Perspective

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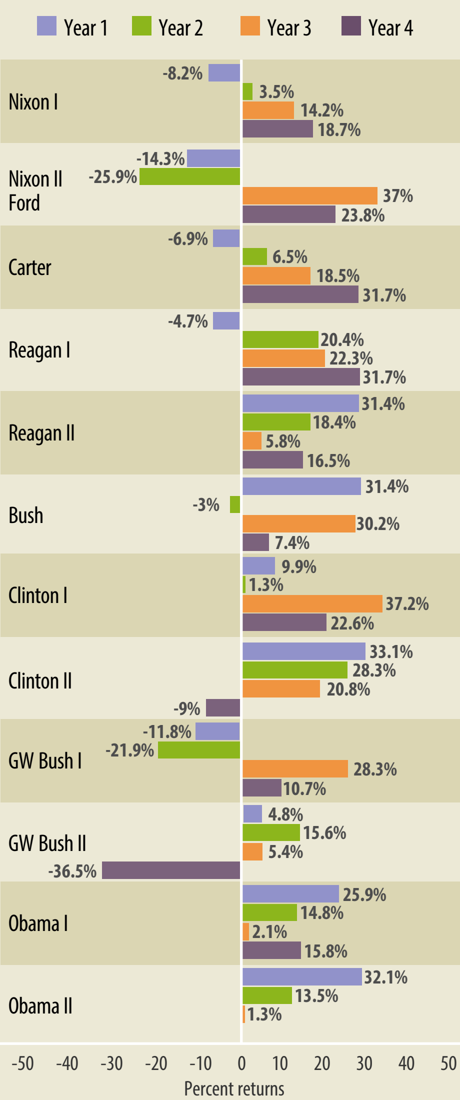
Presidential Election Cycle Theory

Presidential Election Cycle Theory suggests that U.S. stock markets are weakest the year after an election. Then, after the first year, markets improve until the cycle begins anew.

THE PRESIDENTIAL ELECTION CYCLE
(Annual returns on the Standard & Poor's 500 Index[7])



Source: NYU Stern School of Business

Do Presidential Elections Affect Stock Markets?

A change in leadership may be accompanied by policy changes that reshape our economy, and the health of the economy may affect the markets. For example, after his election, President Thomas Jefferson embargoed trade with England and France, which had New England states talking about seceding from the union.[1] The election of Abraham Lincoln charted a new course for the country that dramatically affected our economy.[2] President Jimmy Carter's policies changed energy use in the U.S.[3]

However, economic health isn't the only factor. Markets may respond positively or negatively to economic indicators, demographic trends, political uncertainty or other issues.

Investor sentiment also plays a significant role and can move markets in unexpected ways.[4] It seems that investors hoped signs of a weak economy would encourage the Federal Reserve to pursue economic policies that investors believed would support the bull market.[5]

Researchers in the field have found investors like to take shortcuts by developing rules of thumb, which they substitute for complex analysis. You may be familiar with the:[6]

- **Hemline indicator:** The market rises and falls with hemlines.
- **Pigskin predictor:** If an original NFL team (part of the NFL prior to the 1970s merger) wins the Super Bowl, markets go up and vice versa.
- **Presidential approval effect:** When approval ratings are low, stock markets rise.

While it might be nice to find a shortcut that predicts the direction of the stock market, nothing beats good, old-fashioned research. ■

[1] Miller Center of Public Affairs, University of Virginia. *"James Madison: Campaigns and Elections."* Accessed March 28, 2016.
[2] Miller Center of Public Affairs, University of Virginia. *"Abraham Lincoln: Campaigns and Elections."* Accessed March 28, 2016.
[3] Miller Center of Public Affairs, University of Virginia. *"Jimmy Carter: Domestic Affairs."* Accessed March 28, 2016.
[4] Harper, David. *"Forces That Move Stock Prices."* Investopedia.com. Accessed March 28, 2016.
[5] Cox, Jeff. *"For the US economy, bad news is actually bad news."* CNBC.com. January 21, 2016.
[6] Smith, Lisa. *"World's Wackiest Stock Indicators."* Investopedia.com. July 1, 2008.
[7] Past performance is no guarantee of future results. S&P 500 Index is an index of 500 of the largest exchange-traded stocks in the US from a broad range of industries whose collective performance mirrors the overall stock market. Investors cannot invest directly in an index.

Think Twice Before Tapping an IRA to Buy a Home

If you're a first-time homebuyer looking to buy a home, you may be tempted to tap into the savings in your IRA. It's an option. The question is should you do it?

Usually, IRA owners who take distributions from Traditional IRAs before reaching age 59½ owe ordinary income tax, as well as a 10% penalty tax. The IRS makes an exception for people who are buying, building, or rebuilding a first home.

First-time homebuyers can take up to $10,000 from a Traditional IRA; however, they will owe ordinary income tax on the distribution.[8] If the homebuyer is in the 25% tax bracket, they'll have about $7,500 left for the down payment. (If the homebuyer has a Roth IRA, he or she can take contributions from the account tax-free and penalty free, but not earnings.)

Before taking a distribution from any IRA, consider the opportunity cost. That's what you may be giving up if you take a distribution. You have to weigh the potential costs and benefits of home ownership, such as increases in the value of the home and maintenance costs, against other possible benefits, like earnings in the IRA.

For example, an IRA owner who takes $10,000 from a Traditional or Roth IRA loses any future earnings on that money. Assuming the homebuyer is 25-years-old, would leave the money in the IRA until retirement at age 67, and would earn an average annual return of 6% each year, the opportunity cost is significant. The $10,000 would have increased to almost $122,000.[9] Of course, if the money were invested in a Roth IRA, the amount would be tax-free.

Using assets in an IRA to purchase a first home may be a good idea, and it may not be. It depends on how you calculate the costs and benefits. Please contact my office before you make a decision to use your IRA assets to buy a home. ■

[8] Internal Revenue Service, Publication 590-B. *"Distributions from Individual Retirement Arrangements (IRAs)."* January 4, 2016.

[9] Moneychimp.com

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