How'd They Do?

Reelections And The Presidential Cycle

What happens to the markets when a US President is elected for a second term?

My article "The Kondratieff Wave And The Presidential Cycle" was published in July 2012. At the end of it, I concluded that "with the K-wave suggesting a rise into 2016, the pattern suggests that President Obama will be reelected." It is gratifying to know that technical analysis and the cyclical pattern can predict the future. But to be honest, I hedged my bets with this statement:

> Although the relationship between the Presidential election cycle and the stock market appears to be strong, it does not mean that the play will be the same every cycle. However, when combined with technical analysis, additional insights can assist investors in their investment decisions.

Keeping that in mind, looking at the Presidential cycle in closer detail bears study. Why, for example, did the market fall the week *after* President Obama was reelected? Was this correction forecast by the Presidential cycle? Surely, the Dow Jones Industrial Average (DJIA), the Standard & Poor's 500, and the NASDAQ should have continued rising as forecast by the Kondratieff wave. Surely those Republicans who bought shares betting on a win by their candidate would not have sold their shares indiscriminately without looking at the technicals first?

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by Koos van der Merwe

THE PRESIDENTIAL CYCLE

To figure out all these unknowns, a closer study of the Presidential cycle is necessary. I have also added the Federal Reserve chairmanship cycle to the chart to see if this cycle has any bearing on the movement of the market. Figure 1 shows the Kondratieff wave updated, with an overlay of the S&P 500 to November 18, 2012.

As you can see, the S&P 500 has followed the trend up as suggested by the K-wave, but with a great deal of volatility. We all know the fundamental reasons for this volatility — the fiscal cliff uncertainty; the political fighting

FIGURE 1: THE KONDRATIEFF WAVE. Here you see the Kondratieff wave with the chart of the S&P 500 till November 18, 2012, overlaid on it. This S&P 500 has followed the trend up, suggested by the K-wave, but with a lot of volatility.

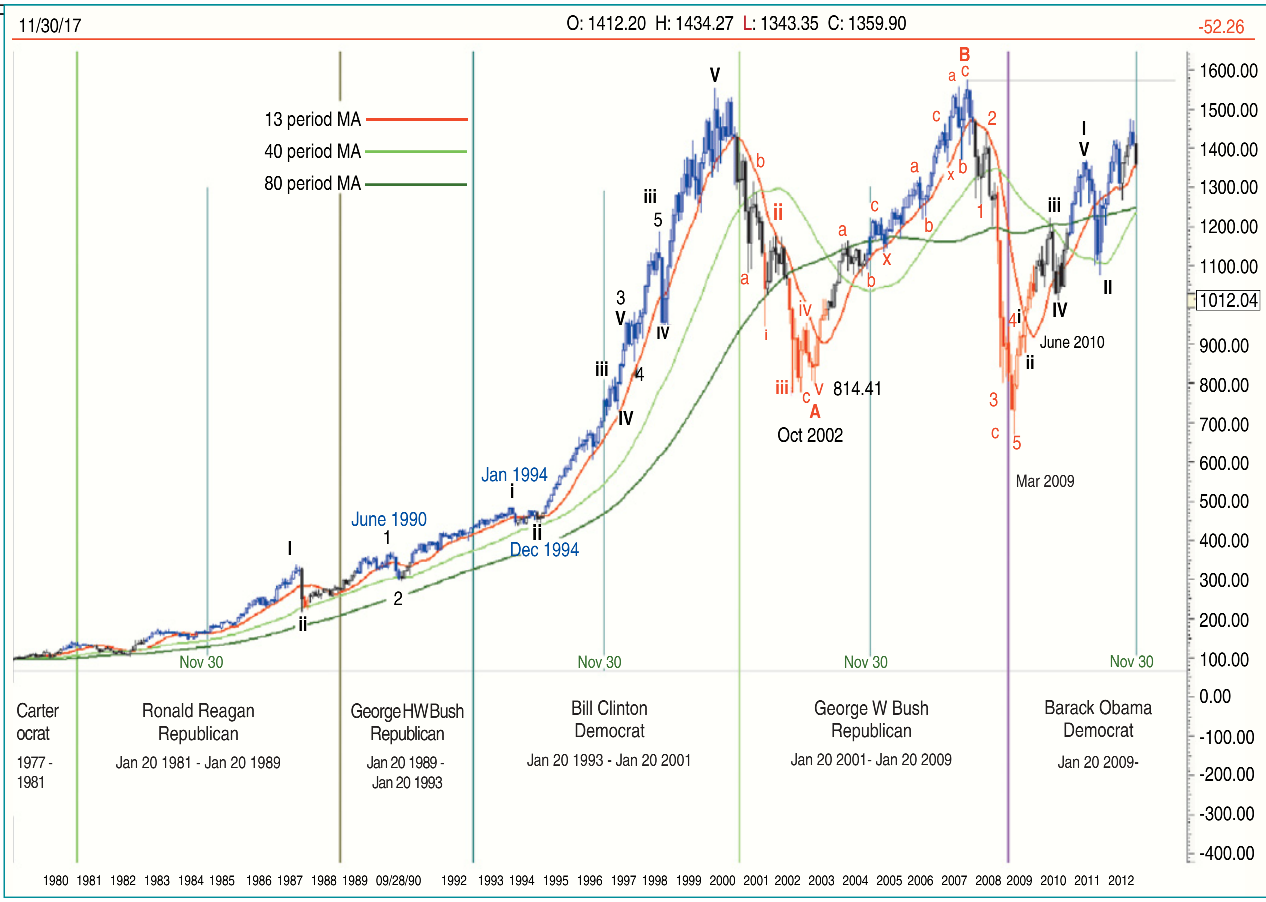

FIGURE 2: THE PRESIDENTIAL CYCLE FROM 1980. Here you see how the market reacted as each President served his term in office. The question is, if the K-wave is predicting a rise of the market into 2016, why, now that President Obama has been reelected, did the market fall? Will it start rising once the emotion from the election settles down, and sensibility, not politics, prevails?

between a Republican Congress and a Democratic President in an election year; fighting in the Middle East. One of the few positives is the gradual reduction of unemployment in the US.

Then, of course, there is also economic uncertainty in Europe, something that is not under American control. With world tension rising, as Iran slowly but surely inches its way to nuclear power, and with the recent Hamas/Israeli fighting, possibly a divergence to take the world's attention away from Iran, the world is in uncertain territory. It is a wonder that President Obama sleeps at night. His mental aggravation is reflected in his gray hair, something that was not there when he took over the position in January 2009.

Figure 2 is of the Presidential cycle from 1980 with an Elliott wave count, overlaid. The chart shows how the market reacted as each President served his term in office. If the K-wave is predicting a rise of the market into 2016, now that the President has been reelected, why did the market still fall? Will it start rising once the emotion from the election settles down, and sensibility, not politics, prevails? To answer this question, we must look at the Presidential cycle more closely.

Figure 3 shows the terms of office of Jimmy Carter, Ronald Reagan, and George HW Bush (referred to hereafter as "HW"). Note how, during the first years of Carter and Reagan, highlighted in dark yellow, the market fell. The market, however, did not fall in the first year of HW but rose, and strongly. I can only assume this was because of the strong recovery methods put into force by Federal Reserve chairman Alan Greenspan after the crash of 1987.

Greenspan served as the Fed chair from 1987 to 2006. The market meltdown of 1987 was his first major challenge, and his actions prevented the crash from spiraling into something much worse. He presided over a long financial-market boom through the 1990s, with the odd strong correction, something HW benefited from in his first year in office.

The market rose in 1989, contrary to the corrections that Carter and Reagan underwent in their first years of office. Was

FIGURE 3: TERM OF OFFICE OF JIMMY CARTER, RONALD REAGAN, AND GEORGE HW BUSH. Note how, during the first year of Jimmy Carter and Ronald Reagan, highlighted in dark yellow, the market fell. The market, however, did not fall in the first year of George HW Bush, but rose, and strongly. The market continued to rise after Reagan was reelected and only corrected slightly for two months after a two-month rise. This is highlighted in blue.

this because of Greenspan?

With the election of Bill Clinton as President in 1992, Alan Greenspan's strong market performance continued. Yes, there was a small correction in January 1994, but the market soon recovered and rose under Greenspan's guidance until February 2000 when, as we all know, the technology bubble burst.

The Kondratieff wave forecast the market meltdown sometime in 1999. We knew it was coming but did not know what would trigger it. From February 2000, the strength of the S&P 500 started faltering, falling heavily from August 2000. Was this because Clinton lost voter confidence after the Monica Lewinsky scandal, or was it lack of guidance from the Fed under Greenspan?

Today we know that the meltdown occurred because of the technology bubble that burst, a bubble created by Greenspan's financial policies. The market started recovering in 2003, not the 2005 that the K-wave predicted.

Elliott wave theory has taught us that this was a wave A correction, with a wave B bull market followed by a wave C meltdown still to come. The top of wave B was forecast by K-wave theory for 2007 as shown in Figure 1 and wave B topped out in October 2007. We knew that the wave C meltdown was coming, we just did not know what the trigger would be. And come it did, bottoming in March 2009, three years earlier than the bottom forecast by the K-wave chart.

As you can see on the chart, with George W. Bush (hereafter referred to as "W") starting his term, Greenspan successfully fought the market collapse of wave A. Was the recovery because of Greenspan's financial policies, or was it because of the financial policies of W?

Fed chair Greenspan resigned in January 2006 and was replaced by Ben Bernanke. Did Greenspan foresee the coming subprime mortgage meltdown and did not want to be there to confront it?

When Barack Obama won the Presidency and took over

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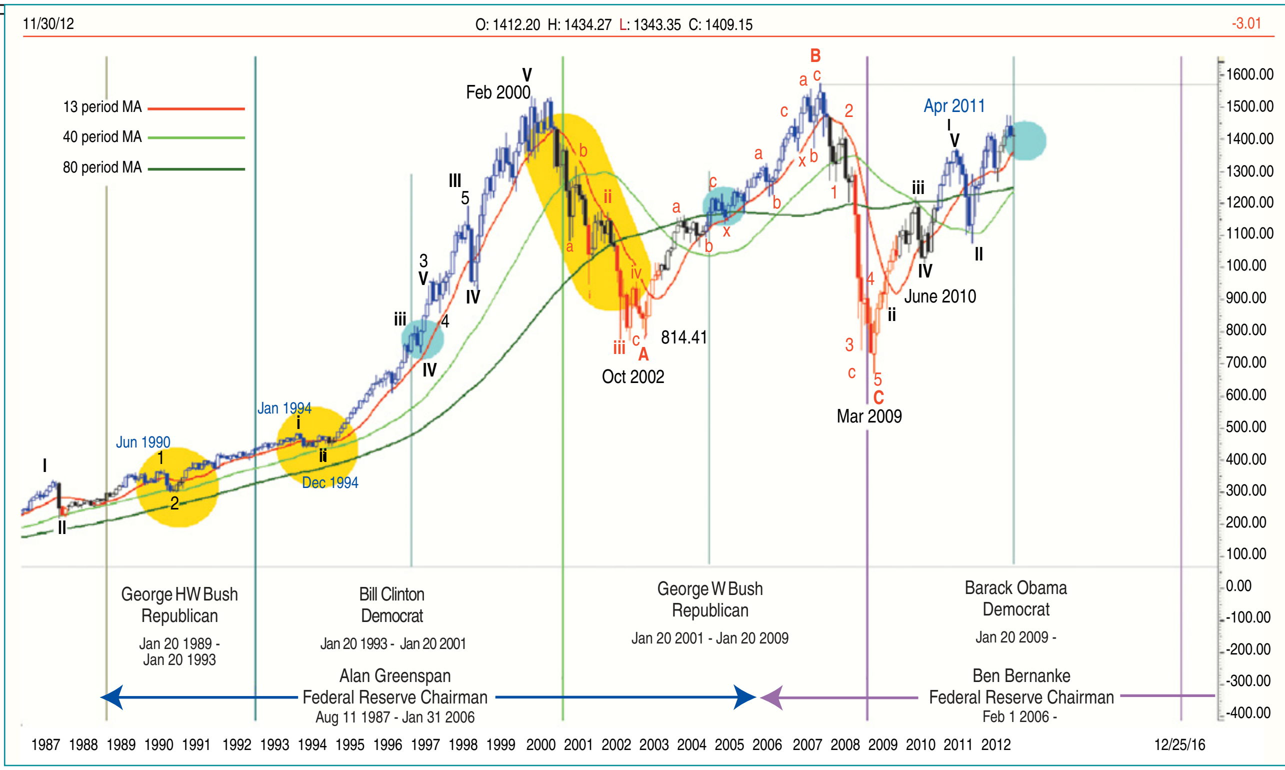


FIGURE 4: SECOND-TERM PRESIDENTS. The correction that occurred during Bill Clinton's second term, after he assumed office, was minor (highlighted in blue). You can also see that George W Bush, when reelected, suffered a minor market correction that lasted four months. Are we seeing a similar scenario with President Obama?

on January 20, 2009, he inherited a market that rose strongly for a year. K-wave students, however, started preparing for a meltdown they knew would occur sometime in 2007, if not early 2008. The subprime mortgage meltdown started at the end of October 2007.

Fed chair Bernanke started his term during the W Presidency, enjoying a strong market rise, the result of Greenspan's policies, but he soon faced a financial crisis that W was unable to contain. Many pundits blamed the crisis on the easy-money policies of the Fed during Greenspan's tenure, a policy that may have solved the technology crises, and one that Bernanke, holding the nickname "Helicopter Ben" because of his willingness to print dollars, allowed to ride.

With Bernanke's help and the policies put in place in the first few months of Obama's presidency, we saw a recovery in the market. Whether this was because of policies instituted by Obama and his financial team, which included former Fed chair Paul Volcker, or whether it was the policies of Bernanke, we cannot be sure. We can only say that unlike the first months of Carter, Reagan, and W, the market recovered strongly in the first months of Obama's Presidency.

When we look at the charts to see what happens when a President is elected for a second term, we see that with Reagan in Figure 3, the market continued to rise after he was reelected and only corrected slightly for two months after a two-month rise. This has been highlighted in blue. Volcker was chairman of the Fed during this period. He is credited with ending the high levels of inflation seen in the United States in the 1970s and early 1980s.

HW did not win reelection as President even though Greenspan was Fed chair, a sign that solid financial policy does not influence the nation's politics. Clinton, with Greenspan still chairman of the Federal Reserve, did serve a second term, and as we can see in Figure 4, the correction that occurred after he assumed office, highlighted in blue, was minor.

The chart also shows that W, when reelected, also suffered a minor market correction that lasted four months. This occurred during Greenspan's final days in office. When Bernanke took over in February 2006, he enjoyed the results of Greenspan's work for just over a year before the market meltdown of the subprime mortgage, a crisis the financial institutions are only now recovering from.

As President, W did not benefit from Bernanke's financial policies. Obama did, as can be seen on the chart. We can only assume that as a new President, he listened to his financial team and Bernanke. The market correction that has usually occurred in the first few months of a President's term of office did not occur with him. A strong correction only occurred in April 2011,

"Make sure your money is properly insulated against the vagaries and fluctuations in your head."

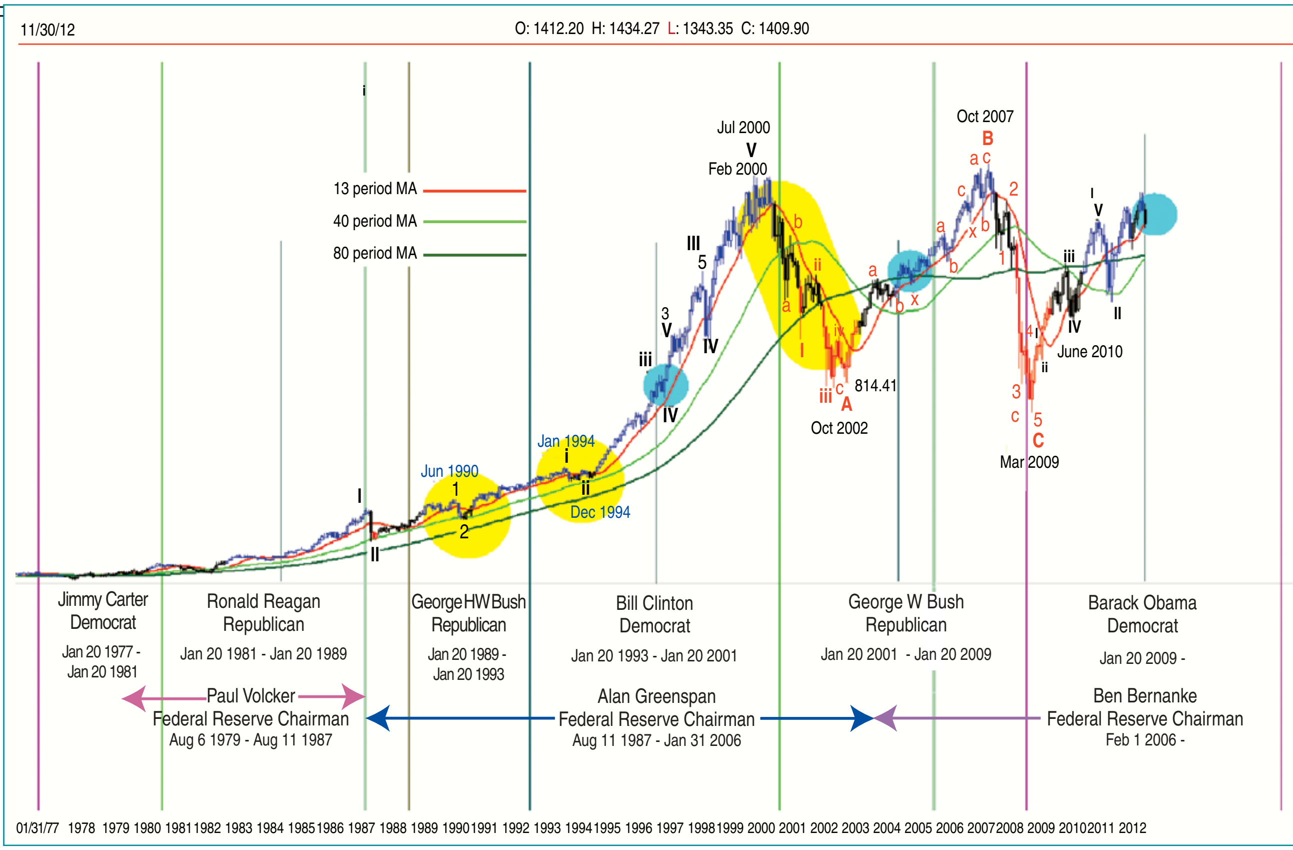


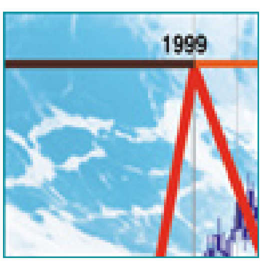
FIGURE 5: DOES THE PRESIDENT HAVE INFLUENCE OVER THE ECONOMY? From this chart, it seems that the President does indeed have influence over the economy.

one that lasted five months and was not excessive.

However, with his reelection in November 2012, the chart shows that a small correction, highlighted in blue, is occurring, one that also happened with previous reelected Presidents. The length of this correction could be anything from one week to four months based on previous Presidential reelection patterns.

Do the Federal Reserve chairman's policies influence a Presidential election? When we look at the Fed chair pattern from Paul Volcker to Ben Bernanke, a cyclical pattern does not appear. The market collapse of October 2007 is blamed on the low interest rate policy and lack of bank regulation on the part of Alan Greenspan, a problem that Bernanke had to handle when he took over in February 2006.

Figure 5 does suggest that a President has influence over the economy, naturally with the support of the Fed. The tenure of W, with two market meltdowns with two different Fed chairs, suggests that it is possibly the policy of the party in power and not so much the policy of the Fed chairs that influences the market. Greenspan's strategy was to react to market conditions. Bernanke, on the other hand, appears to be building a house for the future on a solid concrete foundation.



The power of the K-wave

Finally, with all the politics; with Fed chairmen serving different political Presidents; and with a careful study of the Presidential cycle, I have concluded that the only pattern that predicts the future is the Kondratieff wave shown in Figure 1. The K-wave does not look at the volatility occurring in its bullish or bearish trend; it simply looks at the turning points.

With the advent of computers, where trading today is done with computer programs not influenced by emotion of any kind, not political, Presidential, or Fed, market bottoms are two to three years early and market tops a year late.

The K-wave chart is suggesting a market top in 2017. President Obama, you have a four-year bullish market ahead of you. Volatility will occur because of your differences with a Republican-controlled Congress and a Democratic-controlled Senate, but the K-wave does not look at politics. Enjoy your second term in office!

Koos van der Merwe has been a technical analyst since 1969, having worked as a futures and option trader at a stock brokerage firm in Johannesburg, South Africa. He may be contacted at petroosp@gmail.com.

Suggested reading

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