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What the Midterm Elections Mean for the Markets

Implications for Policy, Sectors, and Performance



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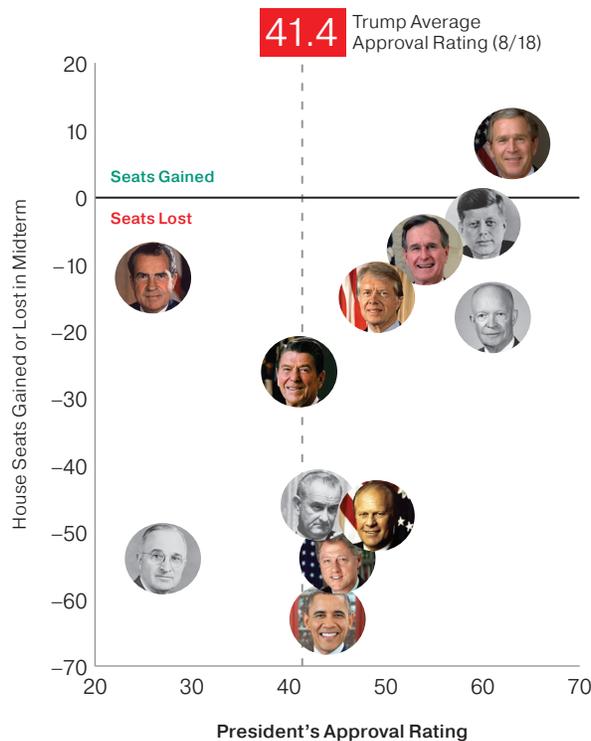
Historically, the Market Performs Well After Midterm Elections

While America—and more than likely, the world—is focused on the U.S. midterm elections, the U.S. stock market continues to reach all-time highs. At the same time, trade wars are weighing on sentiment globally.

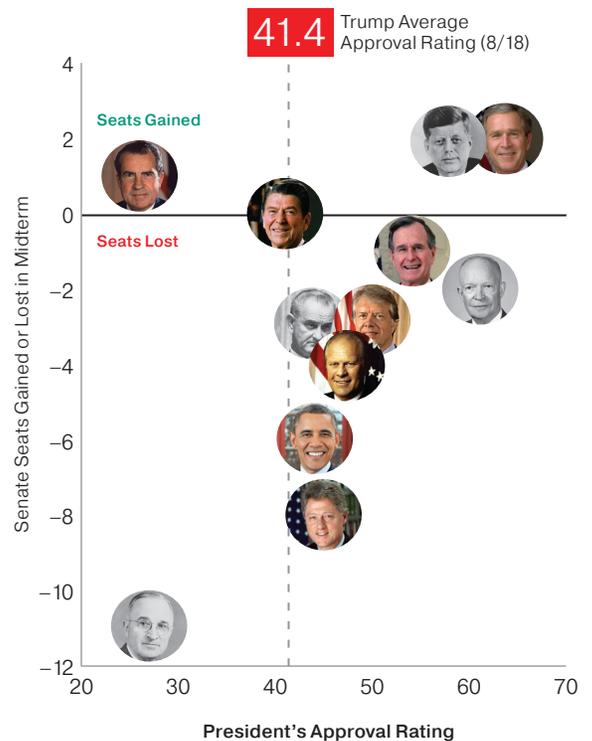
Regardless of party affiliation, investors may try to gauge what will happen on election night and whether to make any adjustments accordingly. From a financial perspective, the good news is that historically midterm elections have not had a major impact on the financial markets or provided reasons for investors to make major changes to their investment plans. It's critical to take a step back and let history be our guide.

The President's Party Often Loses Seats at the First Midterm

U.S. House of Representatives



U.S. Senate

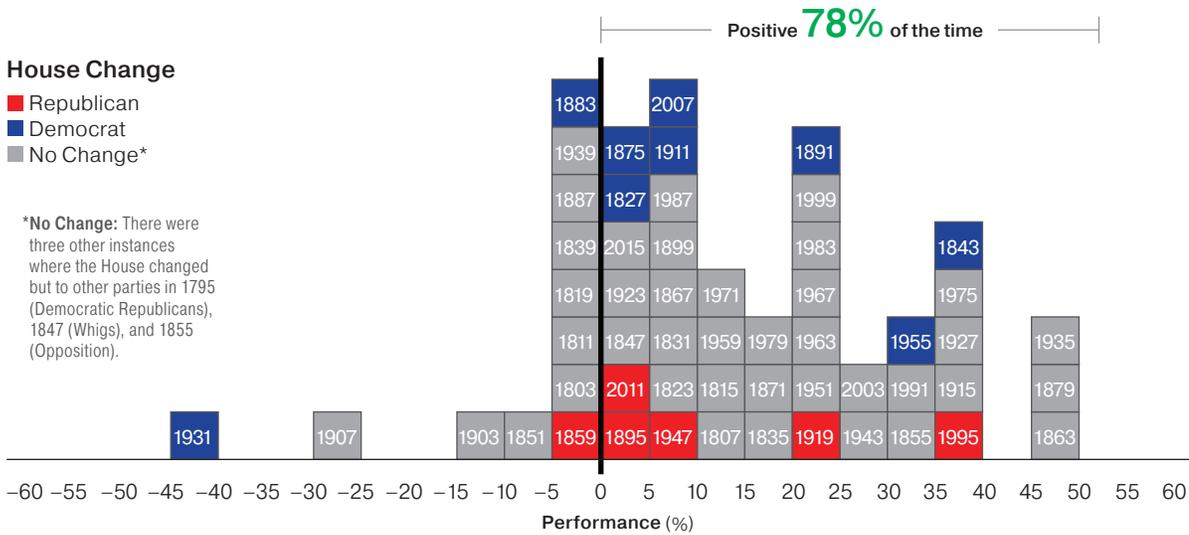


Sources: The American Presidency Project at UCSB and Strategas Research, 12/31/17.

Midterm elections are rarely kind to the political party of the sitting president. Presidents have almost always dropped House and Senate seats in the first midterm election, with only a few exceptions. George W. Bush, in the aftermath of 9/11, was the only president able to pick up both House and Senate seats. The number of seats lost often correlates with the president's approval rating. Less popular presidents have lost upwards of 40 House seats and four Senate seats, while popular ones have been able to stem the losses.

Markets Still Tend to Perform Well, Regardless of the Outcome

S&P 500 Index Performance for the Year After the Midterm Elections (1800–2018)



Source: Global Financial Data, U.S. Congressional Records, 8/31/18. See page 12 for index definitions. Past performance does not guarantee future results.

Looking back at midterm elections since 1800 highlights several key insights:

- ✓ **Change Is Rare:** Control of the House of Representatives rarely changes parties.
- ✓ **Post-Election Positives:** The market typically does well after midterm elections.
- ✓ **Market Shrugs Off Change:** Change in House leadership led to positive performance in most years.

Markets Even Seem to Prefer a Divided Government

Investors fear that a divided government—with a Democratic-controlled House of Congress in opposition to a Republican administration—could derail President Trump’s agenda and put an end to the historic bull market. But throughout history, markets have often performed better with a divided government.

Gains for Stocks (Dow Jones Industrial Average (DJIA, often referred to as the Dow)) 1901–2017

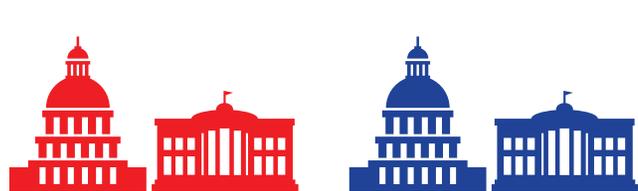
Divided Government

10.1% Annualized Returns



Unified Government

9.0% Annualized Returns



Source: Bloomberg, 12/31/17. See page 12 for index definitions. Past performance does not guarantee future results.

Even with a Congressional Change, All Eyes Are on the Executive Branch

The results of the November midterm elections may:

1. Impact legislation (though executive decision-making looms large).
2. Offer potential short-term sector ramifications.
3. Ultimately bring the issue of impeachment closer to the forefront.

1 While Changes in Congress Could Lead to More Legislative Gridlock...

Policy	Issue	 		Details
		Republicans	Democrats	
Immigration	Border wall	●	●	Unlikely to get passed in any part of Congress post midterms.
	Pathway to citizenship for Dreamers	●	●	Bipartisan support as part of a broader immigration compromise.
	Prevent separations at border	●	●	Motivating issue for voters.
Healthcare	Repeal the ACA	●	●	Remains a priority for Republicans. Pathway to repeal looks unlikely post midterms.
	ACA stabilization bill, funding CSR payments	●	●	Multiple areas of bipartisan agreement, would be net positive for Health Care sector.
	Medicare for all	●	●	Unlikely to pass in any form, but will be featured in debates.
	Lower prescription drug costs	●	●	Bipartisan support, would be negative for drug makers.
Tax	Making individual tax cuts permanent	●	●	Republican priority, can try without majority through reconciliation.
	Rolling back 2017 tax provisions	●	●	Democrats will see any attempt to change vetoed by President Trump.
Trade	Approving NAFTA	●	●	Should be enough support to approve revised version.
	Limiting presidential trade powers	●	●	Need veto proof numbers, could happen if economic impacts are large enough.
Infrastructure	Increased federal funding	●	●	Bipartisan support, could be a tailwind to machinery, construction, and engineering firms.
	Increased private involvement	●	●	Part of a broader infrastructure bill, a positive for materials and industrials.

Sources: Morgan Stanley Research, OppenheimerFunds, 8/31/18.

...the President's Ability to Act Independently May Influence Markets More

Of course, the elections will impact what policy decisions can be made. Since taking office, President Trump has signed over 175 bills into law including the landmark Tax Cuts and Jobs Act. If Democrats take control of even one chamber of Congress, it will be difficult for the full Republican agenda to be enacted. Regardless of the makeup of the House though, the President can still influence policy such as trade agreements by issuing executive orders. The prospect of tariffs and a strong dollar is a risk to global growth.

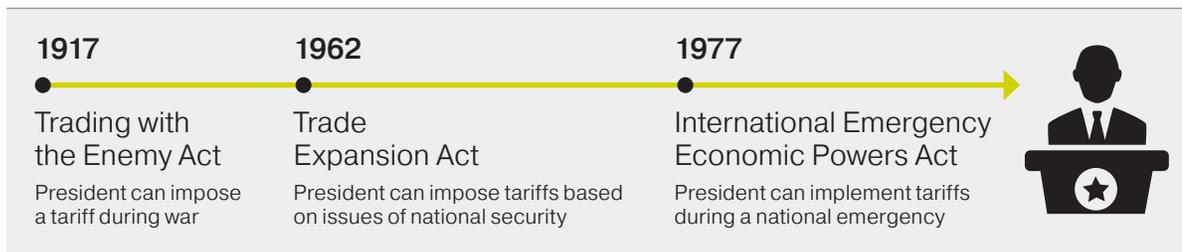
Framers assigned trade power to Congress...

U.S. Constitution: Article 1– Section 8

“Congress shall have the power to regulate commerce with foreign nations.”

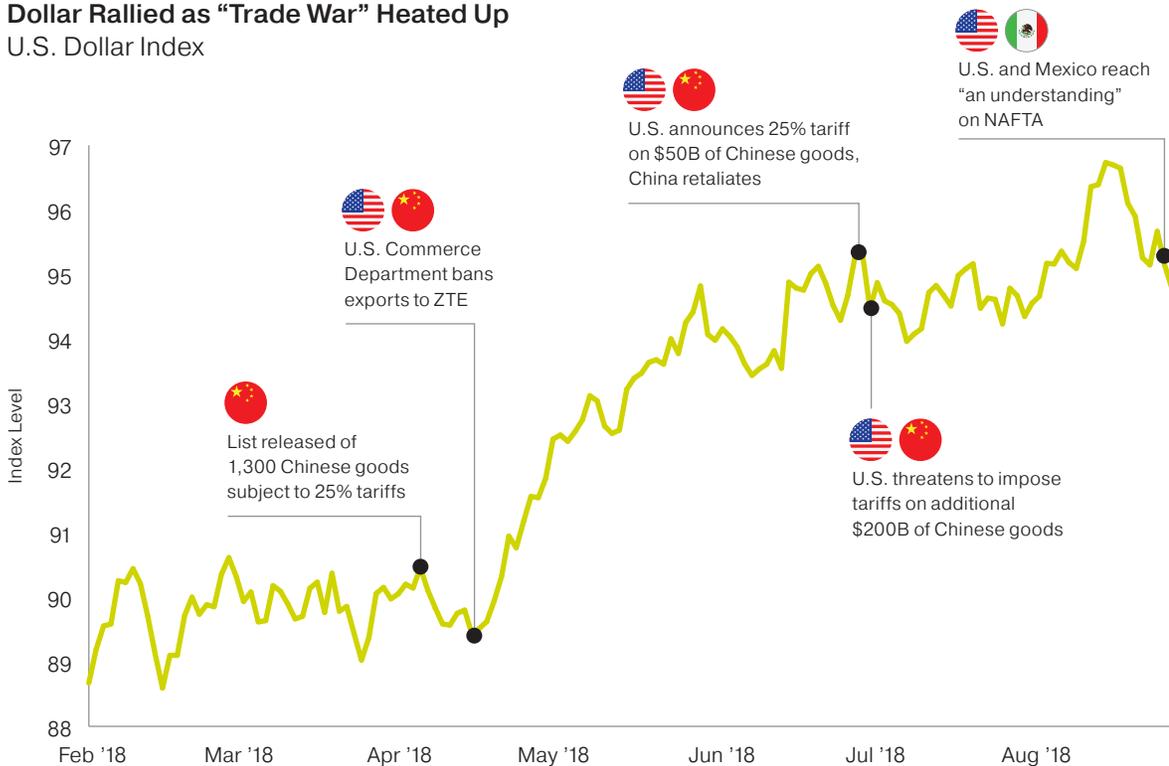


but it increasingly has been shifted to the Executive Branch



Dollar Rallied as “Trade War” Heated Up

U.S. Dollar Index



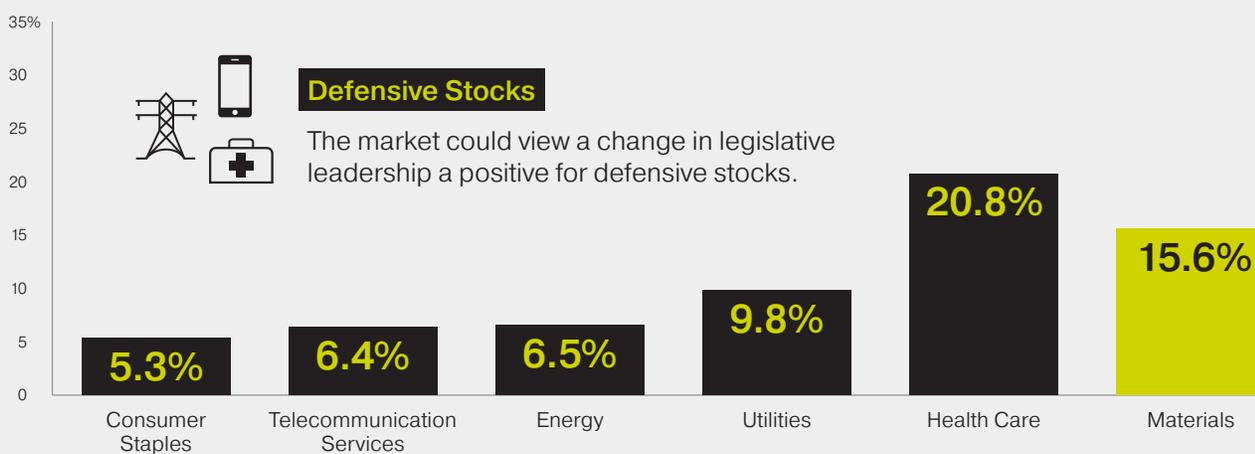
Source: Bloomberg, 8/31/18. See page 12 for index definitions. Past performance does not guarantee future results.

2 Policy Decisions May Impact Sector Performance Over the Short Term

Assessing the impact of public policy on the outlook for individual sectors of the U.S. equity market can seem like complicated guesswork. Nonetheless, investors can still try to entertain some forward-looking scenarios and thought experiments.

Sector Performance Since Donald Trump's Election Victory

S&P 500 Index Global Industry Classification Standard (GICS) Cumulative Sector Total Returns (November 8, 2016–September 13, 2018)



Sources: FactSet, Bloomberg, 9/13/18. See page 12 for index definitions. **Past performance does not guarantee future results.**

Defensive Stocks

Defensive sectors have underperformed as U.S. growth has accelerated and interest rates have risen. The market, in the short term, could potentially view a Democratic wave election and the end of the so-called “Trump bump” as a positive for defensive stocks. We believe that this cycle has room to run and will continue to favor the global cyclical sectors. Market leadership will shift back to defensive stocks at some point when Federal Reserve (Fed) policy becomes too tight, the dollar strengthens, and the U.S. economy begins to roll over.

Health Care

Divided government or razor-thin majorities suggest that no significant changes will be made to the Affordable Care Act. Both the Democrats and President Trump seek controls on drug pricing but it is unlikely to be a priority of the President. A Democratic sweep could benefit Medicaid HMO's and hospitals.

Cyclical Stocks

Cyclicals may do well if prioritized infrastructure projects, spending, and deregulation help offset trade concerns.

Financials

The Financials sector was viewed as among the primary beneficiaries of the Trump victory. Democrats, in the event of regaining House leadership, would be unlikely to roll back much of the administration's deregulation measures. At the same time, further deregulation would meet resistance in the House.

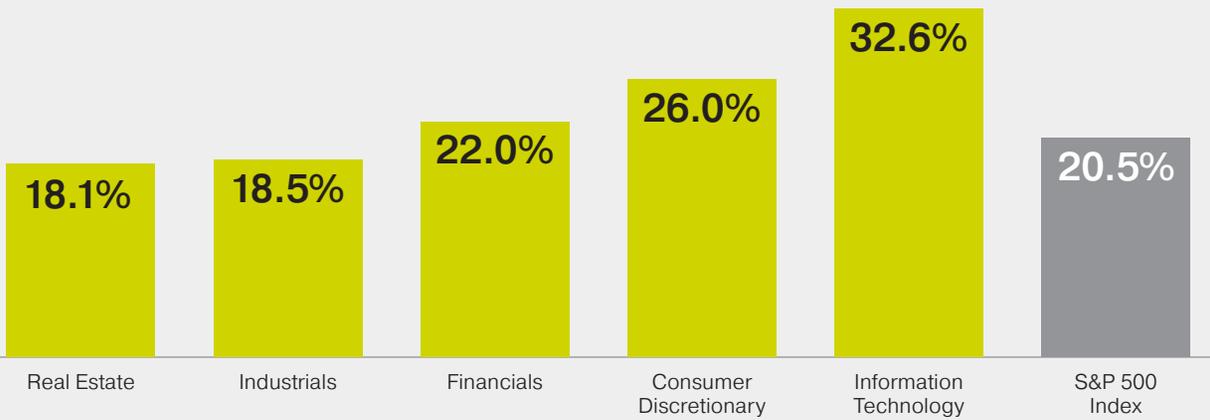
Energy

The administration has been advocates of fossil fuel development and have rolled back regulations. Post-election, the administration may get more aggressive with Iran and Venezuela, likely keeping energy prices elevated.



Cyclical Stocks

May do well if prioritized infrastructure projects, spending, and deregulation help offset trade concerns.



Cyclical Stocks

(continued)

Industrials/Materials

Infrastructure is a priority for the Democrats and the administration but it remains to be seen how it would be funded. Of greater interest for these two sectors now is the outcome of the so-called “trade war” between the U.S. and China.

Consumer Discretionary

The Consumer Discretionary sector was a prime beneficiary of the tax cuts, lowering corporate tax rates and lining consumers’ pockets with more money. Not surprisingly a Democratic wave election could be viewed as negative for the sector. Nonetheless, any attempts at changing the administration’s signature legislative achievement would be vetoed by the President.

Information Technology

The Technology sector is flush with cash following the repatriation tax change. However, the Democrats and the President appear in favor of probing tech firms on allegations of anticompetitive behavior. With a good global growth backdrop, the sector’s outperformance will likely continue despite political headwinds.



Even if the President chooses to retain power through executive order, the question of **impeachment** still hangs over the midterm elections.

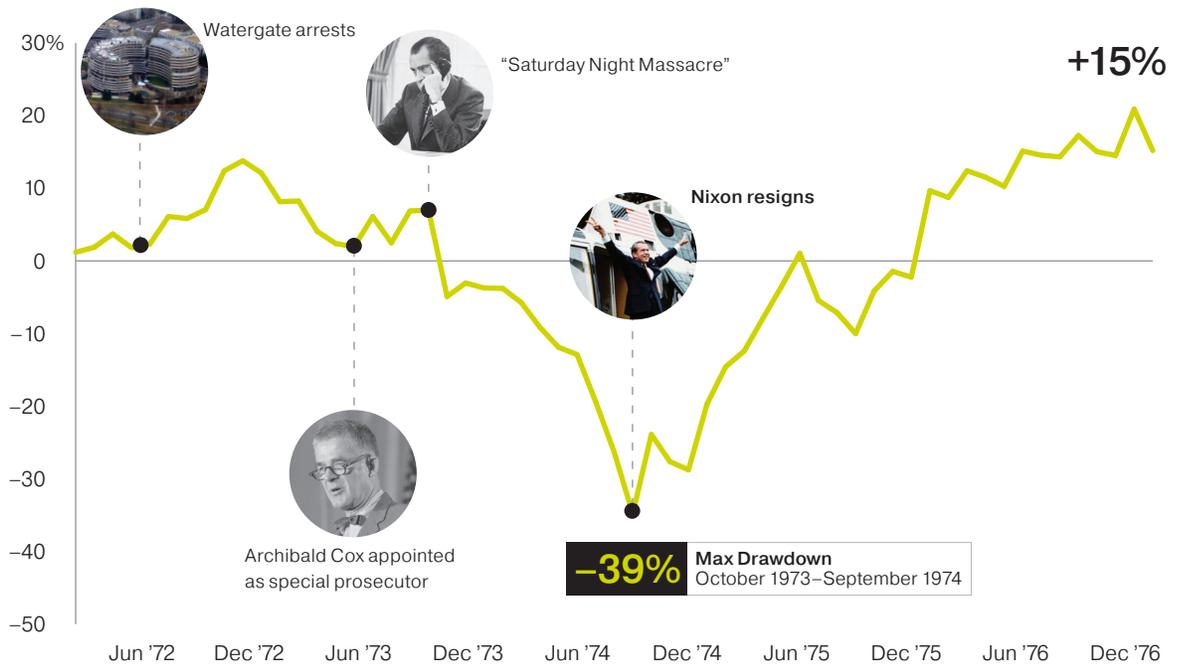
3 Ultimately, the Issue of Impeachment May Come to the Forefront

If Democrats win control of the House of Representatives, it raises the distinct possibility that the House could vote to impeach the President. How might that impact the financial markets? Again, history suggests there may be a spike in market volatility, but perhaps not a severe or extended one that could topple the current bull market. However, in addition to a House vote, removing the President from office cannot happen unless the Senate also votes for it—by two-thirds majority for a conviction.

Markets Might Become Volatile, but Likely Only for the Short Term

President Nixon's Resignation

S&P 500 Index Cumulative Monthly Total Return



?
Did Watergate Kill the Bull Market
 See page 10

Source: Bloomberg, 8/31/18. Max drawdown is the maximum loss from a peak to trough of a portfolio, before a new peak is attained. **Past performance does not guarantee future results.**

History as a Guide



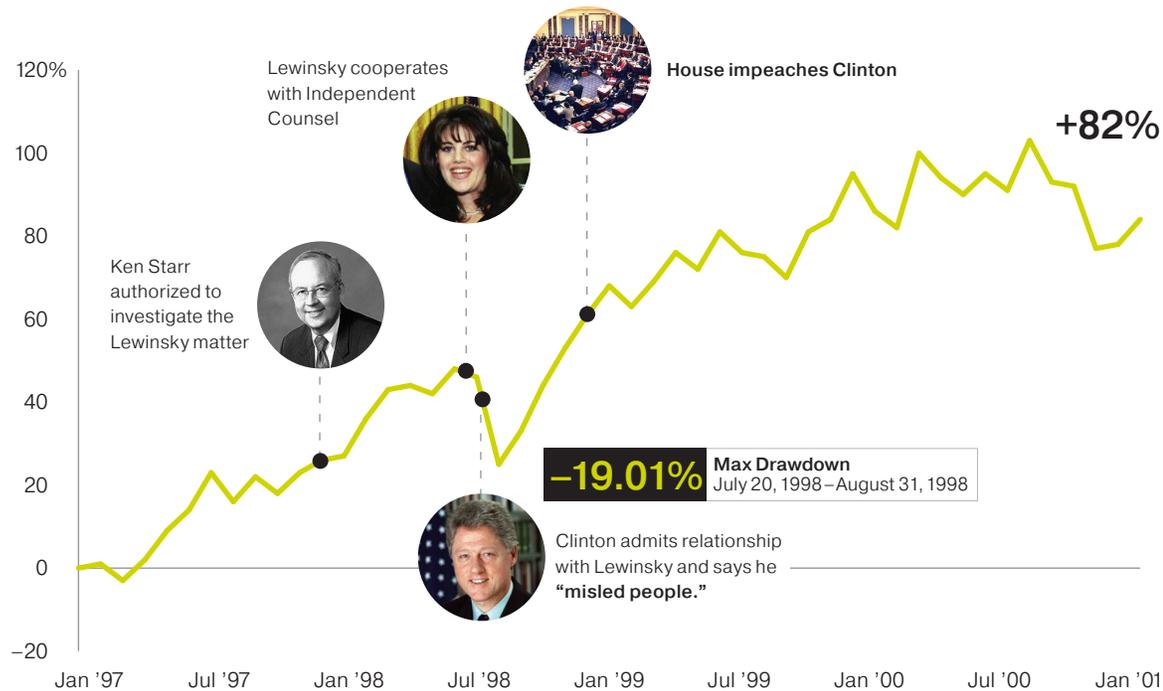
The Nixon Impeachment Hearings

After the "Saturday Night Massacre," when the President pressured his Justice Department to fire the Watergate special prosecutor, the market nosedived. It stayed in negative territory for several years after Nixon's resignation in August 1974, largely debilitated by separate, surrounding market conditions.

Political surprises and machinations may have short-term market implications, but have proved to be mere blips in the long-term advance of the market.

President Clinton's Impeachment

S&P 500 Index Cumulative Monthly Total Return



Source: Bloomberg, 8/31/18. Past performance does not guarantee future results.

History as a Guide

The Clinton Impeachment

The market nearly plunged into bear market territory after Monica Lewinsky agreed to cooperate with the Independent Counsel and Bill Clinton admitted he misled the public, but it quickly recovered and increased 82% over Clinton's full second term, despite his impeachment in late 1998.



Historical Perspective: Watergate Didn't Kill the Bull Market, It Was High and Rising Inflation

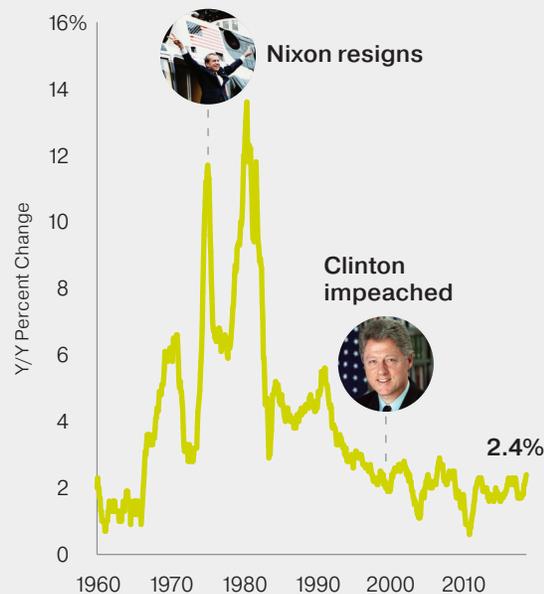
There is a lingering belief that Watergate killed the bull market. That has created fears that removing the current president from office could have the same impact on this bull market.

In our view, the analogy doesn't hold up.

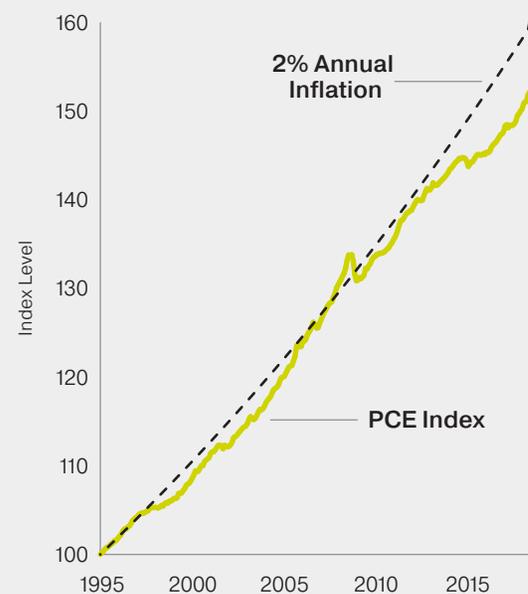
Back then, there were many macroeconomic factors at play, including an oil embargo, the war in the Middle East, and rapidly rising inflation. Inflation, as represented by the Core Consumer Price Index (CPI), increased from below 3% to over 11% in a short time.

Today, the economy is in much better shape, with inflation below its 2% target, making it unlikely that we'd see a repeat reaction.

U.S. Core CPI



Actual Inflation vs. Pre-Crisis Trend
(January 1995 = 100)



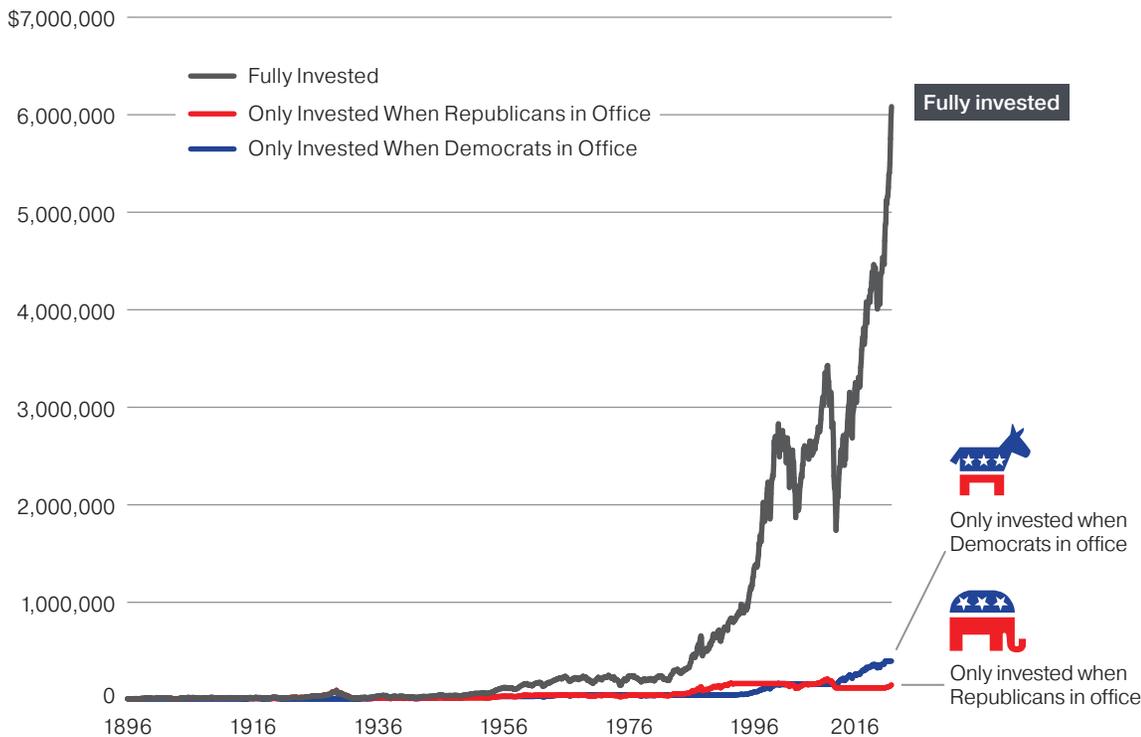
Source: Haver Analytics, 8/31/18. The PCE Index refers to the Personal Consumption Expenditures (PCE) Index. See page 12 for index definitions. **Past performance does not guarantee future results.**

Conclusion: Politics and Investing Don't Mix

While it may be exciting to talk politics, history offers compelling evidence that the current political environment should not influence investment decisions. It is human nature to think the present moment is exceptional and greatly different from anything that has gone before. But the market has weathered “unique” political environments before, and the past has generally demonstrated the value of developing a long-term plan and sticking to it, regardless of who is controlling Washington.

Investing Based on the Political Party in Office

Growth of \$10,000 Since 1896 in the Dow



Source: Bloomberg, 12/31/17. This chart is for illustrative purposes only. This material does not constitute a recommendation as to the suitability of any investment for any person or persons having circumstances similar to those portrayed. It is not intended to depict the performance of any particular security or investment strategy. It is not intended to depict or predict the performance of any Oppenheimer fund. There can be no assurance that any investment process or strategy will achieve its investment objectives. **Past performance does not guarantee future results.**



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The Standard & Poor's 500, often abbreviated as the S&P 500, or just the S&P, is an American stock market index based on the market capitalizations of 500 large companies having common stock listed on the NYSE or NASDAQ. The S&P 500 Index components and their weightings are determined by S&P Dow Jones Indices.

The Global Industry Classification Standard (GICS) is a standardized classification system for equities developed jointly by Morgan Stanley Capital International (MSCI) and Standard & Poor's.

The U.S. Dollar Index (USD, DXY, DX) is an index (or measure) of the value of the United States dollar relative to a basket of foreign currencies, often referred to as a basket of U.S. trade partners' currencies. The Index goes up when the U.S. dollar gains "strength" (value) when compared to other currencies.

The Dow Jones Industrial Average (DJIA) is a price-weighted average of 30 significant stocks traded on the New York Stock Exchange (NYSE) and the Nasdaq.

The Core Consumer Price Index (CPI) is a method for measuring core inflation. It is the consumer price index excluding energy and food prices. The Consumer Price Index (CPI) is a measure that examines the weighted average of prices of a basket of consumer goods and services, such as transportation, food and medical care. It is calculated by taking price changes for each item in the predetermined basket of goods and averaging them.

The Personal Consumption Expenditures (PCE) Index measures price changes in consumer goods and services.

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