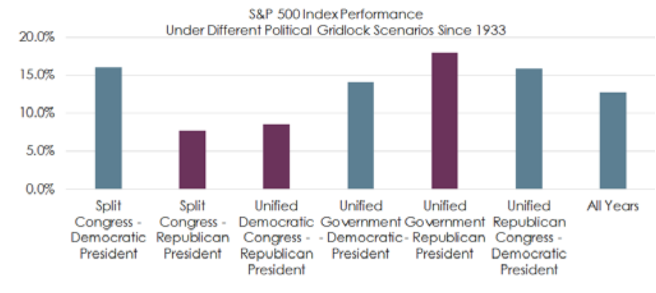
Could this be a "Wave Election"?

According to Ballotpedia, a wave election occurs when one political party makes significant mid-term gains. In the current mid-term election, there are 77 races in the House that are considered battleground races. Of those, 68 are currently held by Republicans. In the Senate, there are 16 such battleground races, but only five are held by Republicans. This suggests that there is more risk to the Republican party in the House. Additionally, there are reports that Republican party leaders fear that potential voter complacency could result in low voter turnout, benefitting the Democrats.

Adding to the complexities of the mid-term elections, is the President's approval rating, recently at 40%, low by historical standards. President Trump's approval rating is closest to Bill Clinton in 1994 or Ronald Reagan in 1982, where both had approval ratings of 42%. Reagan lost a total of 25 seats and Clinton lost a total of 60 seats.

What Matters to the Markets?

Financial markets generally do not like political gridlock due to the uncertainty, and with the prospects for a wave election for the Democrats, the end result could be a split Congress, with the Democrats taking the majority in the House, but the Republicans retaining control in the Senate. This may cause risk-based assets to weaken temporarily. Historically, a split Congress with a Republican president has produced the lowest annualized returns compared to other gridlock scenarios. Despite the potential for sizable Democratic gains, we do not think they will reach the required 67 seats in the Senate, so impeachment of the President seems very unlikely. Therefore, following the mid-term elections, it is expected that the President will resume his agenda of de-regulation, tax-cuts and fiscal stimulus. Should the Republicans retain power in Congress, we would expect little disruption to risk asset pricing. Fundamentals should remain the focus, although an extended cycle and ongoing geopolitical tensions create concern.



Source: ACG Research, Bloomberg (Return data is YTD through September 2018.)

ACG'S POSITION

Timing the market is difficult and positioning portfolios around the upcoming mid-term election is no different. More recently, political forecasting has also proven less reliable (consider Brexit or the 2016 U.S. Presidential Election). The data is mixed regarding market performance driven by mid-term election outcomes. ACG's position is that financial markets are currently focused more on global issues, such as international trade policies and geopolitical negotiations, which in turn have been contributing to recent market volatility. We continue to believe investors should remain globally diversified, long-term focused and employ risk-mitigating strategies, as appropriate.

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