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After brushing off front page trade spats between the U.S. and its global trading partners as well as presidential legal woes brought on by a lingering Mueller investigation, the bull market's next challenge might be expected to come from the ballot box.

"Markets will be watching the upcoming midterm elections closely as shifts in the balance of power in Washington could have meaningful implications for fiscal policy and foreign relations," said Niladri Mukherjee, Director of Portfolio Strategy in the Chief Investment Office at Merrill Lynch and U.S. Trust.

As with the above tangles, however, it isn't clear that the midterm congressional elections on November 6, which could conceivably see Republicans lose control of the House and even the Senate (in an extreme case), would be enough to derail the bull market.

A quick look at historical performance shows that stocks often see rough sledding in September, even if there are no midterm elections. For midterm years, analysts often chalk it up to uncertainty, since midterms typically see the incumbent president's party lose seats. That same look at historical performance shows that stocks tend to do just fine both as Election Day nears and in the aftermath of the vote regardless of the outcome, as this uncertainty begins to fade.

Analysts led by Keith Parker at UBS note that on average the S&P 500 has rallied 14.5% from the end of August to the end of March around midterm elections (see chart below). That includes a rocky start marked by a median decline of 1.4% from the end of August through early October followed by rally through year-end and into the next year. Moreover, this year's rally in equities has been much stronger than the average returns seen in all other years.

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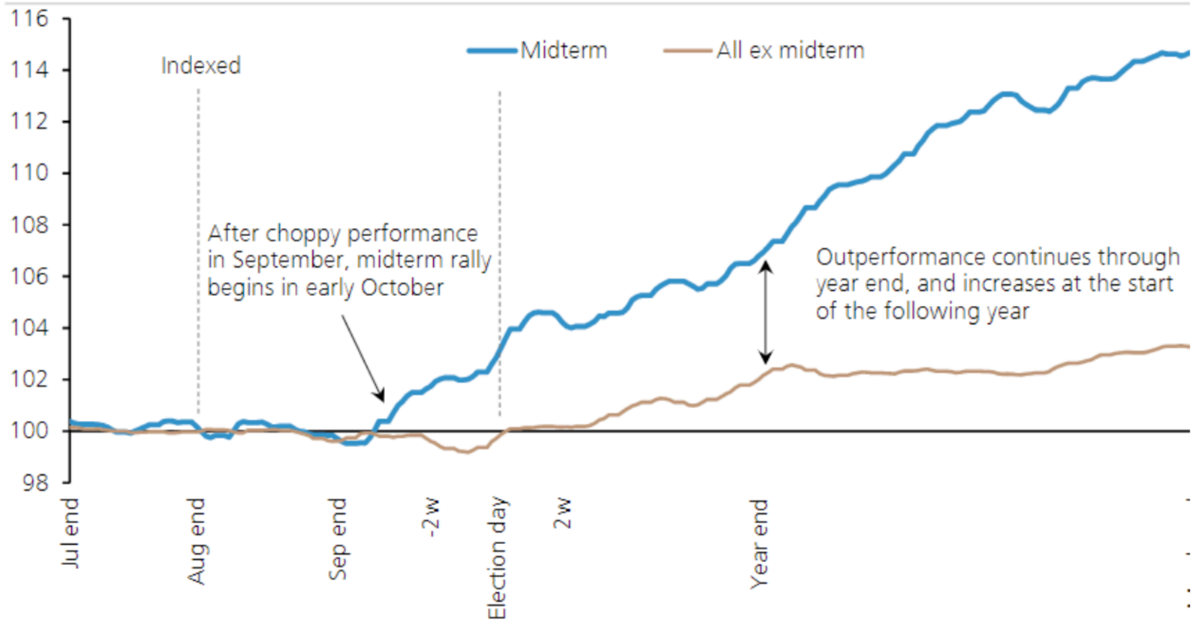
Figure 1: S&P 500 performance around midterms vs all other years (average)



Source: Haver, S&P, UBS

UBS

Taking a more short-term approach, Binky Chadha, Chief Strategist at Deutsche Bank, noted that typically the three-month period running from a month ahead to two months after the election has produced a median 8% gain. And that includes only one decline, a 4% drop in 1978, over that period in the last 21 midterm years. That's all encouraging for market bulls. But as the analysts caution, history is only a guide. Moreover, it isn't clear that the performance is necessarily all about politics and uncertainty.

While Chadha looked at midterm years stretching back 80 years, that's a sample of just 21 elections, which warrants caution when it comes to interpreting the correlations. In fact, he suspects the performance has more to do with the coincidence of other traditional drivers, such as growth and earnings.

Chadha noted that S&P 500 returns around midterms have carried a 76% correlation with changes in the Institute for Supply Management's activity index in the six-month period surrounding Election Day. "This suggests that it was growth and not the midterm elections *per se* that was the key driver of the rallies," he said. We agree with that statement.

The incumbent president's party has historically not fared well during midterm elections. If this pattern holds, it could affect the likelihood of certain pro-growth measures such as the so-called Tax Reform 2.0, which seeks to make individual tax cuts permanent and create new incentives for retirement savings and research and development. But this does not mean the economy won't continue to experience benefit from already reduced government red tape and tax policy.

To summarize, while many will opine that a pickup in seats in the House or Senate could be enough to roil the markets, there is no documentable connection between stock market performance and outcomes of midterm elections. That fact will probably not dissuade market strategists from advocating trades tied to their predictions of changes in the congressional lineup. Like other Americans, many investment experts are fascinated by politics and hold strong opinions on the subject, citing voter surveys and dissecting candidates' messages makes the strategists sound wise.

At Alpha Fiduciary our focus is on designing portfolios to reflect the risk and return profiles of each of our clients, and these profiles reflect long-term considerations rather than the performance possible in a given quarter. That said, economic policy shifts such as a change in the direction of interest rates may well warrant an allocation shift or the replacement of what are expected to be negatively affected securities within an asset class with those securities expected to perform more favorably.

Interestingly, while most investors seem focused on risks facing stocks, over the past couple of years we have found more opportunity to gain an edge by selecting nontraditional bond funds that have outperformed traditional bonds, primarily because they have avoided the deleterious effects of interest rate increases. We feel holding stocks for the long run tends to be more helpful than hurtful in client portfolios, and 2018 has been no different.

As we began the fourth quarter, the S&P 500 had performed quite well, rising nearly 9% through September 30, while the U.S. Aggregate bond had performed rather poorly at -3.48%. The stock market usually sees several corrections a year. For example, between 1983 and 2011, more than half of all quarters had a correction. So as long-term investors we should expect to see a 10% drop or so at some time virtually every year and in many cases 2-3 per year. By Friday, October 12 the S&P 500 was off of its high close by 5.1 percent, indicating half of a correction condition in the market. If this recent downward move is in fact a correction, it could last a few months as the market bottoms out.

But good markets have followed corrections and bear markets, and we expect this time will be no different. As we have always counseled, remain balanced, focus on the performance of your holdings relative to their appropriate benchmarks, and look towards keeping the long-term game plan intact. Despite market volatility this quarter, we are pleased with the performance of the holdings we are managing in our client portfolios.

Be well.