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DON’T LET ELECTION 2016 INTERFERE WITH YOUR INVESTMENT PLAN

Election season is upon us, and almost daily we are bombarded with political ads, election analysis, polls and punditry. Democracy allows us to weigh in with our opinion, to be a part of the process, and to cast our vote. As the election reaches the home stretch, be careful not to let your political emotions affect your investment approach.

Many empirical studies have investigated the effects of Presidential election cycles and investment returns. For every study that appears to glean statistical significance on a set of election outcomes and the markets, another seems to conclude the opposite. Common wisdom suggests that Republican victory is more favorable for stocks than Democratic. Analysis concludes this isn’t the case – Republicans aren’t any more the party of business than Democrats are the party of labor. Another common misconception is that “divided government” (where the party holding the Presidency is different from the one controlling Congress) is a more market favorable market environment. In reality, markets have historically done better when one party is in control of both the executive and legislative branch, and the worst when the House and Senate are divided, regardless of which party occupies the White House.

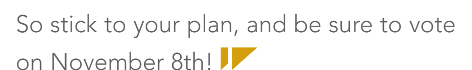
In fact, the markets may be better at predicting election outcomes than elections predicting markets. According to a study by newsletter InvesTech Research, the S&P 500® Index has an 86.4% success rate in predicting the outcome of the election. In the past 22 Presidential elections, 14 were preceded by three months of market gains; eight were preceded by three months of market losses. Following market gains, the incumbent party won 12 of 14 times. Following three months of market losses, incumbents lost seven of eight times. At the time of this writing, the S&P 500 is up 3.29% over the last three months, but we still have nearly 60 days before the election. Much can change.

Another study found that individual investors are highly impacted by their partisan leanings. Those whose party of affiliation win an election tend to take more risk and expect higher returns when their party holds the White House. Investors affiliated with the party not holding the White House tend to trade more often and hold a more jaded view of future market outcomes. Both of these short-term approaches can be hazardous to long-term investment health.

One thing we are certain of is that markets don’t like uncertainty. While each party’s candidate enjoyed an election poll bounce after their respective conventions, recent polls suggest that the two candidates are statistically tied. This creates an environment of uncertainty that will likely lead to market volatility heading into the November election and contribute to further volatility after the election if the outcome doesn’t square with widely held expectations.

What is an investor to do? Our conclusion on the conflicting evidence is straightforward: a long-term investor following a reasonable investment plan tailored to their situation is best served by continuing to follow that plan and not altering course based on anticipated short-term market moves.

So stick to your plan, and be sure to vote on November 8th!



ECONOMIC REVIEW

Beneath the static performance of the overall stock market in August (S&P 500® up 0.1%) was significant churning within market sectors. At the high end, Financials returned 3.6% behind the prospect of impending rate hikes from the Federal Reserve (Fed). However, over the same period the Telecommunications sector had a return of -5.7% after outperforming most of the year as investors piled into high-yielding stocks, often seen as substitutes for the low yields available in bonds. All in all, this calm-looking surface hiding considerable undercurrents is an appropriate metaphor for the investing climate in general.

One measure of the investment atmosphere is the manner in which the market is capable of weathering shocks to the system, as was the case with Britain's surprising Brexit vote in late June. After a few days, calmness once again prevailed. As we can see from the performance of financial stocks in August, the Fed watch remains a serious Wall Street preoccupation. But overall our sense is that complacency rules, perhaps not unusual in August, when vacations are rampant and trading is thin. But this mood is more than just a monthly phenomenon. The 2016 market seems to be one that absorbs whatever realities present themselves with little more than a yawn.

At the Fed's most recent meeting in August, Chairperson Yellen expressed the position that the economy was advancing at a sufficient rate to support rate increases in the near future. The consensus is that we will see a quarter-point hike in December, after the elections. Where once the prospect of rate hikes sent shivers through the investment community, we saw little reaction other than a boost in financial stocks, whose profits tend to increase as rates rise. One factor might have been the relative conservatism of the Fed's current strategy, which shows no eagerness to embrace the negative interest rate policies employed by many of the world's central banks.

While not every domestic economic indicator is shouting growth (manufacturing continues to lag), there is plenty of positive evidence to support the Fed's optimism. New housing starts have been on a record pace, while inventory of existing homes remains thin. Consumer confidence and spending are solid, as have been recent corporate earnings reports. Low prices at the gas pump continue to be stimulative, even as these savings are being eaten up by the increases in health care costs and rents. The prospect for additional rises in health care costs on the insurance front continue to mount as major insurers reduce their exposure to loss-inducing Affordable Care Act subscriptions.

Overseas economic risks have hardly abated. While Britain struggles to manage its Brexit commitment, other European nations show early signs of wavering from the Union. Italy is facing a vote this fall which, while not as precipitous as Brexit, could usher in political leadership which leans towards nationalism over regionalism. Italy is not only a major economic factor in the European Union, it is, unlike Britain, a user of the Euro currency. Currently, the vote is considered a toss-up.

International turmoil does nothing to upset the belief (which we share) that U.S. stocks remain the strongest equity investments in the world. At the same time, there seems increasing confidence that equities are today's most attractive asset class, despite what we see as full valuations. In fact, the acronym TINA, "There Is No Alternative," once used by Britain's Margaret Thatcher to justify her party's positions, is now being applied to the purchase of U.S. stocks.

That an investment trend can be popularized in an acronym strikes us as another reason to keep a close eye on the risk parameters of every position in your portfolio. We expect to see an increase in market volatility should the examination of risk become a more popular pastime as the presidential election nears and if the general mood of complacency begins to wear thin.

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