NEXT GENERATION WEALTH MANAGEMENT

Are Republicans or Democrats Better for the Financial Markets?

As the polls continue to indicate George W. Bush's popularity is at low levels, and the outlook for Republicans controlling both houses of Congress and the presidency fades, Next Generation Wealth Management, Inc. pondered these questions at one of our Monday meetings: "Does this matter to the financial markets? Are prospects of a Democratic victory in November negative for stocks? What does the historical data tell us?"

Clearly, the recent behavior of our stock market says "No!" However, we must admit that for the stock market to ignore Bush's unpopularity seems strange. After all, the vast majority of large stockholders and active traders are Republicans, and the Republican rhetoric tends, generally speaking, to be very market-friendly.

A LOOK BACK AT THE BUSH-KERRY ELECTION

On the afternoon of Election Day, November 2, 2004, exit poll numbers were released from both Florida and Ohio that suggested Kerry was doing much better than expected. If the Democrats won Ohio or Florida, electoral math made it very difficult for Bush to win. Immediately upon the release of Kerry's supposed success, there was a sell-off in stocks. The Dow Jones Industrial Averages, which were up strongly early in the day, plunged about 100 points when the polls were released. But in the evening, the exit polls proved wrong, and Bush was the clear victor. The following day stocks made up all the lost ground and then some.

STOCKS HAVE ACTUALLY DONE BETTER WITH DEMOCRATIC LEADERSHIP

Despite the behavior of the financial market during the last Presidential election, over longer periods of time, the stock market has done significantly better under Democratic administrations.

The accompanying chart shows stock returns under each occupant of the White House since the beginning of Harry Truman's second term. The returns are calculated from the end of the November election, since stocks will react to the policies of the incoming administration when it is elected, not when it takes office.

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PRESIDENT	PARTY	DATE	MONTHS IN OFFICE	ANNUALIZED STOCK RETURN
Truman	D	11/48 - 10/52	48	18.28%
Eisenhower	R	11/52 - 10/60	96	14.96%
Kennedy	D	11/60 - 10/63	36	15.15%
Johnson	D	11/63 - 10/68	60	10.39%
Nixon	R	11/68 - 07/74	69	- 1.32%
Ford	R	08/74 - 10/76	27	17.21%
Carter	D	11/76 - 10/80	48	11.04%
Reagan	R	11/80 - 10/88	96	15.18%
Bush	R	11/88 - 10/92	48	14.44%
Clinton	D	11/92 - 10/00	96	19.00%
Bush, G.W.	R	11/00 - 02/06	63	-0.92%

AVERAGE FROM 1948 - FEB. 2006		
DEMOCRAT	42.8%	15.26%
REPUBLICAN	57.2%	9.53%
Overall	100.0 %	11.95%

THE TABLE TELLS THE STORY

Since 1948, Republican Administrations have controlled the White House 57.2 percent of the time. But during the period that the GOP was in office, stock returns have averaged only 9.53 percent per year, while under Democratic administrations, stocks returned 15.25 percent per year, more than five percentage points higher.

Equities did best over the 8 years of the Clinton administration, with stock returns at 19 percent per year. Stock returns were above average during the Truman, Ford, Reagan, Kennedy, Eisenhower, and Bush Senior administrations. And stock returns were only slightly below average during the Carter and Johnson Administrations.

By far the worst stock returns came under the Republican administrations of Richard Nixon and George W. Bush. Of course, even George W. and Nixon cannot compare to the Great Depression era stock returns during the Republican administration of Herbert Hoover.

During the 69 months from the election of President Nixon in November 1968 through his resignation in July of 1974, stock returns averaged minus 1.32 percent per year while inflation exceeded 6 percent. Similarly, during the 63 months since the election of George Bush in November 2000, stock returns have been negative.

IS EITHER PARTY TO BLAME?

The poor performance of the stock market during these two Republican administrations should not be pinned solely on the president. Nixon inherited a war in Vietnam that was escalated by Lyndon Johnson. Furthermore, the market endured increasing inflation that was due to bad Federal Reserve policy. Nixon, however, is to blame for appointing Arthur Burns as Chairman of the Federal Reserve Board, a man who did very little to curb the rampant inflation.

On the contrary, it would be difficult to place all of the blame for the poor stock returns under the watch of George W. Bush. Stocks were in an unsustainable bull market that peaked in March 2000 and then broke just before he was elected President. History suggests Bush was sworn in near the top of one of the greatest bubbles ever.

Bush's policies have been very favorable for the market. The reduction in the tax on capital gains and dividends was a welcome development for stockholders. Certainly, the excessive government spending under this administration, including sizable deficit spending in Iraq has absorbed a lot of saving that could otherwise be put to work in the stock market. One can blame a bad outcome of the War in Iraq squarely on George W., but the poor stock returns under his administration were almost completely beyond his control.

CURRENT OUTLOOK

Both the dividend and capital gains tax cuts are due to expire in 2008. The Republicans, despite controlling both Houses, have so far not been able to extend these cuts, not to speak of making them permanent as President Bush has repeatedly sought. The Democrats, who are feeling increasingly good about their prospects in November, never liked these Bush tax cuts and are anxious to block them.

This is where politics can really matter. If the Democrats do wrest political control from the Republicans, the extension of these stock-friendly tax cuts in their current form would become highly uncertain. This will be most unfortunate since the dividend tax relief offsets the double taxation of corporate income and eases the burden on retiring boomers who are looking to their portfolio to fund their retirement.

Nevertheless, tax policy is only one element that impacts the financial markets. Economic growth, interest rates, world trade, and geopolitical issues should be more important in determining the market's direction.

Ultimately, the party that does the right thing for America will be rewarded by good stock returns, whether this is under the Republicans or Democrats. We are confident the Democrats recognize that stocks are held by millions of investors, both Democrats and Republicans, and keeping the financial market healthy is a high priority. Perhaps that is why stocks are ignoring the Bush polls.

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