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Cheerleader in Chief?

by Craig D. Hafer, President

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It was a historic time eight years ago. Senator Barack Obama had just won the 2008 Presidential election over Senator John McCain, becoming the first African-American president of the United States. I was hosting my quarterly radio show on WEEU of Reading, PA and amongst the many callers, there was a general sense of optimism about the potential impact of this historic moment. As someone who grew up near the race riots in New Jersey, I could appreciate the sense of hope. Yet, such enthusiasm was not felt by everyone when it came to the future of the economy. One older gentleman was adamant that the best thing to do was to get out of stocks immediately and buy gold in preparation for the inevitable collapse of the U.S. economy due to Obama's "liberal agenda." Despite my dissenting response, the caller was steadfast. I can only hope that the listeners did not heed his advice. Since Obama gave his inaugural address in January 2009, the S&P 500 Index has grown around 160%, while gold has gained just 31%. Unless there is a significant drop in the stock market in the next six months, President Obama's eight years in office may be some of the best for stocks. As the nation is faced with choosing Obama's successor, it is once again asking, which candidate is better for the stock market and the economy?

Every four years, voters head off to the polls to elect the next president and the press presents their recurring news stories, with pundits opining on who will be the next president, and what impact he or she may have on stocks and the economy. (The press has the good fortune that a four-year span is long enough for voters to forget just how inaccurate many of these predictions were!) As the U.S. is set to soon vote for its 45th president, the Internet is overflowing with such stories. A Google search will yield millions of results for Hillary Clinton's and Donald Trump's "potential impact on the economy."

According to Stephen J. Dubner, co-author of the entertaining bestselling book *Freakonomics: A Rogue Economist Explores the Hidden Side of Everything*, asking a family member or friend how much the president really affects the economy would turn one into an "instant target of scorn." Most people assume that the president has a huge effect on the economy, and this belief seems to be supported by extensive research showing that macroeconomic performance is a strong indicator of U.S. presidential election outcomes. Regardless of the president's inability to set interest rates, change lending standards, or direct international economies,

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Source: The Washington Post

With a post-war economy and increased fiscal spending, as President Truman continued the programs of the New Deal, stocks grew over 220% during his two terms in office.

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presidential elections and approval ratings are often affected by how voters feel about the economy. President Bill Clinton's campaign strategist, James Carville, capitalized on this association with the 1992 campaign slogan (which is often credited with helping defeat sitting President George H. W. Bush), "It's the economy, stupid."

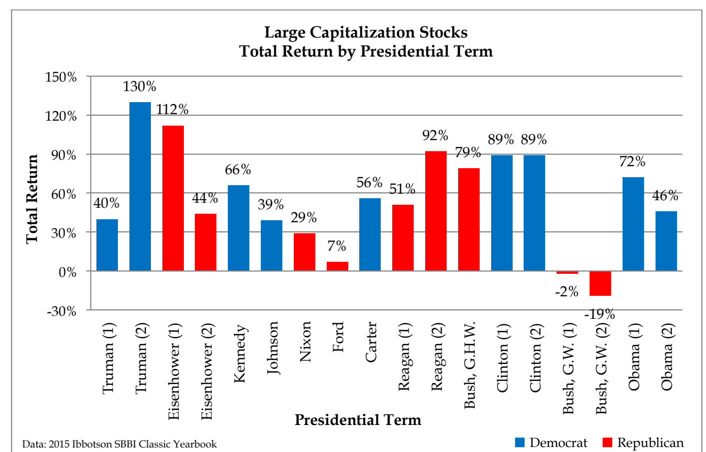
Which party is better for the economy? It may be surprising to some, but according to two Princeton University professors, the Democrats win this one. Professors Alan Blinder and Mark Watson indicate that the U.S. economy has performed better when the president was a Democrat rather than a Republican. It's just not clear why that is, or how much a president's policy choices have to do with it. Their 2013 study, "Presidents and the Economy: A Forensic Investigation" explores why GDP growth has been stronger when a Democrat is in office. From 1947:Q1 to 2013:Q2, real GDP growth averaged 3.33% at an annual rate. But the average annual growth rates under Democrat and Republican presidents were starkly different from each other, at 4.35% and 2.54% respectively. The 1.81% gap between the two was determined to be statistically significant.

Blinder and Watson present three main factors causing the difference in GDP growth rates under a Democrat versus a Republican leader. Together they account for one-half to two-thirds of the gap. They are oil prices, surges in productivity, and swings in consumer confidence. They dismiss the roles of Presidents Nixon and Carter in the oil price shocks that occurred during their terms, but felt that President George W. Bush and George H. W. Bush's policy decisions did affect oil prices. They also felt that any productivity gains were a matter of luck. Lastly, it was not clear why consumers tended to be more optimistic while there was a Democrat in office, resulting in an increase in consumer spending.

Since the publication of Blinder and Watson's study in 2013, GDP growth rates were 2.4% in 2014, 2.4% in 2015, and 0.8% for the first quarter of 2016. It appears that the Democrats' edge may be declining.

While the notion of there being greater economic growth under one political party than another may be attractive, Blinder and Watson's study does not mention the declining GDP growth rate and disinflation that we explored in our Spring 2016 letter. It may seem reasonable to accept the notion that a Democrat president *may* be more apt to rely on fiscal policies to stimulate economic growth than a Republican, who may want to limit such government spending; however, this is not always the case. First, such efforts would require the support of Congress, which seldom gives carte blanche to whomever is in the Oval Office. Second, not all presidents are ardent followers of economic theories often associated with their own party. According to David Harsanyi, President Bill Clinton supported several conservative economic policies including free trade and "declared the era of big government over and signed more consequential conservative legislation than any president since - and perhaps, anyone before him."

For investors, the question may be less "Which party is better for the economy?" than "Which party is better for my portfolio?" To evaluate stock performance during presidential terms, we calculated the total return of large capitalization stocks for each president from Truman (1944-1952) to Obama (2008-2016). The results are as follows:



As in Blinder and Watson's study of GDP growth, this chart shows that Democrats also have the edge when it comes to stock performance. From 1945 to 2016, the average total return for large capitalization stocks during a presidential term was 70% when a Democrat was in office, versus 44% for a Republican. For most investors, including our clients, President Obama's tenure has been a strong period for stocks.

While interest rates, trade pacts, oil prices and taxes are all areas where a president's impact is dependent on other legislative/government branches or foreign entities, there is one way in which the commander in chief may play a significant role. Dubner wrote in 2007, "As for the economy itself: even though there is debate over the president's effect on matters affecting people on a daily basis – gas and food prices, interest rates and the housing market – most economists agree that he is more of a cheerleader in this regard than a playmaker." The best president for stocks and the economy may be the one who gives us the greatest confidence as investors and consumers.