Views From The Heartland

Investment Perspective of Buena Vista Investment Management

Volume 10 Issue 3
September 2012

Presidential Politics and Your Investments

Are Economics & Corporate Earnings More Important Than Politics?

As Sargent Joe Friday said in the TV series Dragnet… We want the facts, just the facts. At a time when we are being bombarded by conflicting political ads full of economic sound bites, we thought you might find it interesting if we presented some cold, hard facts about politics and your investments.

First, let's dig a little deeper into some statistical data relating to the election of our President and your investments. Our friends at the Leuthold Group recently put together this chart detailing stock market performance during each Presidential term since 1928. What the data shows is that the stock market does <u>not</u> favor one party over the other; rather the median return under Democratic administrations (27.5%) is almost exactly the same as during Republican administrations (27.3%).

S&P 500 Performance By Presidential Term, 1928 To Date

President (term)	S&P 500 Price Return*
Franklin D. Roosevelt (1st term)	162.0 %
Bill Clinton (1st term)	79.2
Barack Obama (through 9/6/2012)	77.8
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Jimmy Carter	27.9
Franklin D. Roosevelt (3rd term)	27.5
Gerald Ford (partial term)	27.3
Lyndon B. Johnson (partial term)	24.4
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Richard M. Nixon (1st term)	16.2
John F. Kennedy (partial term)	16.1
Harry S. Truman (partial term)	10.3
Franklin D. Roosevelt (4th term - partial)	5.2
George W. Bush (1st term)	-12.5
George W. Bush (2nd term)	-31.5
Richard M. Nixon (partial term)	-31.6
Franklin D. Roosevelt (2nd term)	-41.3
Herbert C. Hoover	-73.3
Median For Democrats:	27.5 %
Median For Republicans:	27.3
Median For All Terms:	27.4

*Return measured from inauguration days, except for those ended by death or resignation.

What is interesting to us is that barring a market collapse between now and inauguration day in January, President Obama's term will have produced either the second or third highest S&P 500 returns for a sitting President's term since Franklin Roosevelt's first term (1933-1937). All this has occurred with a backdrop of high unemployment, slow economic growth, divided government and a President that has been perceived as "bad for business".

As we have counseled many times in this newsletter since the market bottom in 2009; it is not about the politics but rather the economic fundamentals that drive stock prices higher or lower over time.

The recent success of the stock market directly relates, in our opinion, to two fundamental issues. First, corporate profits for US corporations are at an all-time record high. Second, we have an accommodative Federal Reserve Bank that has helped push interest rates to their lowest levels in the last 50 years.

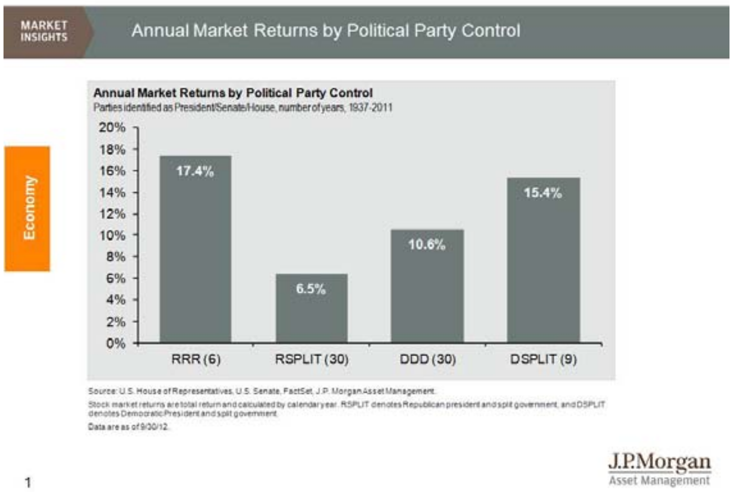
The statistical data shows us the stock market does not favor a specific political party in the oval office but it is a somewhat different picture when you add Congress to the equation. It is Congress that passes the laws affecting your taxes and determines how your tax dollars are spent. So let's look at stock market performance based on political party control of the White House and Congress.

(continued)

Are Economics & Corporate Earnings More Important Than Politics? (continued)

JP Morgan Asset Management provided us with 75 years of annual return data directly relating to which political party was in charge of the White House, the Senate and the House. Here is how the data lays out….

In three of the four scenarios; 1) Republican President and Republican Congress (six years)
2) Democratic President and Republican Congress (9 years) or 3) Democratic President and Democratic Congress (30 years) the stock market generated returns better than the historical long-term norm.



Once again, based on market facts, we can make the case that the market performs well under different political scenarios and doesn't specifically favor any one political party.

What is necessary to understand about this election is that the investment markets and corporate America want and need some certainty as it relates to future tax policy and longer-term deficit reduction. If we can get some answers, rather than kicking the problem down the road for another two years, we may find investment markets respond very favorably regardless of who is in office.

Let us leave you with one final piece of statistical data relating to politics and your investments. It comes from the August publication of InvesTech Research. They point out that since 1900 there have been 28 Presidential elections. In 25 of those elections, the stock market's direction in the final two months leading up to the election accurately predicted whether or not the incumbent party would retain control of the White House. In other words, if the stock market was positive in those final two months preceding the election, the incumbent party won. If the stock market was lower in the last two months the incumbent party lost. A political prediction tool with a 90% accuracy rate is one that we find interesting and worthwhile.

So in closing we want to emphasize one final point… regardless of who is in the White House or which party controls Congress, it is our obligation to our clients to produce competitive investment returns.

BUENA VISTA INVESTMENT MANAGEMENT LLC

LONG-TERM MARKET INDICATORS

Buena Vista Conservative Buy/Sell Discipline:	Bullish (turned positive 1-2012)
Leuthold Major Trend Index	Buy (turned positive 12-2011)
InvesTech Negative Leadership Composite:	Positive (turned positive 2-2012)
S&P 500 Stock Index:	1,440 (14.56% thru 9-28-12)
Dow Jones Total Market Index:	15,025 (14.40% thru 9-28-12)

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September, 2012

Buena Vista Investment Management LLC

Supporting Materials

1. Does the Stock Market Predict the Election –
   Provided by InvesTech Research of Whitefish, MT
   August 24,2012

2. U.S. Political Perspectives, Corporate Profits, Interest Rates & Inflation
   Provided by JP Morgan Asset Management of New York, NY
   4th Quarter 2012 Guide to the Markets

3. Presidential Elections and Financial Assets
   The Leuthold Group of Minneapolis MN
   September 2012

FIRST: *Don't Let "Probable" Election Market Scenarios Dictate Your Strategy*

The games have already begun on how the market will likely perform from now through year-end based on who wins the White House and which party will control Congress. As reason might have it, the stock market should rally strongly if conservative Mitt Romney starts pulling ahead in the polls. And, in contrast, one might expect Wall Street to fall into a precipice in November if Barack Obama wins re-election. At least that's how most stock market pundits seem to view the probable scenarios ahead.

One valuable lesson we've learned over the years, and also in our extensive research of past market history, is that the seemingly probable scenarios rarely happen as expected – especially with respect to politics and the stock market. Perhaps the most credible example of this was the election of President Reagan (over Jimmy Carter) in 1980.

It was one of the most lopsided Presidential Elections of the past half century with Reagan garnering 91% of the Electoral Vote. Yet after a quick two-week 6.7% spurt, the DJIA floundered and ended the year only 10 points (1%) from where it was two months prior to the election. In 20/20 hindsight, the market was anticipating the return to recession by the middle of the next year, and all but ignoring the political exuberance.

So history suggests that painting a market outlook based on which party might win the White House or control Congress is financial folly. As always, the market performance between now and December 31 will depend more on underlying economic factors and whether the technical evidence remains in place for a bull market.

Reversing cause-and-effect…

While politics do not determine the future of the stock market, there is a remarkable past link where the stock market appears able to predict who will win the White House. With just a little over two months to go until the November 6 Presidential Election, it's time to reintroduce this table that we published earlier this year. →

In almost 90% of the Presidential Elections over the past 112 years, the direction of the market in the 2 months preceding the election accurately predicted whether the incumbent party would retain control of the White House. Is that pure coincidence? One might think so based on the absence of any direct connection between Wall Street and the polling booth.

However, when you stop to consider that the market is actually reflecting economic outlook in the weeks leading up to when voters mark their ballots, then the connection is much more obvious. A rising stock market indicates an improving economy, which means rising confidence and increases the chances of an incumbent's re-election.

Does the Stock Market Predict the Election?

Election Year	DJIA 2 mo Gain/Loss*	Incumbent Party
1900	4.1%	Won
1904	18.4	Won
1908	0.4	Won
1912	-1.1	Lost
1916	13.3	Won
1920	-2.0	Lost
1924	1.1	Won
1928	7.7	Won
1932	-16.7	Lost
1936	6.3	Won
1940	0.8	Won
1944	3.0	Won
1948	2.9	Won
1952	-2.4	Lost
1956	-2.8	Won ✓
1960	-2.3	Lost
1964	3.5	Won
1968	3.1	Lost ✓
1972	2.3	Won
1976	-1.9	Lost
1980	-1.2	Lost
1984	2.1	Won
1988	3.1	Won
1992	-1.2	Lost
1996	8.5	Won
2000	-2.7	Lost
2004	-2.5	Won ✓
2008	-14.0	Lost

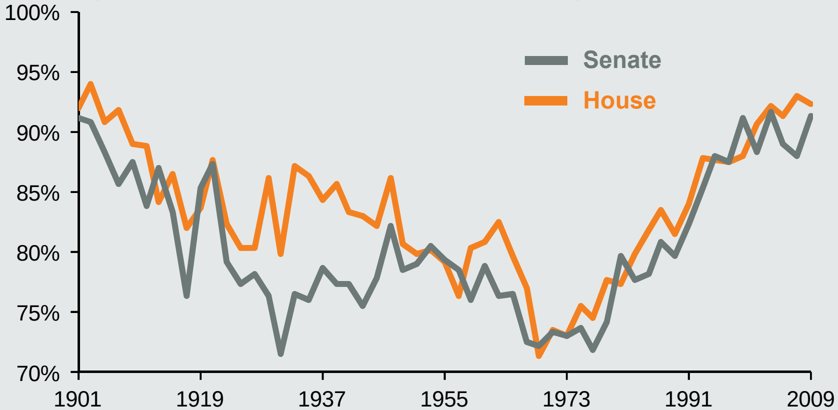
Accuracy: 25 out of 28 (89.3%)

* Market performance in the 2 months preceding Election Day

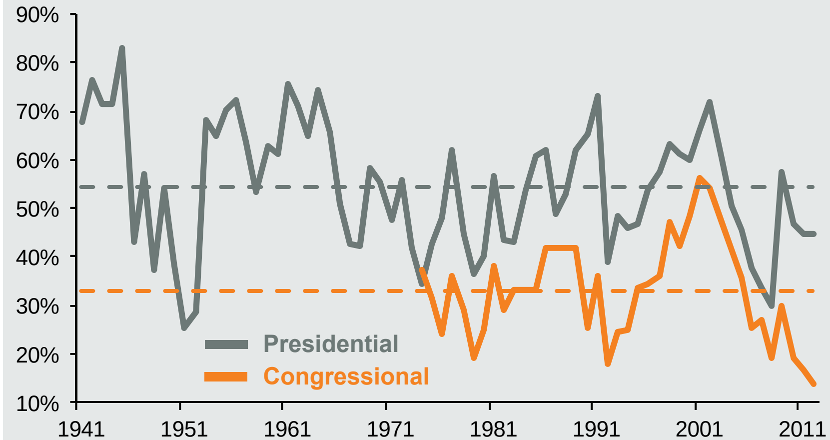
U.S. Political Perspectives

Political Polarization

% of Representatives voting with the majority of their party*

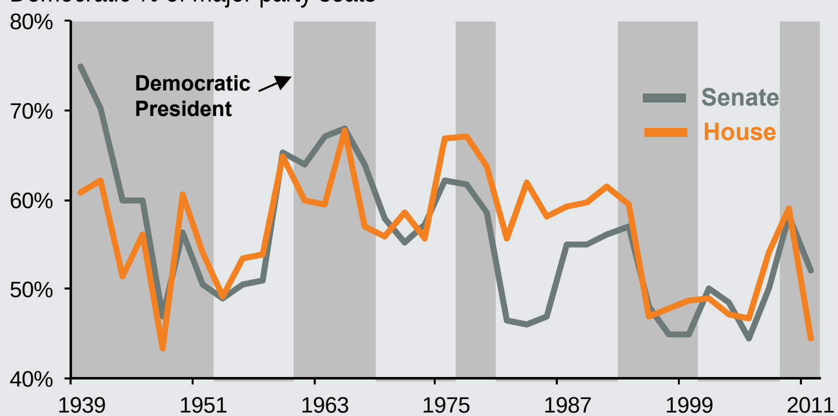


Congressional & Presidential Approval Ratings



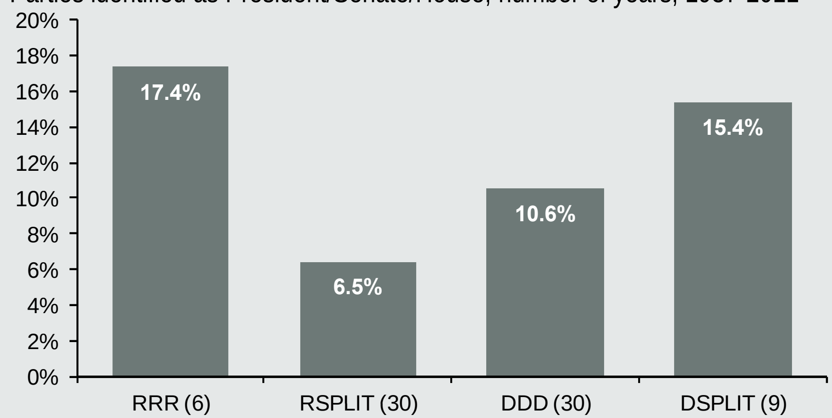
Political Party Dominance

Democratic % of major party seats



Annual Market Returns by Political Party Control

Parties identified as President/Senate/House, number of years, 1937-2011



Source: U.S. House of Representatives, U.S. Senate, Gallup Inc., FactSet, J.P. Morgan Asset Management.

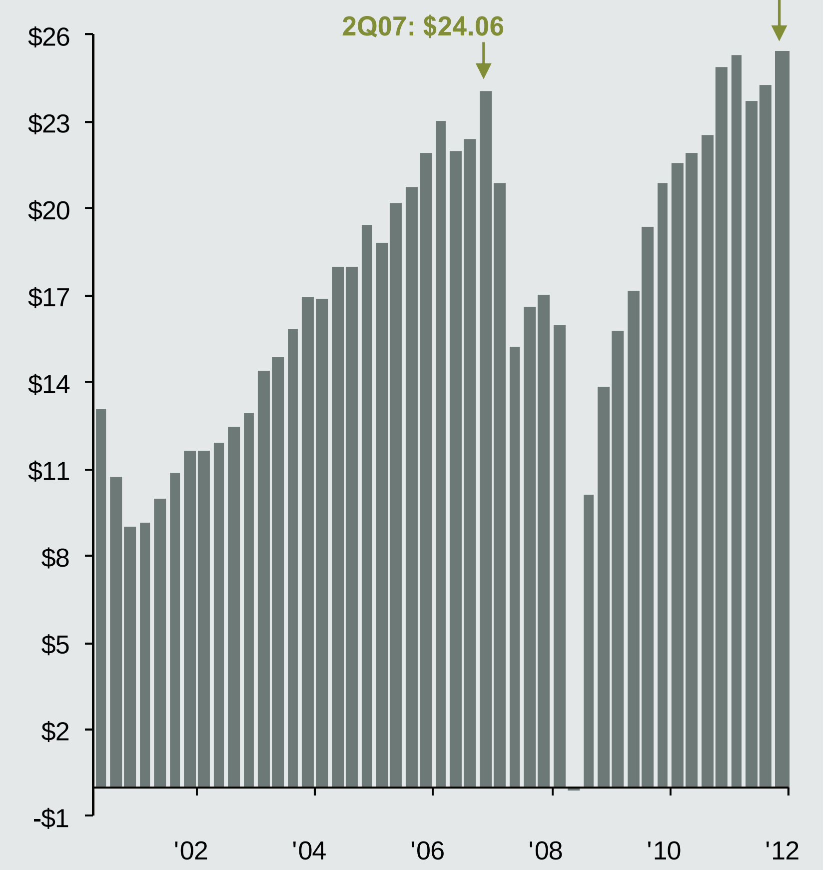
*In roll call votes where the majority in one party voted the opposite way to the majority in the other. Data compiled by Professors Keith T. Poole and Howard Rosenthal, available at www.voteview.com. Stock market returns are total return and calculated by calendar year. RSPLIT denotes Republican president and split government, and DSPLIT denotes Democratic President and split government.

Data are as of 9/30/12.

Corporate Profits

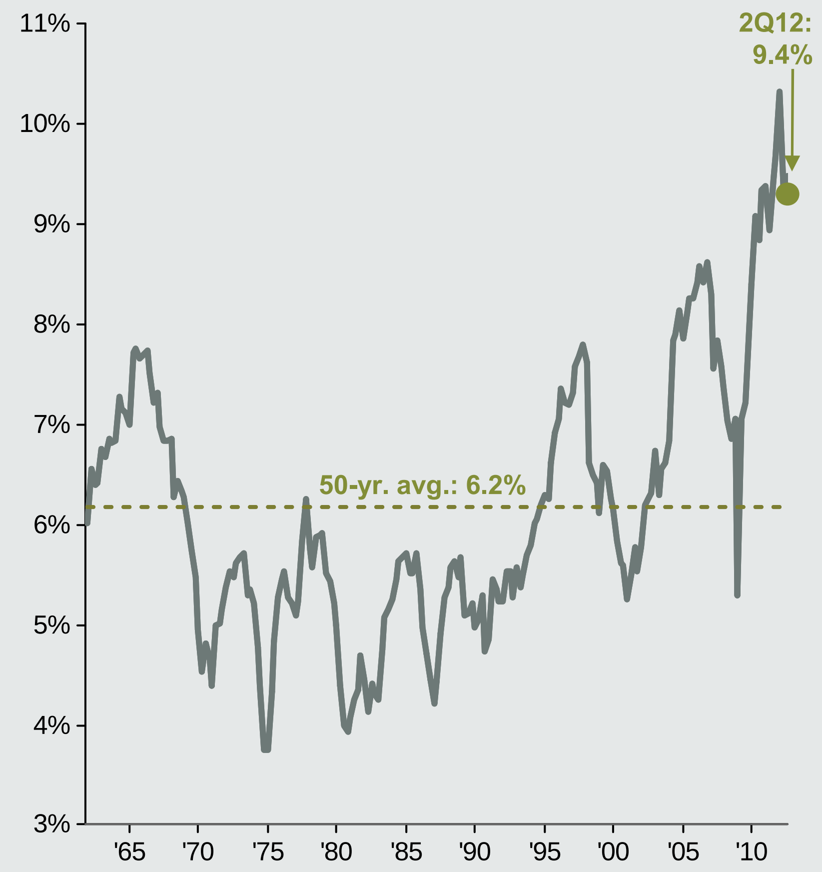
S&P 500 Earnings Per Share

Operating basis, quarterly



Adjusted After-Tax Corporate Profits (% of GDP)

Includes inventory and capital consumption adjustments



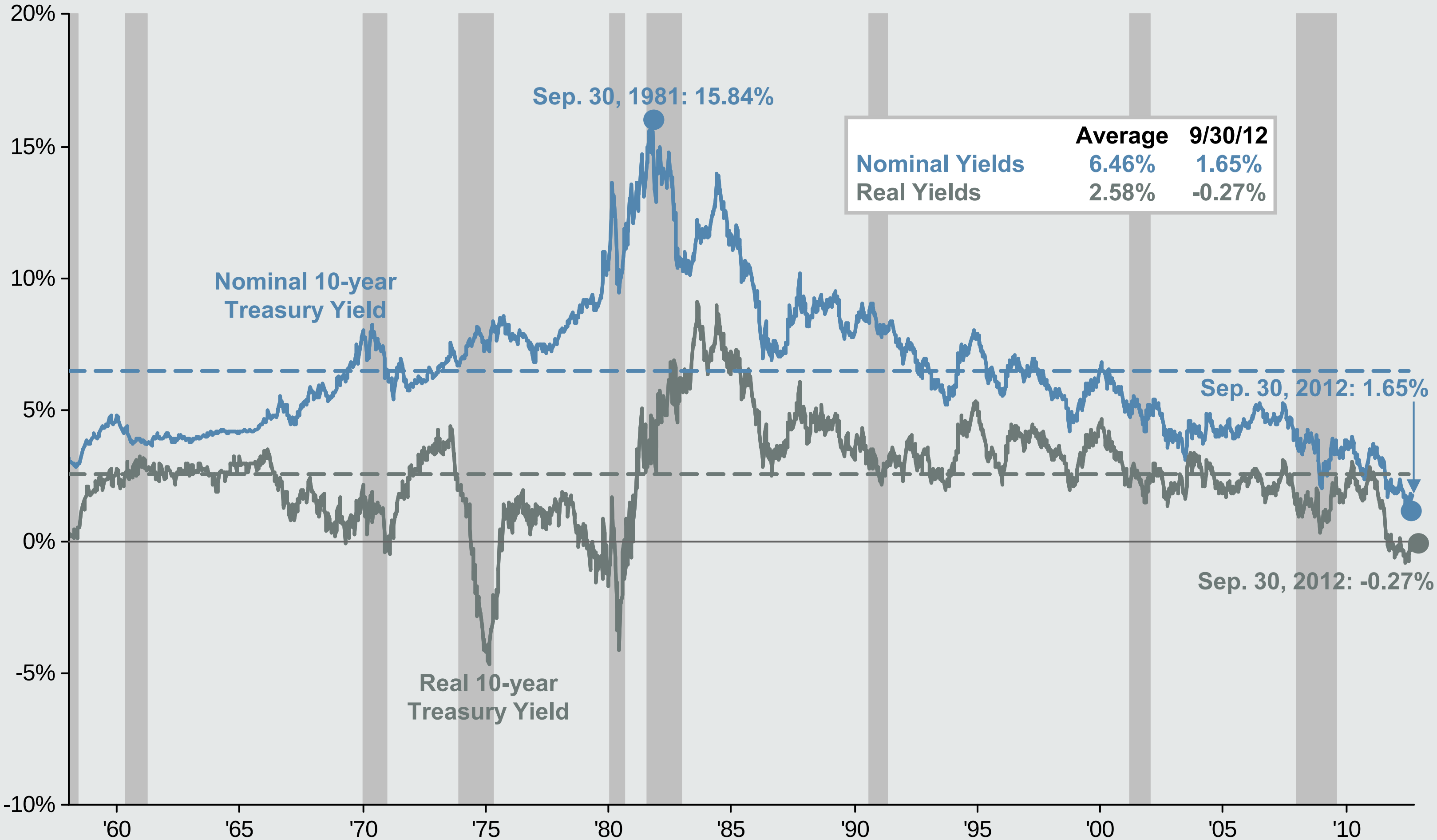
Source: Standard & Poor's, Compustat, BEA, J.P. Morgan Asset Management.
EPS levels are based on operating earnings per share. Most recently available data is 2Q12.
Past performance is not indicative of future returns.

Data are as of 9/30/12.

J.P.Morgan Asset Management

Fixed Income

Nominal and Real 10-year Treasury Yields



	Average	9/30/12
Nominal Yields	6.46%	1.65%
Real Yields	2.58%	-0.27%

Source: Federal Reserve, BLS, J.P. Morgan Asset Management.

Real 10-year Treasury yields are calculated as the daily Treasury yield less year-over-year core inflation for that month except for September 2012, where real yields are calculated by subtracting out August 2012 year-over-year core inflation.

Data are as of 9/30/12.

J.P.Morgan Asset Management

Prepared by: *Doug Ramsey & Chun Wang*

Presidential Elections And Financial Assets

- **For Stocks, There Is No Party Preference In The Presidential Election**
  Investors might want to rethink their knee-jerk assumptions between party affiliation and market performance.

- **But Significantly Different Patterns Emerge For Bonds**
  A Republican victory usually leads to a rising interest rate trend, while a Democrat's victory leads to falling interest rates post-election.

- **The Economy Is The Key Driver, Unemployment Rates The Best Proxy**
  The two unemployment reports between now and the election should figure prominently in the outcome.

Election Year Cycles: Expectations For The Near Term

Presidential election years have (on average) been decent ones for the U.S. stock market, and 2012 action is conforming to this pattern after an especially painful detour in 2008. In fact, this year's S&P 500 gain (+13.9% through September 6th) is already double the average +6.7% election year gain dating back to 1928.

Is there any discernable market bias in the final months of a presidential election year? Not really. The S&P 500 has (on average) posted small losses of –0.4% and –0.1% during the typically troublesome months of September and October. However, the small September loss is a vast improvement over the typical September performance seen in the other three years of the electoral cycle. The average December performance in election years has been a healthy +1.4%... but this is often the last hurrah before the market moves into the traditionally lean post-election and mid-term years in which average annual market gains are below 5%.

S&P 500 Performance:
Election Versus Non-Election Years

	January through August	September	October	November	December	Annual
Presidential Election Years	4.8%	-0.4%	-0.1%	0.6%	1.4%	6.7%
Post-Election Year	6.2%	-1.8%	-1.4%	0.5%	0.3%	4.1%
Mid-Term Year	-1.2%	-1.2%	2.6%	2.0%	1.7%	4.5%
Pre-Election Year	12.1%	-1.1%	0.4%	-0.8%	2.4%	13.4%

(Returns are price only)

Presidents And Stock Market Performance

We've argued lately the S&P 500 could soon eclipse its 2000 and 2007 highs (of 1527 and 1565, respectively), but there's another looming target few are discussing: S&P **1443**.

Why is 1443 significant? Because a close above this figure at next January's inauguration would make Barack Obama's presidential term the **second most profitable for stock investors since 1928**, trailing only the +162% rebound off Great Depression lows in FDR's first term. [Of course, Obama didn't build that market. Somebody along the line gave him some help. There was a great Princeton economist somewhere in his life. Somebody invested in printing presses and helicopters…]

Does Party Matter?

- Barring a near-term collapse, Barack Obama's term now stands to rank among the best handful of terms in modern stock market history (which he has curiously failed to list among his important first-term accomplishments). The three best previous presidential terms for stock prices also occurred with Democrats at the helm. (Again, though, don't expect the party to trumpet that fact.) Meanwhile, among the five presidential terms associated with a cumulative **loss** in the S&P 500, four occurred under Republicans (with "W" appearing on the list two times).

- The above summary of the best and worst stock markets by term certainly favors the Democrats. But when all terms are considered, the numbers are a wash. The median S&P 500 price gain during a Democratic presidential term is 27.5%, compared with 27.3% for Republican terms. (James Simons' Medallion Fund must have arbitraged away any previous statistical discrepancy here.)

- **Investors shouldn't base their vote on these results, but they might rethink their knee-jerk assumptions on the relationship between party affiliation and market performance**. Republicans might "talk a good game" with investors, but their policies are either (1) fully discounted by markets before their candidate takes office; (2) overwhelmed by larger cyclical forces; or (3) fundamentally indistinguishable from the Democrats'. In practice, all three factors are likely at work.

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Franklin D. Roosevelt (4th term - partial)	5.2
George W. Bush (1st term)	-12.5
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Herbert C. Hoover	-73.3
Median For Democrats:	**27.5** %
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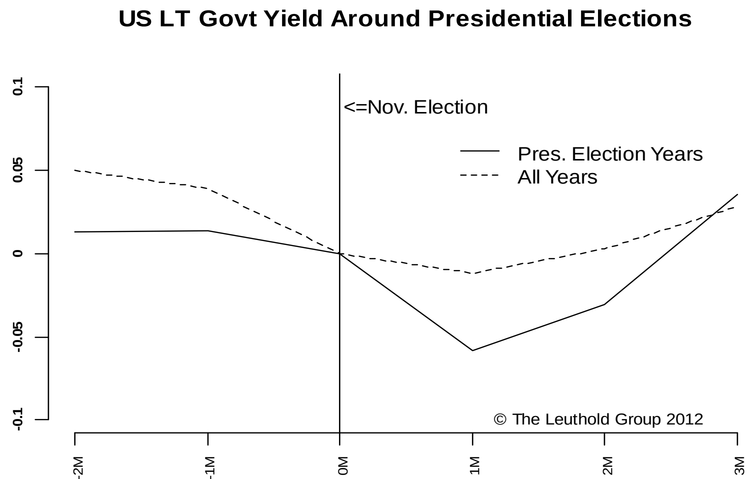
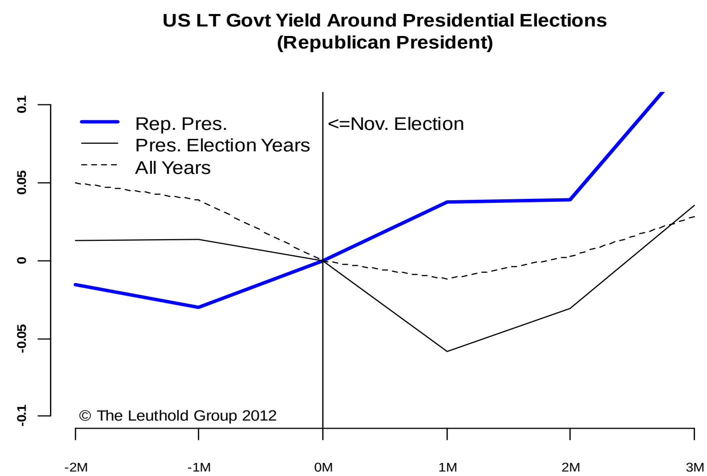
Presidential Election Cycles And Interest Rates

After a prominent financial guru last month declared an end to the "cult of equities", we decided it might be appropriate to extend our election cycle analysis to the asset class he would presumably approve of: **bonds**.

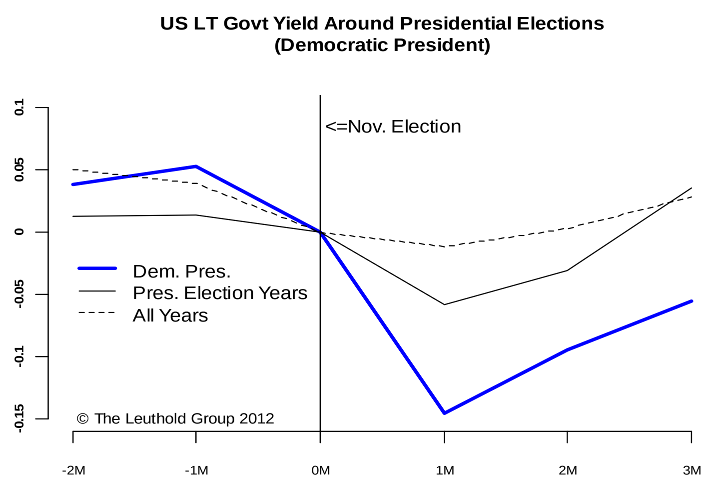
Using the U.S. Long-Term Government Bond Yield going back to 1925, we looked at the average pattern from two months before, to three months after, the presidential election. The solid line on the top chart shows the pattern of the LT bond yield movements around the elections, while the dashed line shows the pattern for all years. Interest rates tend to move a bit lower heading into the election, then start increasing a month after the election. However, the election year pattern is not that different from the "all years" pattern.



But when we **break the analysis down by the <u>party</u> of the winning presidential candidate, significantly different patterns emerge.** The thick solid line on the chart at right shows a generally *rising* interest rate trend in the years when Republican candidates win the White House.



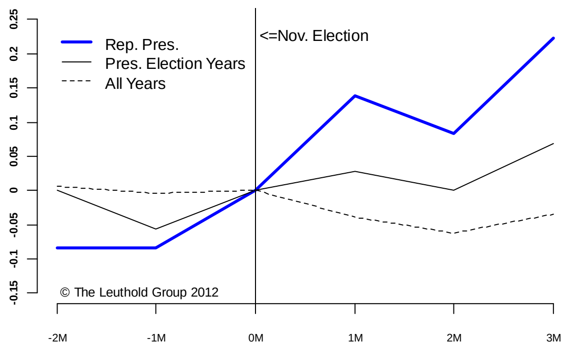
However, when Democrats have captured the White House, interest rates have generally trended lower immediately following the election. (It might be tempting to try to explain these differences with theories over the putative fiscal responsibility of the respective parties… but in reality, **neither party** has demonstrated responsibility on this front for decades.)



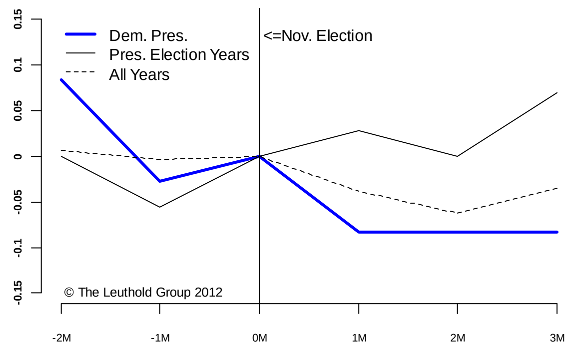
What might have caused the divergent interest rate patterns observed following the election of Republican versus Democratic presidents? **Fed policy** immediately comes to mind; after all, monetary policy is the main driver (and, lately, manipulator) of interest rates.

We proxy Fed policy with the U.S. discount rate, and find it confirms the pattern we saw on the previous page. Fed policy is usually tighter (higher discount rates) when Republicans win the White House (left chart), but tends to be looser (lower discount rates) when Democrats win the White House right chart).

US Discount Rate Around Presidential Elections (Republican President)



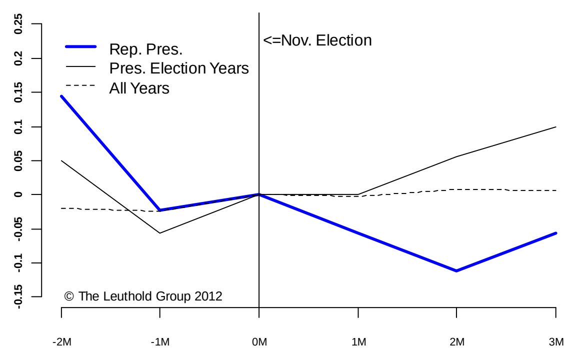
US Discount Rate Around Presidential Elections (Democratic President)



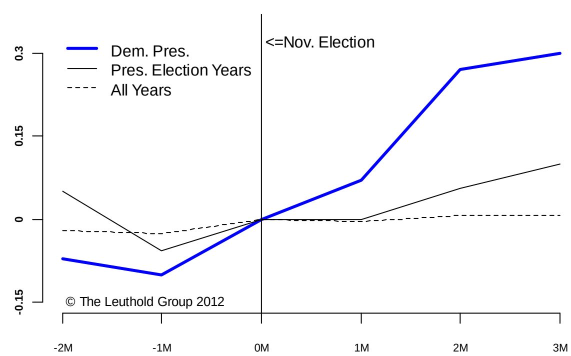
Fed policy is largely driven by the economy. When the economy is weak, the Fed typically eases to provide support. This is confirmed by the charts at right, which examine trends in unemployment immediately before and after the election. The message is clear: **unemployment rates are typically lower (i.e. a better economy) when Republicans are elected and vice versa.**

Not surprisingly, the key driver of the election is the economy, with unemployment rate the most accurate proxy. When the unemployment rate is high (weak economy), voters gravitate towards the party that provides more entitlement benefits and bigger government spending (usually a Democrat). **The next two employment numbers should figure prominently in November's final result.**

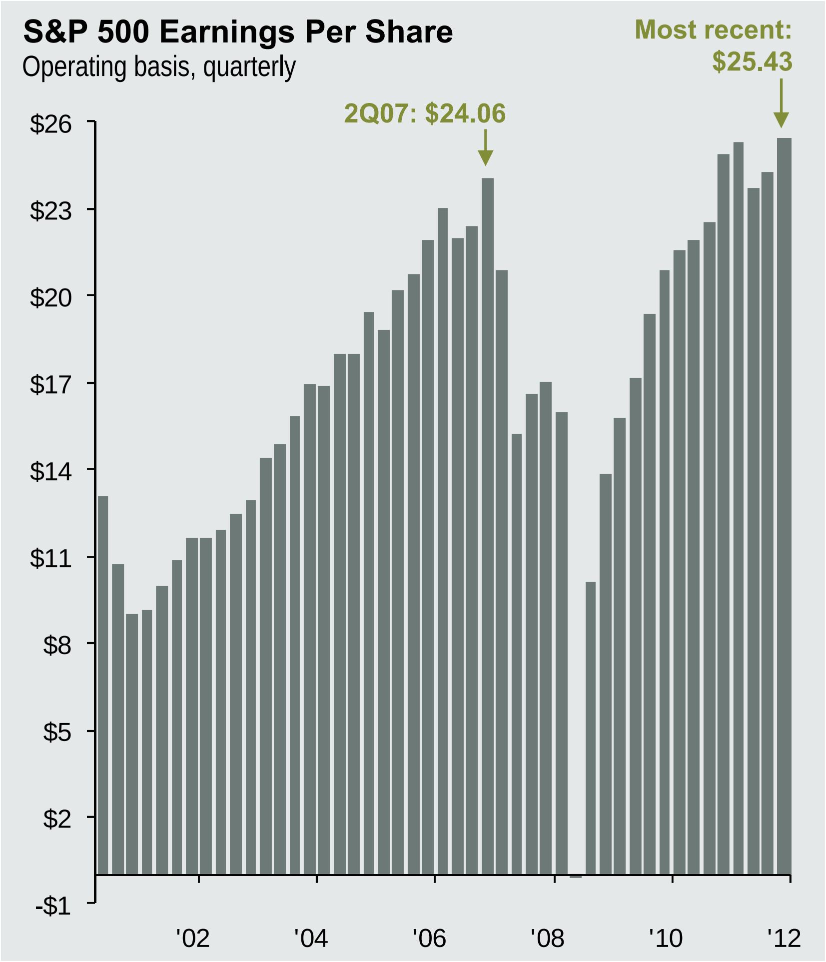
US Unemployment Rate Around Presidential Elections (Republican President)

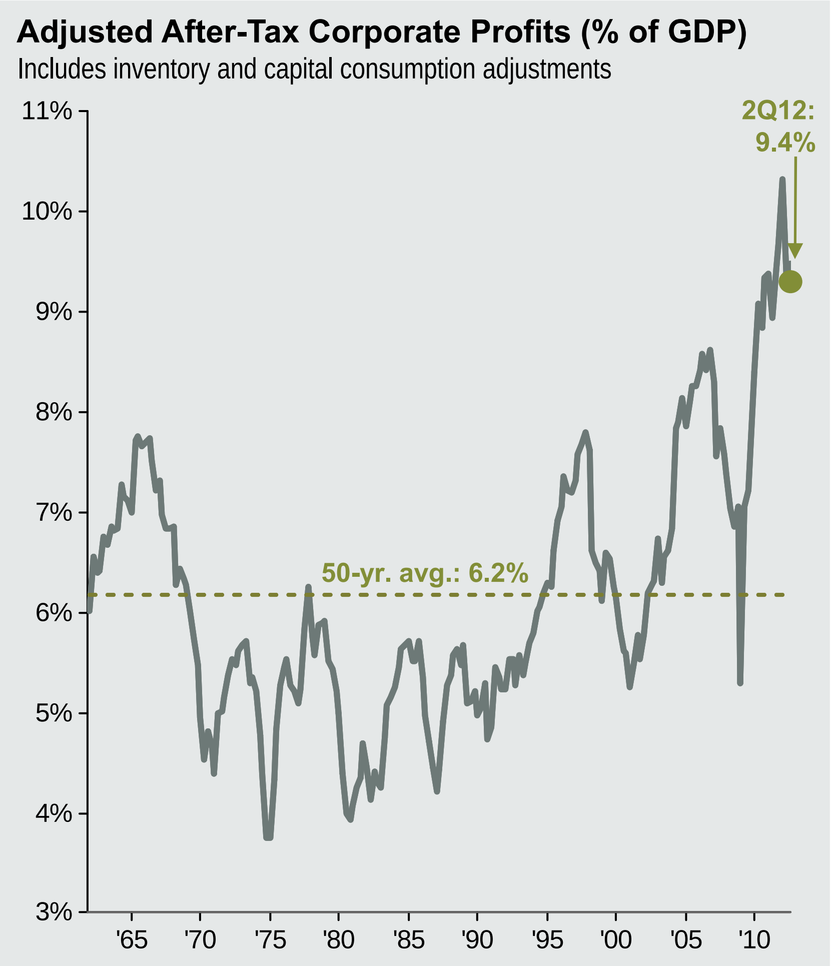


US Unemployment Rate Around Presidential Elections (Democratic President)



Corporate Profits





Source: Standard & Poor's, Compustat, BEA, J.P. Morgan Asset Management.
EPS levels are based on operating earnings per share. Most recently available data is 2Q12.
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