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Be on your guard this election season for those using the stock market to predict who will win the White House in November. That's because the historical data can be tortured to say almost anything.

This isn't to say that there is no relationship between stock market performance, consumer confidence, voters' moods and the incumbent's chances of staying in the White House. But, as Campbell Harvey, a Duke University finance professor, told me in an email: "The sample [of past Presidential elections] is too small and there are hundreds of variables."

Given this, it's difficult to come up with any conclusion that has genuine statistical significance. Consider the notion that is currently making the rounds that the stock market's direction between Labor Day and Election Day predicts whether the incumbent party wins. On the surface this appears to enjoy strong statistical support, at least since the late 1890s, when the Dow Jones Industrial Average (DJIA) was created.
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over the trailing one month prior to Election Day — or the trailing six months. Why should the market over a two-month period be a good election forecaster but not over a one- or six-month period?

These are statistical red flags, and they’re not the only ones. As I also pointed out in that earlier column, the Dow’s trailing nine-month return is strongly correlated with the incumbent’s re-election odds, but not the Dow’s trailing eight- or trailing 10-month returns.

This discussion brings up a broader statistical lesson we should always keep in mind: To properly assess the significance of a given correlation, we must take into account the number of hypotheses that were analyzed during the process of “discovering” that correlation. As the number of tested hypotheses increases, the odds also increase of reaching a conclusion that appears to be statistically significant but isn’t really — a false positive, so to speak.

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