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BONDS INDEPTH:

Summers Of Discontent: U.S. Pre-Election Market Reactions

As we approach the start of the first of two or three major political conventions, it is interesting to review how major financial markets react in the summers preceding U.S. Presidential elections. We have examined the performance of several key markets in the May to October period preceding each of the 11 post-war Presidential elections. A variety of interesting conclusions can be gleaned.

Equity markets - in 9 of the 11 post-war Presidential elections the U.S. stock market rallied over the summer. Seven of these rallies were substantial. Only the 1956 and 1960 elections saw a declining stock market in advance of the elections. The last three elections have seen very sharp stock market advances over the preceding summer, confirming the adage that stock markets tend to favor pro-business Republicans.

Interest rate direction - the general direction of bond markets is unclear prior to Presidential elections. The short-end has weakened in 7 of the last 11 elections, while the long-end has been about evenly split. It does appear that the short-end favors the election of a Democrat and dislikes the election of a Republican - perhaps due to a belief that Democrats will apply greater pressure to the Fed for the easing of short-term rates, favoring the fight against unemployment over inflation. The long-end, however, does not appear to have a favored party.

Yield curve - it is interesting to note that the yield curve rarely steepens over a pre-election summer. In only 2 of the past 11 elections did the yield curve steepen, by 10 bps in 1952 and by 53 bps in 1960. The yield curve flattened by more than 100 bps in each of the last three elections, and by sizable margins in the two elections before that. It may be difficult to draw conclusions about this, since flattening yield curves can be interpreted either as a statement about inflationary expectations, and thus the performance of the Fed, or as precursors to recessions, which implicate the upcoming fiscal policies of the next Administration. We suspect the strong flattening of the last three elections was more a referendum on Volcker and Greenspan than on the Republican incumbents.

Currency markets - since the dollar has not been free-floating for more than the last 4 or 5 elections, trends are more difficult to detect. Indeed, it appears as though the dollar follows an inertial cyclical pattern that is relatively unaffected by changes in the White House or by political campaigning.

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Conclusion for current election - with Perot in the campaign it is difficult to speculate on market reaction. If Perot has the lead at summer's end, all bets are off. We suspect that either way the equity market may not react favorably this time, although it is a safe bet to expect another yield curve flattening. Bond and dollar direction may not be fathomable until we can see which candidate is actually in the lead.

The following table gives the details of the various reactions in the last 8 pre-election summers.

Year	Stocks	Bonds	Bills	Yield Curve	\$/Dmark	\$/Yen
1988	+ 8.3%	- 29 bps	+109 bps	flatten 138 bps	- 7.0%	+0.1%
1984	+ 5.3%	-125 bps	- 33 bps	flatten 116 bps	+11.6%	+7.1%
1980	+20.9%	+157 bps	+183 bps	flatten 147 bps	+ 2.9%	-8.4%
1976	+ 0.7%	- 49 bps	- 26 bps	flatten 21 bps	- 5.2%	-2.6%
1972	+ 1.8%	+ 35 bps	+ 77 bps	flatten 70 bps	+ 0.9%	-1.1%
1968	+ 5.9%	- 29 bps	- 20 bps	neutral	- 0.1%	-1.0%
1964	+ 5.1%	- 1 bps	- 14 bps	flatten 10 bps	N/A	N/A
1960	- 2.7%	- 46 bps	-138 bps	steepen 53 bps	N/A	N/A

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