

# MARKET SIGHT LINES



## Will midterms impact equity returns? Midterm Market Monitor

By Michael O’Keeffe, *Chief Investment Officer*

In our Outlook 2022 [report](#) and [video](#), we discuss our market views for the coming year, including the volatility we’ve experienced so far. Market volatility, and market returns, are influenced by many factors like earnings, the pandemic, and government policy. So, like many, we are focused on how the midterms may affect markets leading up to, through, and beyond the elections.

In this week’s Sight|Lines, we review how the midterms may be affecting market performance and share some charts we’ll be monitoring throughout the year.

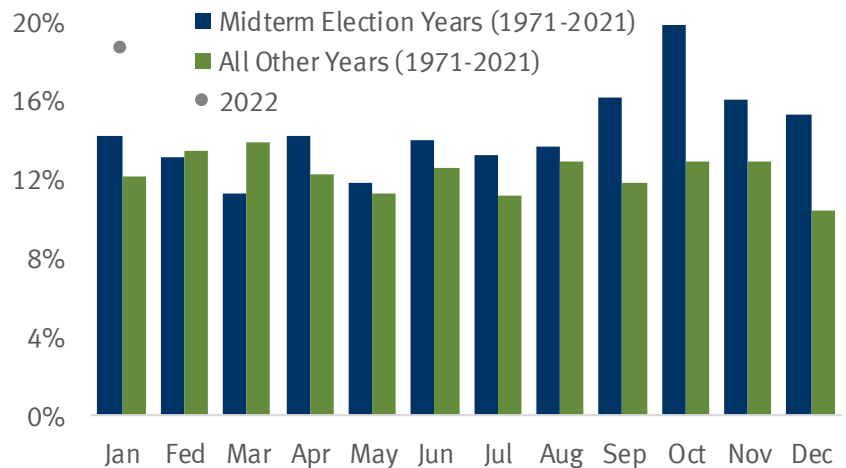
### State of Play

While it took a runoff election in Georgia, the Democrats won control of the U.S. government in 2020, completing the “blue wave.” Joe Biden won the presidency, the party kept the control of the House, albeit with fewer seats, and a 50-50 Senate means Vice President Kamala Harris can cast the deciding vote as president of the Senate. However, given the Senate cloture rule, which for most bills requires a 60-member vote to end debate (filibuster) and move to a vote, Republicans continue to have influence. And within the Democratic Party, progressives are trying to advance a bold agenda, while moderates are blocking elements they believe too bold. So, even with Build Back Better, a budget reconciliation bill not subject to a filibuster, Democrats are divided. In many ways, we are operating with a divided government.

### Midterms and Market Volatility

Let’s turn to what history tells us about midterm years, and start with volatility. Consider Figure 1. Using daily returns of the S&P 500, we calculate volatility for each calendar month through history, then evaluate midterm years versus all others. What do we learn? We see that for most months, midterm years are more volatile than other years, especially as we head into, and through, the election in November.

**Figure 1. S&P 500 | Annualized Monthly Volatility**



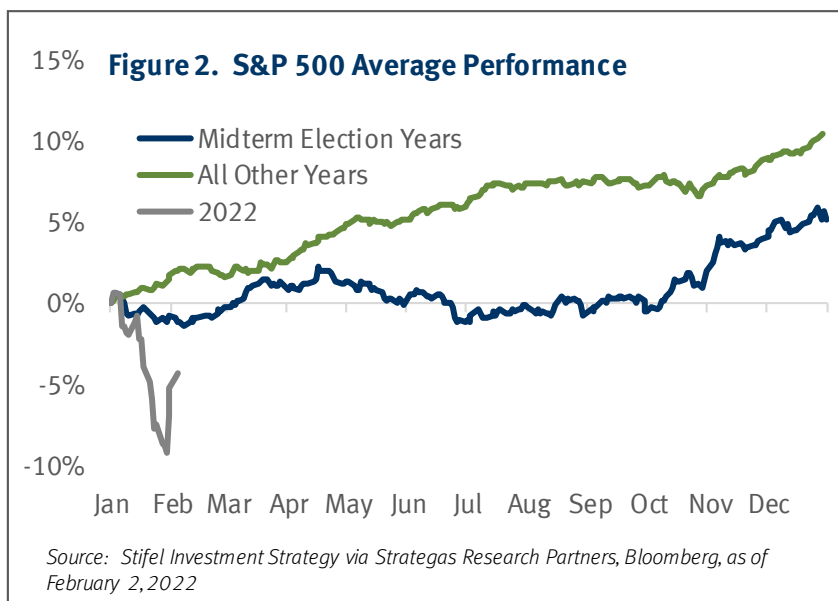
Source: Stifel Investment Strategy data via Bloomberg, as of February 2, 2022.

Volatility is calculated based on the standard deviation of daily returns for each individual month using 252 trading days a year. The median volatility for month is displayed.

Throughout the year, we'll update this chart to include results for 2022. And we see that volatility in January was higher than average for midterm and non-midterm years alike, likely driven by the news of a more hawkish Federal Reserve.

### Market Performance

While a review of volatility is important, it is also helpful to review how the midterms might affect market performance. Figure 2 provides a historical perspective. We plot the daily returns for midterm years compared to all other years. Note that for both, the full year is positive, showing that the equity market, on average, posts a positive return for midterm years and non-midterm years. Midterm years, on average, have had a slightly less positive return. But more interestingly, the average market return has hovered near zero during midterm years, then has moved higher, on average, as the election approaches and we make our way through.



So, given patterns of history, we may expect a more volatile and flattish market until the election approaches. Of course, we've experienced some negative performance in early 2022. But the figure shows us that markets are recovering. We'll continue to compare 2022 results through the year.

### A Power Shift?

As we approach the election, we'll hear and read a lot about forecasted election results. Historically, the party of a first-term president usually loses seats in Congress. Stifel's Chief Washington Policy Strategist, Brian Gardner, is expecting a shift in power in the House, with Republicans likely taking narrow control from the Democrats. He views the Senate as more of a toss-up, leaning toward Democrats keeping a majority, but nowhere close to the 60 seats needed to break the filibuster. The next result? We should anticipate a divided government after the midterms, resulting in a narrower focus on a limited bipartisan agenda.

We will continue to monitor activity in D.C. and the market's performance through the year.

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