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Sep
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Government Shutdown Looms, Stocks Say ‘Been There, Done That’

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Tuesday, September 19, 2023

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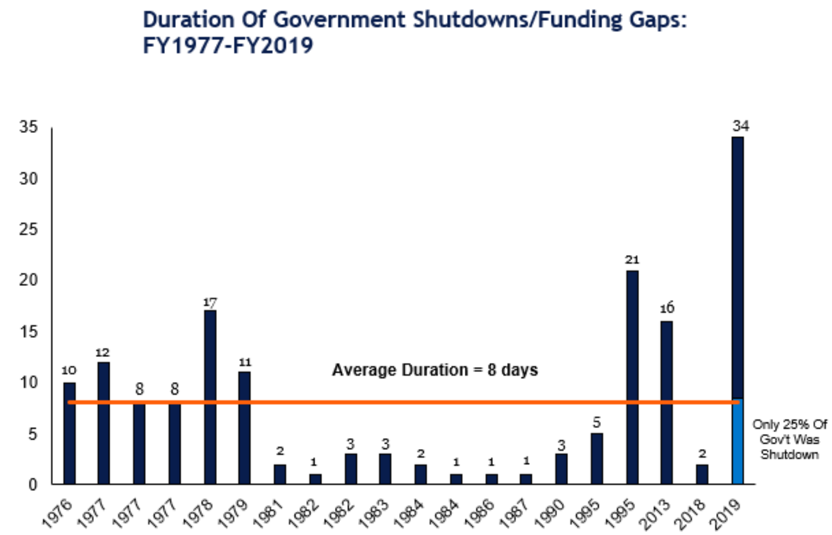
The specter of a U.S. federal government shutdown continues to loom this week as Congress has just 12 days to agree on a budget before the October 1 deadline. House Republicans released a temporary measure on Sunday which could push the deadline out another month, with the hopes of a final solution coming in the interim. However, that proposal has encountered pushback even from within their own ranks, not to mention from across the aisle, and has yet to be voted on. The bad news is it looks like the government is headed for another shutdown; the good news is the stock market has seen this before.

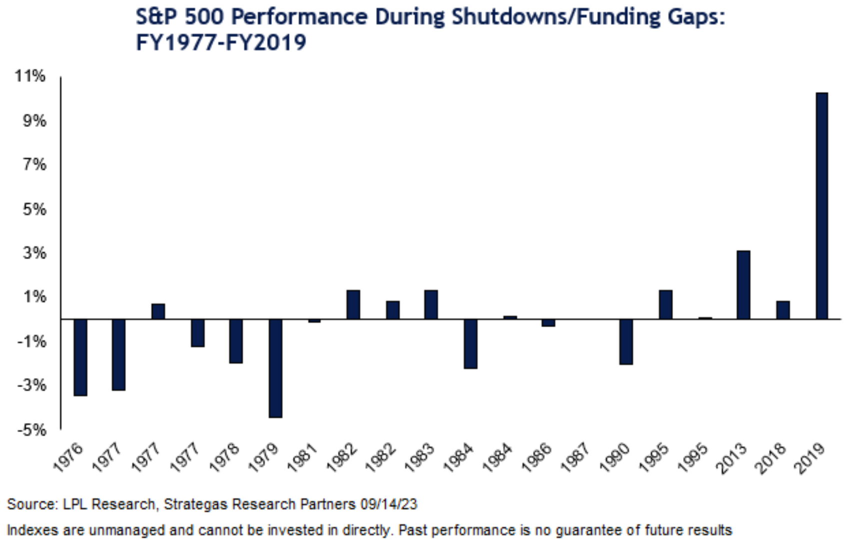
The government has had 20 shutdowns since 1976. The average length of those shutdowns was eight days. The most recent, which started in December 2018, and extended into 2019, was the longest in history and lasted 34 days. The chart below, with data provided by Strategas Research Partners, shows the duration of each shutdown since 1976.



Source: LPL Research, Strategas Research Partners 09/14/23

View enlarged chart

As it has a reputation of doing, the stock market has been able to shrug off this gridlock in Washington. In fact, according to Dan Clifton, Policy Strategist at Strategas, during the 34 days of the most recent shutdown the index managed to return a whopping 10.27%. The simple average return of the S&P 500 during those 20 government shutdowns is 0.04%. The chart below shows the performance of the S&P 500 during each period.



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Not only does the market usually hold up while lawmakers dither, but history also shows it bounces higher shortly after a resolution has been reached. During the one- and three-month periods following a budget being passed the average returns for the S&P 500 are 1.17% and 2.64%, respectively. Investors have been able to look past budget speedbumps as corporate earnings, the overall economic outlook, and other more impactful macroeconomic events took precedent. That said, certain segments of the market that rely on government contracts can be more susceptible to shutdowns. Typically, segments such as defense and life sciences pull back as their revenue sources become less clear; however, they tend to outperform once the spigots are turned back on.

While history has shown the stock market can weather such events, it remains to be determined if other secondary impacts will be felt (barring the unlikely event that a compromise is made before the deadline). Heightened political divisions, a slim majority in The House of Representatives, and intra-party factions could potentially prolong negotiations. An extended shutdown would put economic data aggregation in jeopardy as many government entities responsible for collection and dissemination would be dormant. This would put the data dependent Federal Reserve in an unenviable position as the market awaits its signals. While LPL Research maintains a neutral weight to equities, we view any *outsized* declines as an opportunity to buy-the-dip, based on the strength of historical patterns.

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