



# Weekly Market Commentary



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## What Wall Street Is Saying About the Election May Surprise You

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#### Highlights

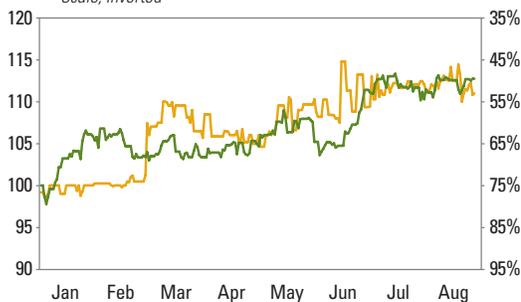
A stock market-based "election poll" is useful, in that it highlights what the market is pricing in about the outcome of the November elections.

Our "Wall Street" Election Poll suggests Republicans have yet to erode the gains in the odds that Democrats retain their control in Washington.

Investors may have become too complacent that the Senate Democrats will retain their seats and quickly find a grand compromise with House Republicans to avoid going over the so-called fiscal cliff into a recession in 2013.

#### 1 Democrats Chances of Retaining Power Have Improved

— "Wall Street" Election Poll (Dem. vs. Rep.), Left Scale  
— Intrade.com Odds Republicans Win Senate, Right Scale, Inverted



Source: LPL Financial, Intrade.com, FactSet Research Systems 09/04/12

While there are many election polls, what matters most to investors is what is priced in on Wall Street rather than what people are saying on Main Street. A stock market-based "election poll" is useful, in that it highlights what the market is pricing in about the outcome of the November elections.

Based upon the most legislation-sensitive industries, earlier this year we created two indexes to help us track the market's implied forecast of the election outcome reflected in the performance of these industries. Each index is composed of an equal weighting among eight industries that when combined total well over 100 stocks in the S&P 500 index. To track what the market has priced in for the Democrats' odds of retaining the White House and Senate, we took our Democrats index and divided it by our Republicans index. This is what we track as the "Wall Street" Election Poll, published by LPL Financial Research on Thursdays. An upward sloping line suggests the market may be pricing in a rising likelihood of the Democrats retaining the White House and their majority in the Senate, while a downward sloping line suggests improving prospects for the Republicans.

What Wall Street is saying about the election may surprise you. Our "Wall Street" Election Poll suggests Republicans have yet to erode the gains in the odds that Democrats retain their control. These odds improved early this summer as the Supreme Court upheld the Affordable Care Act, more commonly known as Obamacare. Our poll reflects the path taken by other market-based assessments of the election such the Intrade.com futures contracts on President Obama's re-election and on the party control of the Senate, which have moved from about a 75% chance the Republicans prevail in the Senate to a toss-up now.

With the S&P 500 having risen back to around four-year highs, investors may have become too complacent that the Senate Democrats will retain their seats and quickly find a grand compromise with House Republicans on extending the Bush tax cuts and other actions to avoid going over the so-called fiscal cliff into a recession in 2013. The Congressional Budget Office recently confirmed our long-held view that a recession is a given in 2013, if no action is taken to moderate the combination of tax hikes and spending cuts totaling over \$500 billion already written into current law. We think a compromise may be harder to reach than the market seems to think if the Democrats prevail in the Senate and the House remains, as is likely, in the hands of the Republicans. Recall that the status quo in Washington was no help to markets last year, as the unwillingness to compromise on both sides



## 2 S&P 500 Industries Likely to React More Favorably to One Party

Democrats	Republicans
S&P 500 Health Care Facilities	S&P 500 Coal & Consumable Fuels
S&P 500 Food & Staples Retailing	S&P 500 Diversified Financial Services
S&P 500 Gas Utilities	S&P 500 Oil & Gas Exploration & Production
S&P 500 Health Care Services	S&P 500 Oil & Gas Drilling
S&P 500 Life Sciences Tools & Services	S&P 500 Managed Care
S&P 500 Construction Materials	S&P 500 Electric Utilities
S&P 500 Homebuilding	S&P 500 Specialty Retail
S&P 500 Construction & Farm Machinery	S&P 500 Telecommunications Services

Source: LPL Financial 09/04/12

For detailed information about this index's construction, please see our *Weekly Market Commentary: The "Wall Street" Election Poll* (05/07/12).

## 3 Dow Jones Industrial Average and Congressional Control Since 1901

Party	Annualized Return %	% of Time
Democrats	5.5%	55.4%
Republicans	7.8%	32.3%
Split	-3.0%	12.2%

Source: Ned Davis Research 08/31/12

of the aisle led to the debt ceiling debacle last August, sending the S&P 500 down over 10% in three trading days.

Governor Romney's Vice President pick of Congressman Ryan may raise the stakes further for investors in 2013. If President Obama wins by focusing his re-election campaign on attacking the controversial and potentially unpopular elements of the Ryan plan (which is supported by the House Republicans and, notably, Ryan is chairman of the House Budget committee), it may make a grand compromise even more difficult between the White House and Congress in 2013 to avoid going over the fiscal cliff into a recession and bear market.

It is possible that stocks may be overstating Democrats' momentum ahead of what are likely to be close elections. If so, look for a potential surge in the Republican-favored industries. If not, stocks may begin to stumble until a clear path to a compromise on the fiscal cliff can be reached.

It is not just this year that markets may begin to fear a divided Congress. Since 1901, the Dow Jones Industrial Average has fallen an annualized -3% during the 12% of the time that featured a split-party Congress, according to Ned Davis Research. Returns were much better when the control of Congress was in the hands of one party or the other. Gridlock is unlikely to be good for investors in 2013.

We will continue to publish the LPL Financial "Wall Street" Election Poll each Thursday as part of our investor election analysis as politics become a bigger driver of the market in the coming weeks. ■

### IMPORTANT DISCLOSURES

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

Dow Jones Industrial Average (DJIA): The Dow Jones Industrial Average Index is comprised of U.S.-listed stocks of companies that produce other (non-transportation and non-utility) goods and services. The Dow Jones Industrial Averages are maintained by editors of The Wall Street Journal. While the stock selection process is somewhat subjective, a stock typically is added only if the company has an excellent reputation, demonstrates sustained growth, is of interest to a large number of investors and accurately represents the market sectors covered by the average. The Dow Jones averages are unique in that they are price weighted; therefore their component weightings are affected only by changes in the stocks' prices.

This research material has been prepared by LPL Financial.

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