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Taking Stock of the Parties

By Richard W. Rahn
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Does the value of your stock market holdings depend on which party controls Congress? There is overwhelming evidence it does.

As can be seen in the accompanying chart, over the last quarter of a century when the Republicans controlled both houses of Congress, the stock market rose by an average of about 20 percent per year. When the Democrats controlled both houses of Congress, the stock market only rose at an average annual rate of 6.9 percent for the Dow Jones and a tepid 5.1 percent for the Standard and Poor 500.

CONTROL OF CONGRESS AND CHANGES IN MARKET (1983-2008)

Party in control (House/Senate)	Average Percent Change per Year in Market Indices	
	Dow Jones Industrial Average	S&P 500
Democrats/Democrats	6.9%	5.1%
Republicans/Republicans	19.3%	20.1%
Shared	15.6%	12.7%

When one party controlled one house and the other party controlled the other house of Congress, the growth in the stock market was significantly less than when the Republicans controlled both houses (15.6 percent for the Dow Jones and 12.7 percent for the S&P), but significantly more than when the Democrats controlled both houses.

There is a natural tendency for people to focus on the party of the president who is in power; but, in fact, the Congress is far more important to markets because it decides how to, and how much to, tax and spend. Some Democrats will try to argue that this is merely random variation, but the averages are sufficiently disparate to compensate for the small sample size (the last 25 years).

The Democrats have controlled 10 years, the Republicans 11 years, and in five years they shared control. Actually, the numbers should come as no surprise. The Republicans have generally pushed for lower capital gains tax rates, lower tax rates on dividends, and less burdensome taxes on business. All this has the effect of raising the after-tax rate of return on investment, so there is no surprise that the stock market does better under such conditions.

In general, the Democrats have taken the opposite tack and supported higher business taxes and higher capital gains taxes - but President Clinton did sign a capital-gains tax rate cut in 1997 after overwhelming pressure from the Republican Congress. Sen. Barack Obama and most of the Democrats running with him have said they want to increase the capital-gains tax rate, the dividend tax rate and business taxes, so it is no surprise that the markets have reacted poorly to the possibility of an Obama presidency and increased Democratic control of both houses of Congress. The stock markets have done even worse as Mr. Obama developed a lead in the polls.

Was it because the markets had an increased fear of a Democrat majority, or have the poor performances of the markets driven more people to support the Democrats? This is a chicken-and-egg problem no one can prove for sure either way, but either hypothesis may well be true.

The responsiveness of the markets to the party in control in Congress has been consistent with the shifts back and forth between the parties. When the Democrats and Republicans each controlled one house in the 1983-87 period, the S&P rose at an annual rate of 19.5 percent. When the Democrats controlled both houses during the 1987-95 period, the S&P rose at annual rate of 10.8 percent, and again when they controlled both houses from 2007 to the present, the S&P dropped at a 20.4 percent annual rate.

The Republicans controlled both houses from 1995-2001 when the S&P rose at annual rate of 29.9 percent, and again from 2003-2007 when the S&P rose at annual rate of 14.0 percent. During the 2001-2003 period, the control of the Senate shifted back and forth between the Republicans and Democrats, neither party having sustained control, and the S&P dropped at an annual rate of 14.6 percent for those two years (which also coincided with the Sept. 11, 2001, aftermath).

The Democrats will argue that the recent stock market drop was the fault of President Bush, but the problem with this explanation is that the primary cause of the financial crisis was the subprime bubble facilitated by Freddie Mac and Fannie Mae.

And the video tapes and transcripts show that those were Democrats, for the most part, who blocked the necessary reforms proposed three years ago by the Bush administration and many congressional Republicans.

People, for very good reasons, are greatly concerned about the drop in value of their savings and retirement portfolios. Given the empirical evidence of how much worse the markets perform when the Democrats are in control, if I were in charge of the Republican House and Senate campaign committees, I would extensively publicize the data in the accompanying chart. My headline would be: "History shows if you want your stock portfolio to increase at a rate of 20 percent per year, make sure Republicans control Congress; but if you want your portfolio only to increase 6 percent per year, go with the Democrats."

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