

Divided Government Is Best for the Market

By Donald L. Luskin

Let's get something settled once and for all. Have the stock markets and the economy historically done better under Democrats or Republicans?

There is no shortage of exaggerated claims on both sides. But on the surface, the Democrats would appear to have statistics on their side. How many times have you heard some Democrat pull out some "study" (they always call it a study, it sounds so scientific) by some professor or some "nonpartisan" think tank that purports to show that since 1948 (it's always 1948 for some reason) stock performance or economic growth has been better under Democratic presidents than Republican ones?

So there you go. Forget about the tax increases. Forget about the regulations, the protectionism, the union influence. Democrats are great for growth. The study proves it!

I've run the numbers myself. Superficially at least, the Democratic claims are true: Since 1948, the Standard & Poor's 500 total return (capital gains plus dividends) has averaged 15.6% when a Democrat was in the White House and only 11.1% when a Republican was in the White House.

You get a similar result if you look at growth in real gross domestic product. Under Democratic presidents, the average since 1948 has been 4.2%. Under Republican presidents it has been only 2.8%.

But it's not so simple when you study that "study." First, not all Democrats act like Democrats, and not all Republicans act like Republicans. John F. Kennedy, for example, was an enthusiastic supply-side tax cutter, and George H.W. Bush raised taxes. Bill Clinton promoted free trade, and Richard Nixon imposed wage and price controls.

If you assign those four presidents to the opposite party based on that -- make the two Democrats into Republicans and the two Republicans into Democrats -- the numbers completely reverse. Now stocks average 14.7% under Republicans and only 10.5% under Democrats.

In fact, it turns out that if you do just one single switch -- if you make Richard Nixon into a Democrat -- it's enough to reverse the numbers. Then stocks average 14% under Republicans and only 12.1% under Democrats. This fact discredits this whole study more than it does Republicans, or even Richard Nixon himself. Any analysis that can be undone by omitting or changing a single data point isn't very robust.

There are other problems with this study as well. While stocks could be expected to react very quickly to changes and expectations of changes in the political environment, the whole economy doesn't just turn on a dime. So when we compare real GDP growth under Democratic and

Republican presidents, maybe we should lag the results by a couple years. That is, we'll assume that the growth in a given year was the result of the president's policies from two years ago.

When we do that (putting Nixon back as a Republican, by the way), we find that the economy performed pretty much exactly the same regardless of the president's party: 3.5% under Democrats and 3.4% under Republicans.

But then who ever said that the president alone determines the economy or the stock market? It's Congress that makes the laws. The president just signs them. Based on congressional control, the study results look very different. Under Republican Congresses, stocks have averaged a 19% return, while under Democratic Congresses only 11.9%. Real GDP growth, lagged two years, has averaged 3.7% under Republican Congresses, and only 3.2% under Democratic ones.

Then there are the various party mixes between the president and Congress. If John McCain wins and we have a Republican president and a Democratic Congress, history leads us to expect an average 10.3% total return from stocks and 3.3% real GDP growth. If Barack Obama wins, and we have a Democratic Congress too, then according to history stocks will average 13.8%, and real GDP growth 3.3%.

But that's no argument for voting for Mr. Obama. Vote for Mr. McCain -- but vote for Republican senators and representatives too. When Republicans have controlled the whole government, it blows away anything Democrats can do. Stocks have averaged 17.5% and real GDP growth 3.3%.

By the way, as fond as Democrats are of saying how poorly stocks have performed under George W. Bush, here's a sobering fact: Stocks averaged 14.1% return in those Bush years when Republicans controlled Congress -- and when Democrats got in there and mucked things up, the average has been a *loss* of 8.9%. That's not even including 2008 year-to-date, which doesn't look so pretty.

If the electorate were really smart, it would elect a Democratic president and a Republican Congress. Under that deal, stocks have averaged a 20.2% total return, and real GDP averaged 4%. That tells us that economic and stock market success isn't really about partisan politics at all. Sadly, nobody has a political incentive to conduct a study about that.

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