US Equity and Derivatives Strategy
Presidential Elections and the S&P 500

Equity Strategy

Americas

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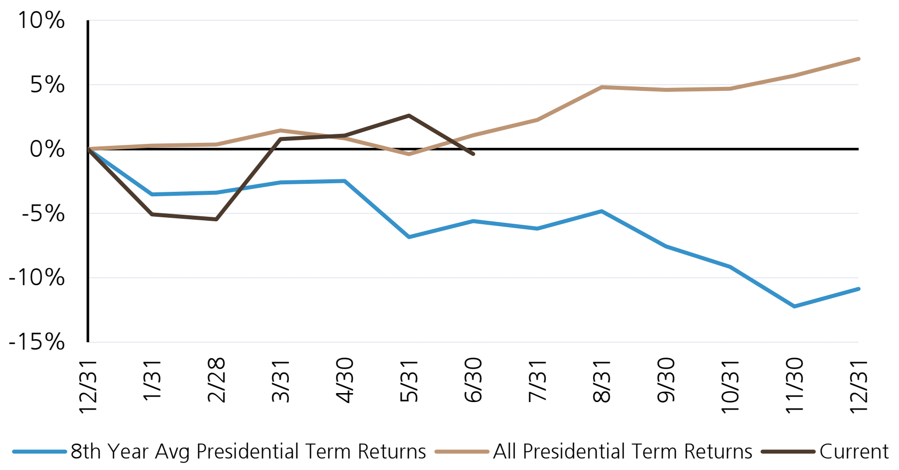
Stocks and Sectors from Hoover to Obama

As investors continue strategizing for the financial markets after the leave outcome of the UK Referendum, the focus will also now turn to the US Presidential Election on November 8. Thus we ask the question "What happens to US Equities leading up to and once the Presidential vote is cast?" Clicking on the Link to our "Interactive Spreadsheet" allows you, the reader, to examine S&P 500, Sector and Industry Group total return performance for the 3 months before and 1, 3, 6 and 12 month periods following each quadrennial election date from 1928 (Hoover vs. Smith) through 2012 (Obama vs. Romney). The reader can further sort election cycle outcome returns in groups, comparing performance against historical ranges on both an absolute and relative basis.

Investing for the Inevitability of Change

Can historical precedent instruct as to what to expect from US equities over the balance of 2016 and into 2017 given the exceptional desire for change on the part of the US electorate – change that is likely to result in either the first woman President or a President who has been in politics for a year? While presidential election years tend to be positive for equity markets - particularly the second six months - returns in the last year of a two term president's tenure (years including the Tech Bubble burst of 2000 and the Financial Crisis of 2008) have been decidedly less robust (Figure 1). For a potential 2016-17 "equity market blueprint" we look at four elections which, either due to generational transitions (1960, 2008) or strong third party challenges (1980, 1992), in our view approximate the electorate's restive mood in 2016. The common thread among these years is an expectation for elevated volatility/market choppiness against the backdrop of positive returns in the year following the vote (Figure 3, p. 3); Notably, Technology (a Strategy overweight sector) shares exhibited positive returns in the year following all four "Change Election" years.

Figure 1: Presidential Election Year Returns (since 1928)



Source: Bloomberg, UBS

Investing for the Inevitability of Change

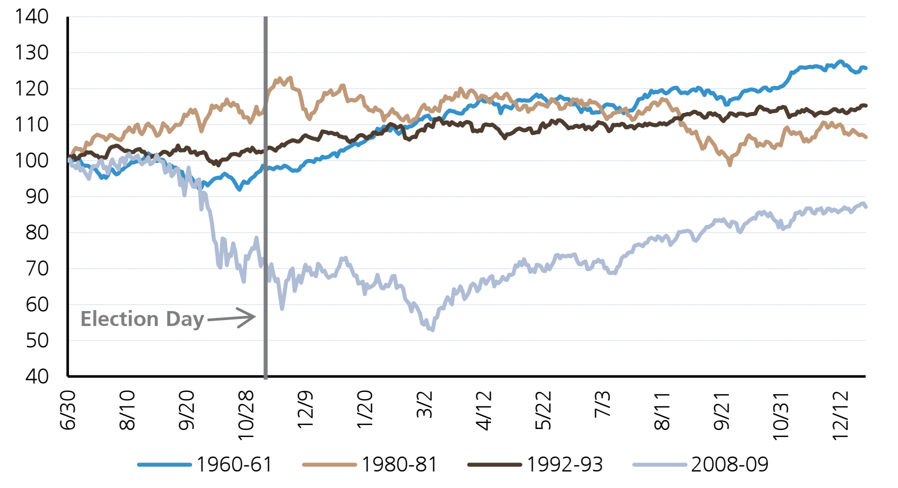
The prospect for change in the US has been manifest for months now – a political outsider presumptively seizing the nomination of the Republican Party after having bested 16 challengers during Primary season, set to run against the presumptive nominee of the Democratic Party, who could become the first woman president in United States history.

Can presidential political history be informative for investors?

The record of markets generally being strong in presidential election years is overshadowed by the less-than-stellar return profile of those years in which the sitting president was in his eighth (and final, by law, post-FDR) year in office – FDR, 1940; Eisenhower, 1960; Reagan, 1988; Clinton, 2000; George W Bush, 2008 (Figure 1, p.1); and now, Obama in 2016.

Where we believe historical precedent has relevance is in thinking about 2016 as inevitable change based on it being both the last year of President Obama's term as well as the Electorate's having presumptively put forth two "change" individuals on the Republican and Democratic sides. Such "Change Election" years whether Generational (JFK in 1960, Obama in 2008) or those with strong third party candidates (Reagan vs. Carter vs. Anderson in 1980, Clinton vs. G Bush vs. Perot in 1992) have not shared a directional bias during the second half of those election years – rather the commonality has been elevated volatility with a certain degree of market choppiness, followed by positive returns in the year after Election Day (Figure 2).

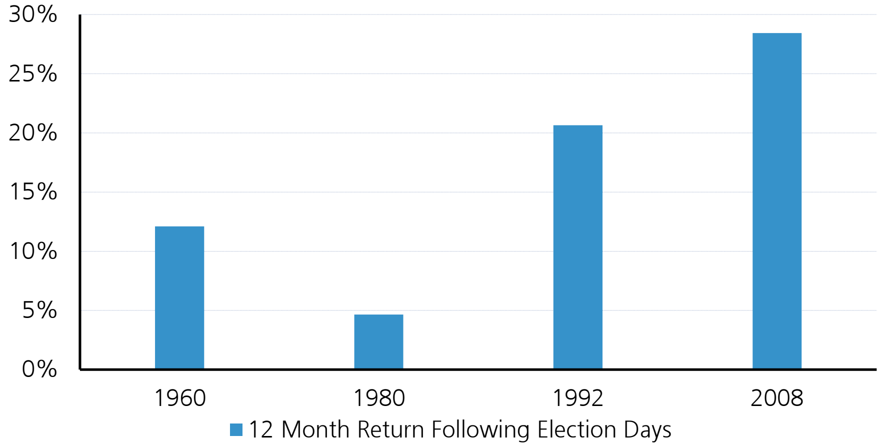
Figure 2: "Change Elections" and Subsequent Returns



Source: Bloomberg, UBS

In terms of sector performance, Technology is a positive performer in the year following all four prior "Change Elections" (Figure 3).

Figure 3: Political Change – A Positive for Tech

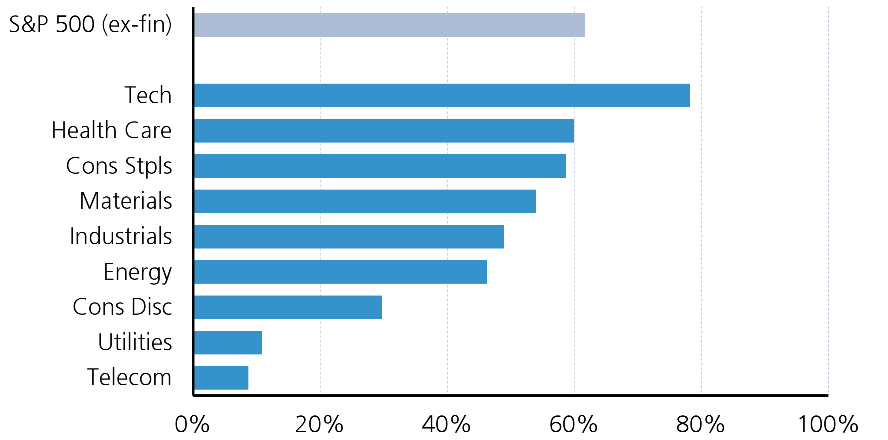


Source: UBS Quantitative Research

Given Technology's attractive absolute and relative valuation as well as the prevalence of a number of high "Quality" companies in the sector which could outperform in the months ahead given the economic and market volatility which we view as remaining elevated into 2017 (see 6/28 US Equities: Uncertainty 101) we continue to believe that our sector Overweight stance on Technology is warranted.

It's also worth noting that should the US Electorate vote for a type of change that makes tax reform coupled with offshore cash repatriation a possibility in 2017, Tech has by far the largest holdings of offshore cash (Figure 4). Such change is a potential "positive tail risk" to both Tech and the market generally looking into 2017.

Figure 4: Overseas Cash by Sector (as % of Total, FY 2015)



Source: FactSet, Bloomberg, company financial statements, UBS

Valuation Method and Risk Statement

Past performance is not indicative of future returns. Investing in equities globally poses country, industry and company-specific risks. Valuations can be impacted by changes in the macroeconomic landscape as well as financial market stability.

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Source: UBS. Rating allocations are as of 31 March 2016.
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