Karbon Koch Group at Morgan Stanley

MACRO VIEW

Macroeconomic Opinions and Strategic World Views

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OVERVIEW

Markets have continued to perform well this year, though many investors remain cautious about what lies ahead. While there is plenty of evidence supporting the possibility of further gains, there is also credible data suggesting market performance could slow. During times like these, reviewing historical trends can provide valuable perspective. History indicates that markets should finish the year with more upside from current levels, but mid-term election years (such as 2026) could bring periods of muted performance. In this edition of our Macro View, we explore these "seasonal market performance" patterns and what they mean for investors.

BOTTOM LINE: As investors consider the path forward, there is no shortage of data to support bullish and cautious views. Historical trends can offer helpful context for navigating these uncertain environments.

MARKET SEASONS

Investor conviction has been mixed, with evidence pointing both to continued economic strength and to emerging headwinds. On the positive side, we see robust Gross Domestic Product (GDP) growth, healthy corporate earnings, strong consumer spending (especially from the affluent), lower interest rates, continued AI spending, deregulation, stimulus from the "One Big Beautiful Bill", and roughly $8 trillion in cash sitting in money markets. [1] From the opposite perspective, other datapoints suggest persistent inflation, slowing labor market, growing US deficit, elevated stock prices, possible AI bubble, trade uncertainty, government shutdown, and geopolitical tensions. [2] Based on the data and many factors stated, we believe markets will provide investors with both upside and downside over the next year. When we review market seasonality trends, these patterns suggest this may be the case as well.

The premise behind market seasonality is just as the name implies - recurring historical patterns in performance that tend to appear during specific times of the year or cycle. The current "holiday market season" which we are entering now, has been favorable. Since 1950, the S&P 500 has averaged a 4.2% gain in Q4 – roughly double the average return of any other quarter and has been positive 80% of the time. [3] This pattern is driven by year-end bonuses, holiday spending, tax planning, year-end portfolio adjustments, etc. Taking this a step further, when the S&P 500 is up 10% in the first three quarters (as we are this year), Q4 returns have been even better. In this scenario, Q4 returns have been positive 14 of the last 15 times, (a 93% win rate), with an average return of 6.1%. [4]

As we approach 2026, we enter a new market season: a mid-term election year. The first three quarters of mid-term election years have often been more volatile and less rewarding than average, as political uncertainty weighs on markets. [5] Investors don't like uncertainty, and early in mid-term election cycles there is less certainty about political outcomes. More specifically, it is common for the president's party to lose ground in Congress. Over the past 22 mid-term elections, the president's party has lost an average of 28 seats in the House of Representatives and four in the Senate. Only twice has the president's party gained seats in both chambers. [6] Since losing seats is so common, it is usually priced into the market early in the year. But further research suggests there is a silver lining. Markets tend to rally in the weeks leading up to the November election date. Additionally, market performance often rebounds strongly in subsequent months and carries the momentum into the following year. Since 1950, the average one-year return following mid-term elections is 15%. [7] That is more than twice the return of all other years during a similar period.

Market seasonality is not always consistent. There are factors that can influence different results during these periods. For that reason, it's important to incorporate other forms of analysis and stay vigilant. However, we don't think it's wise to completely dismiss these historical trends either. If the data holds true, markets could rise into year-end, flounder a bit next year, and then rally at the end of 2026 and through 2027.

BOTTOM LINE: Using history as our guide, we believe the S&P 500 could end the year on solid footing. Next year may bring some bumps in the road, but patient investors who stay disciplined could be rewarded as 2026 progresses and the election related uncertainty fades into year-end.

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[1] Tom Essaye, “Sevens Report” October 23, 2025
[2] Tom Essaye, “Sevens Report” October 23, 2025
[3] Tom Essaye, “Sevens Report” October 23, 2025
[4] Tom Essaye, “Sevens Report” October 23, 2025
[5] Matt Miller and Chris Buchbinder “Can midterm elections move markets? 5 charts to watch” Capital Ideas by Capital Group, September 8, 2022
[6] Matt Miller and Chris Buchbinder “Can midterm elections move markets? 5 charts to watch” Capital Ideas by Capital Group, September 8, 2022
[7] Matt Miller and Chris Buchbinder “Can midterm elections move markets? 5 charts to watch” Capital Ideas by Capital Group, September 8, 2022

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