US Equity Market

After experiencing the best September performance since 1939, the S&P 500 is off to a robust start in October as a strong kick-off to 3Q10 earnings season highlights attractive fundamentals on a both a historical and relative value (versus bonds) basis. Aside from positive seasonality (4Q historically exhibits the strongest performance), robust earnings growth (3Q10 earnings growth represents the fourth consecutive quarter of growth in excess of 20%) and continued aggressive monetary policy (i.e. QE2 should be formalized at the upcoming November 3rd FOMC meeting), the equity rally may be fueled through year-end by the conclusion of the November 2nd mid-term elections (especially if “gridlock” ensues). Recent polls suggest a high probability (~80%) that the Republicans will win at least the House of Representatives which would result in “gridlock.” Going back to 1930 (11 observations), years that gridlock results from a mid-term election, the average S&P 500 return from election day to year-end is 280 bps (3.6% vs. 0.8%) higher than in the years when no “gridlock” occurs. A strong showing by the Republicans would increase the probability of the Bush tax cuts being extended, foster the expectation of a more business friendly environment (i.e. less regulation) and likely reduce the immediate implementation of healthcare reform, each should be supportive of a further rally in equities. In addition, equities tend to continue their strong rally into the following year, as historically, the third year of a Presidential term is the strongest (average annual return: 14.1%).