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From Washington to Wall Street:
The Effects of the Presidential Election on the Stock Market

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Historically, election years are generally good years for the stock market, especially if you follow the Presidential Market Cycle Theory. According to this theory, the economy fluctuates in fairly regular patterns over the course of each presidential term.

The first two years after a presidential election tend to be weak as the new administration makes tough decisions on the economy and taxes. The third year (the pre-election year) tends to be the best performing year, and the fourth year (the election year) is the second best year in the four-year cycle as the administration takes steps to stimulate the economy and win votes.

Reviewing the Market's Voting Record

The table below shows how bear markets usually occur in the first two years of a presidential term, while the third and fourth years are far friendlier for market returns.

While the election year is typically the second best year within the four-year Presidential cycle, it is significantly skewed when the incumbent wins or loses. For instance, a study of election years since 1900 by Ned Davis Research shows that the market performs better on average when the incumbent party wins the Presidential election. In the 15 cases in which the incumbent party won the election, the market rose an average of 16.4%, compared to an average decline of 1.4% in the 10 cases in which the incumbent lost. While no one can predict how the stock market will finish out 2004, through the first half of the year it was on track for an election year cycle—with the S&P 500 Index up 1.47% as of May 31, 2004. Nevertheless, President Bush will have to do all he can to thwart economic setbacks and market declines as the election approaches.

Campaign Issues to Consider

- **Presidential Approval Rating.** The Bush approval rating is at a low for his presidency (56% as of this writing), which is clearly cause for concern. As we progress through the summer months, expectations for a democratic victory could have a negative impact on the outlook for economic growth and stock prices. The Bush tax cuts are widely viewed as playing a significant role in sparking the economic recovery in 2003 and paving the way for sustainable growth. Democratic challenger John Kerry plans to reverse much of the tax cuts, including the reduction in taxes on dividends—a strategy that could derail the recovery.
- **War in Iraq/Terrorism.** Polls that once showed broad support for President Bush's leadership of the war on terrorism have eroded in the wake of an escalation of violence in Iraq, the Iraqi prison abuse scandal and the 9/11 hearings. Developments on this front may overshadow any credit Bush receives for the improved economy.

Election Years Have Generally Been Good for the Market

4-Year Cycle Begins	Elected President	Year 1	Year 2	Year 3	Year 4
1953	Eisenhower (Rep)	-0.98%	56.62%	31.56%	6.56%
1957	Eisenhower (Rep)	-10.78	43.36	11.96	0.47
1961	Kennedy (Dem)*	26.82	-8.75	22.65	16.39
1965	Johnson (Dem)	12.35	-10.06	23.95	11.08
1969	Nixon (Rep)	-8.47	3.98	14.32	18.94
1973	Nixon (Rep)**	-14.80	26.49	37.27	23.61
1977	Carter (Dem)	-7.40	6.52	18.48	32.47
1981	Reagan (Rep)	-4.95	21.55	22.56	6.27
1985	Reagan (Rep)	31.73	18.67	5.25	16.61
1989	G.H.W. Bush (Rep)	31.69	-3.11	30.47	7.62
1993	Clinton (Dem)	10.08	1.32	37.58	22.96
1997	Clinton (Dem)	33.36	28.57	21.05	-9.11
2001	G.W. Bush (Rep)	-11.88	-22.10	28.67	?
	Up Years	6 of 13	8 of 13	13 of 13	11 of 12
	Average Gain	6.67%	8.16%	23.52%	12.82%

*Death while in office. **Resigned.

Past performance cannot guarantee comparable future results. Due to significant market volatility, results of an investment made today may differ substantially from the historical performance shown. Source: Ned Davis Research. Data as of Dec. 31, 2003. The stock market is represented by the S&P 500 Index which is an unmanaged index considered representative of U.S. large-cap stocks. An investment cannot be made directly into an index. Returns reflect the reinvestment of dividends.

- **National Deficit.** The United States faces a mounting budget deficit that must be addressed in the coming years. This represents a long-term risk to equity and fixed income valuations. The deficit is not currently a major focus for investors, and neither candidate has developed a deficit reduction plan that is likely to move the markets.

Our View as a Money Manager

The outcome of the election is unlikely to be a primary driver of our portfolio stock selections. While we recognize that some companies may be more affected by the election than others, each portfolio adheres to a disciplined investment process that analyzes many factors to evaluate each company on an individual basis. Political influences are taken into consideration, but we believe factors such as financial strength, profitability, valuation, competitiveness and industry attractiveness are most important.