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ELECTION SPECIAL #1

Point Election Special: Dawn of a New Day in DC

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Democrats and Republicans were shocked by the extent of the "blue sweep" in the US Congress on Tuesday, November 3. So were global financial markets.

Overnight, S&P 500 futures contracts traded down by as much as 1.5%. Then, as the results rolled in, stocks rallied +1.6% by the end of trading Wednesday.

There were three big themes today. Democrats pledged to focus on relieving the economic burden of Americans, on ending corruption in DC and returning power to the legislature. But now, the rubber hits the road. Will Democrats stymie the pace of data center and related energy investment? Will they attempt to thwart the President's disruptive tariffs? And how will the war in Iran be resolved?

President Trump's remaining years in office will be much "less comfortable" with Democratic control of both the Senate and House. Yet, as we wrote in October, simply having the uncertainty of the election results behind us will provide relief for investors. And having landslide, "undisputable" results buoyed markets Wednesday, November 4.

A Discrete, Relief Rally

An incredible daily rally on a discrete event requires thoughtful consideration for forward-looking investors.

Global crude oil fell 8.8% on news of the election. We've noted since the US strikes on Iran began that the absence of safe passage through the Straits of Hormuz was the sole driver of a 60% rally in petroleum costs. Has the loss of Congressional backing in the coming year dramatically increased the probability of a negotiated peace with Iran? Traders think so. Crude oil price futures declined for the full year ahead.

A true recovery in global oil supplies and key Persian Gulf exports will lead to much larger oil price declines. Hope alone won't provide that relief. The US President and Iran's leadership will need to make that happen. Congressional results will not.

Distinguishing Beta from Alpha

Over the last 12 months, the S&P 500 has risen 13.5% while S&P 500 EPS have risen 32%. This provided considerable room for the equity market to snap back with election certainty. And this is consistent with bullish “post mid-term” stock performance. Please see final table.

The roughly 20% valuation contraction for the S&P 500 over the last 12 months was driven by many factors. These include investors’ forward-look on profits, which are expected to grow more slowly than the recent past. It includes the pricing-in of 125 basis points of Fed rate hikes. Yet, the drop in the crude oil price was a factor that left fixed income markets scaling back expected Fed tightening to just four 25 basis point increases in total (including September’s).

Market Movements Are Not Predictive of Future Results

Figure 1 shows key sector and industry price moves of November 4. Several conclusions from the market action are obvious.

1) Traders believe the conflict in Iran will end sooner (Oil, Energy, Defense shares lower)
2) The lower oil price will blunt upward pressure on interest rates (bonds rallied, oil, US dollar fall, foreign shares gain).
3) The benefits of lower energy, rates and possibly tariffs are viewed as boosting the consumer outlook (Discretionary is the strongest sector gainer)
4) Markets expect Congress to inhibit data center building. Industrials and DRAM makers led declines in semiconductors. However, large tech firms (mag 7, communications) and software gained.
5) Financial stocks rallied more than market averages. However, we would attribute this to “high beta” rather than an improved outlook. While the sitting administration is still largely in charge of regulation, oversight and involvement is set to dramatically increase in the next Congress.

FIGURE 1

Key Asset Class and Industry Group Price Changes on November 4.

	Nov 4
Asset Classes	
S&P 500 (US Stocks)	+1.6%
World Ex-US Equities	+1.4%
Brent Oil	−8.8%
US Dollar Index	−0.4%
Long-Term US Treasuries	+0.8% *
High yield bonds	+0.7% *
Gold	+3.3%
Bitcoin	+3.0%
S&P sectors, industries, special groups	
Financials	+3.5%
Energy	−4.8%
Industrials	−1.1%
Materials	+3.1%
Consumer Discretionary	+4.3%
Consumer Staples	+2.9%
Healthcare	+3.0%
IT	+0.5%
Communications Services	+3.0%
Clean Energy	+3.0%
Defense and Aerospace	−3.6%
Magnificent 7	+2.2%
DRAM	−5.3%

*ETF close (TLT for Long-Term US Treasuries, HYG for High yield bonds); the Bloomberg indices are not published for Nov 4 until overnight.

SOURCE: CIO GROUP, BLOOMBERG

Hopes, Fears, and a New Dawn in DC

Many hopes and fears were shifted by Tuesday's historic election. Without a doubt, the willingness of American voters to make a bold statement for change will result in new conversations, legislative priorities and greater expectations for investors. Yet, investors need to be mindful not to extrapolate a powerful, discrete political event too far. Sometimes markets rise on the news. But they can only retain value with results.

Appendix – Post Mid-Term Rallies in 90% of Cases Since 1950

FIGURE 2

S&P 500 returns around US midterm elections, with the S&P 500 on Nov 4 and the day after each election.

Midterm	President	S&P 500 3-mo. pre-election	S&P 500 3-mo. post-election	S&P 500 on Nov 4	S&P 500 day after election	2nd term President House and Senate Control	Control of Congress changed?
1950	Harry Truman	5.2%	13.6%	n/a	n/a	Yes*	No
1954	Dwight Eisenhower	2.6%	15.2%	n/a	n/a	No	Yes — House & Senate → Dem.
1958	Dwight Eisenhower	7.6%	6.8%	closed	0.9%	No	No
1962	John F. Kennedy	1.0%	13.8%	closed	0.6%	No	No
1966	Lyndon B. Johnson	−3.6%	8.7%	0.3%	0.8%	Yes*	No
1970	Richard Nixon	9.3%	14.7%	0.2%	0.2%	No	No
1974	Gerald Ford	−5.3%	5.1%	−1.1%	−0.5%	No	No
1978	Jimmy Carter	−9.4%	3.5%	closed	0.6%	No	No
1982	Ronald Reagan	26.2%	4.2%	−0.7%	3.9%	No	No
1986	Ronald Reagan	4.3%	13.6%	0.2%	0.2%	No	Yes — Senate → Dem.
1990	George H.W. Bush	−6.8%	14.9%	closed	−1.8%	No	No
1994	Bill Clinton	1.7%	3.3%	−1.2%	−0.1%	No	Yes — House & Senate → Rep.
1998	Bill Clinton	−0.1%	14.5%	0.7%	0.7%	No	No
2002	George W. Bush	9.7%	−7.8%	0.8%	0.9%	No	Yes — Senate → Rep.
2006	George W. Bush	8.4%	4.9%	closed	0.2%	Yes	Yes — House & Senate → Dem.
2010	Barack Obama	6.0%	9.3%	1.9%	0.4%	No	Yes — House → Rep.
2014	Barack Obama	3.8%	1.5%	−0.3%	0.6%	No	Yes — Senate → Rep.
2018	Donald Trump	−3.3%	−0.9%	closed	2.1%	No	Yes — House → Dem.
2022	Joe Biden	−7.5%	7.6%	1.4%	−2.1%	No	Yes — House → Rep.
2026		TBD		1.6%	1.6%		
	Average	**2.6%**	**7.7%**	**0.2%**	**0.5%**		
	cases positive	63.2%	89.5%	63.6%	76.5%		

*Succession of Deceased President. Nov 4 and day-after columns: daily close-to-close; 'closed' = Nov 4 fell on a weekend or the exchange was shut; averages over 11 and 17 years (1950 and 1954 n/a, daily data begin 1955).

SOURCE: CIO GROUP, HAVER ANALYTICS, BLOOMBERG

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