Election Year Uncertainty – This Too Shall Pass

Recently, we have seen a big uptick in market volatility, which is not surprising given the many questions anxious investors currently face. With political uncertainty rampant, investors are naturally concerned about the future. The strength of the economy and recovery remains in question and geopolitical stability around the world is uncertain. Many divisive issues that could impact the country's financial stability, as well as individuals on a personal basis, still hang in limbo. In this election year, the only certainty appears to be that the U.S. will have a new President next year.

S&P 500 % Price Changes During the Presidential Cycle
Data: 12/31/45-12/4/15

Year of Pres. Cycle	Avg. S&P 500 % Changes (w/o dividends)					Batting Averages (Frequency of Price Gains)				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Year 1	(0.4)	2.6	1.1	3.7	7.6	50%	56%	61%	78%	61%
Year 2	1.2	(2.1)	(0.2)	6.9	5.7	50%	50%	61%	83%	61%
Year 3	7.0	5.0	1.0	2.9	16.1	88%	76%	59%	71%	88%
Year 4	1.2	2.3	0.4	1.7	6.1	59%	65%	53%	76%	76%
All Years	**2.2**	**1.9**	**0.6**	**3.8**	**8.8**	**61%**	**61%**	**59%**	**77%**	**71%**

Small-Cap % Price Changes During the Presidential Cycle
Data: 12/31/78-12/4/15

Year of Pres. Cycle	Avg. Small-Cap % Chgs. (w/o dividends)					Batting Averages (Frequency of Price Gains)				
	Q1	Q2	Q3	Q4	Year	Q1	Q2	Q3	Q4	Year
Year 1	1.2	8.1	2.7	5.8	17.6	56%	100%	67%	78%	89%
Year 2	4.1	(2.5)	(6.7)	2.4	(3.8)	67%	33%	33%	89%	56%
Year 3	9.5	7.9	0.9	1.2	19.3	78%	67%	56%	67%	67%
Year 4	2.8	2.2	3.8	1.5	10.9	67%	67%	67%	67%	78%
All Years	**4.5**	**4.0**	**0.4**	**2.6**	**11.2**	**66%**	**66%**	**57%**	**74%**	**71%**

Source: S&P Capital IQ. Russell 2000 from 1979-1994, S&P SmallCap 600 thereafter. Past performance is no guarantee of future results.

The chart above shows S&P 500 returns through elections cycles. Since 1900, the S&P 500 has fallen by an average 1.2% in the last year of a U.S. President's second term, while decreasing about two-thirds of the time. This pattern may be explained by investor preference for policy certainty, regardless of what the policy may be. We see a number of reasons for this market behavior, but several of these are more pronounced this year.

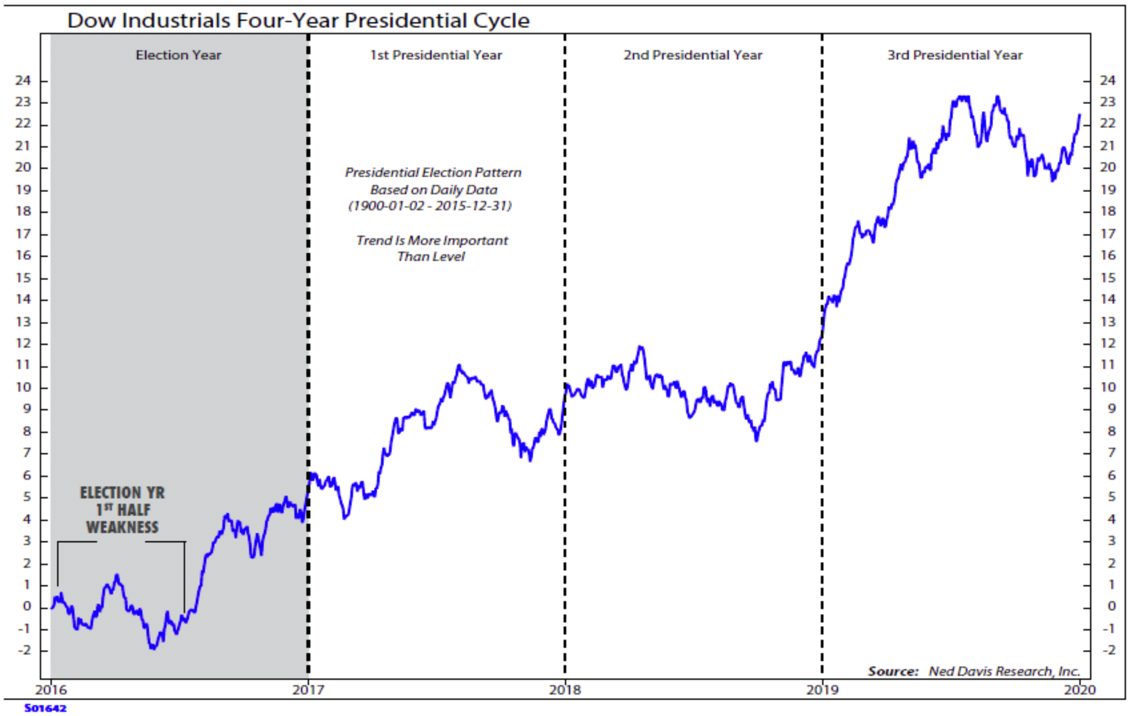
1) The political system's increasing reliance on unconventional measures, which circumvent normal processes to pass legislation, highlights the dysfunction in Washington. This reliance has undermined the public's confidence and investor certainty. With so many questions hanging in the air, investors find it difficult—if not impossible—to position themselves with any confidence.

2) A lame duck President has little to lose in his last year and more to gain by taking bigger political risks to push through last minute executive orders, which adds unpredictability to the situation. Additionally, with fewer accords having been reached between parties, changes in party control will likely result in efforts to reverse big policies. This likelihood is another reason for nervous investing.

3) Already, this election has broken records in campaign expense and financing, voter turnout, and media ratings. It has also defied all sorts of precedents set by previous elections.

Frustration and fear over an uncertain future appear to be driving individuals to exercise their voting privileges, and similar sentiments are likely driving investor behavior in the markets these days.

While we expect volatility to linger, there is good news. As shown in the chart below on the left, looking at the Dow Jones Industrial Average since 1900, election years on average have seen choppy market action over the first half of the year followed by solid gains in the second half of the year.



Source: Ned Davis Research

However, trying to predict economic or political market cycles can quickly become a fool's errand, which can cause individual investors to make poor investment decisions in the near-term. Regardless if markets follow history and bounce back in the second half of 2016, we expect volatility to remain elevated as investors balance the aforementioned concerns with positives that still exist. These positives include:

- Low global interest rates.
- Improved manufacturing data.
- Accommodative central banks.

We continue to encourage investors to take a long-term market view in line with their financial goals and individual time horizons and focus on what they are able to control. We highlight the importance of maintaining a well-diversified portfolio as the best defense again market volatility.

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*The **S&P 500** is an index of 500 stocks chosen for market size, liquidity and industry grouping (among other factors) designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.*