PERSPECTIVES

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Markets Like Gridlock

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On November 5 the United States will conduct a national election that will reconstitute the Senate, House of Representatives and presidency. Over time, markets have shown a predilection for political gridlock, where the balance of power is split between the ruling political parties. The stock market, in particular, generally prefers different parties controlling the various branches of government. When no single party can enact a sweeping legislative agenda, it tends to create an environment favorable for stocks.

In a world where stability and predictability are sought after traits by investors, it's a bit ironic the stock market seems to like the after effects of a somewhat more volatile and unpredictable force - political gridlock. While most Americans dislike the thought of our elected leaders being unable to agree on issues, the stock market tends to view this state of dysfunction with a peculiar sense of relief. It's as if the market has developed an affinity for the political infighting brought on by impasse.

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Gridlock Positives

Why does the stock market tend to like political gridlock?

There are a few key reasons for this phenomenon. First and foremost, it reduces uncertainty and unpredictability around major policy changes. When one party controls all the levers of power, there is always the risk they will push through dramatic shifts in areas like taxes, regulations and spending, among others. This policy uncertainty can make it very difficult for businesses to plan and tends to make investors nervous.

Limited New Policymaking

There is also the simple fact that divided government, by its very nature, tends to limit the scope of policymaking. With multiple power centers that can veto legislation, the government is less able to pursue aggressive or radical agendas that could potentially disrupt the economy and financial markets. Moderation and incrementalism become the order of the day.

This creates an environment generally supportive of the stock market. Investors want to be able to make informed decisions about where to allocate capital without having to constantly worry about major policy shifts which could upend their plans.

Checks and Balances

Of course, it's important to note political gridlock is not an unalloyed good for the markets. Periods of divided government can also lead to brinksmanship, dysfunction and the inability to address pressing national challenges. The failure to pass critical legislation, such as measures to raise the debt ceiling or avert a government shutdown, can create market turmoil.

But on the whole, the tendency toward legislative inaction and policy stability outweighs the risks of government dysfunction. As long as the different branches of government remain at an impasse, the market backdrop is likely to continue to be constructive.

In summary, the stock market's fondness for political gridlock stems from the reduced uncertainty, increased predictability and limited policymaking that tends to characterize divided government. Investors value this stability and moderation, even if it comes at the cost of bold, transformative action.

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The Upside

So, the next time you see the news broadcasters and commentators lamenting the inability of Congress to get anything done, take a moment to consider the other side of the coin. While political gridlock may be a source of frustration and consternation for the average citizen, for the informed investor, it can represent an opportunity. The stock market, it seems, has an appetite for the very dysfunction that can send many of the populace into hand wringing despair. In the end, perhaps the only thing more predictable than the market's affinity for gridlock is our own frustration with it.

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