The Post-Election Investment Landscape
Views from U.S. Bank Wealth Management
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Executive summary
Donald John Trump has been elected the 45th President of the United States. With the final tallies in, the Congressional elections reflected more than 230 House of Representatives seats going to the Republican Party, 51 seats in the Senate going Republican and several gubernatorial races reflecting Republican victories. A Republican sweep was widely unexpected and the natural question is “what does this mean for markets and investors?”

While digesting this outcome remains a fluid and dynamic process, we have arrived at three main conclusions:

- The factors driving global economic and capital market forces tend to be larger than single-country election results and for long-term investors, the election will not have a material impact over the next few years.
- While election results tend to have a minor impact on capital markets, Trump’s victory could represent a modest departure from this tendency and cause some near-term angst, likely with a bias towards selling pressure on traditionally risky asset classes, like stocks. Implications for the bond market appear to be more mixed but with a bias towards lower prices and higher yields.
- The Republican sweep will have a much larger impact at the individual industry, sector and country level than across broad equity and fixed income categories.

One of investing’s bedrock principles is that markets dislike uncertainty, and the Trump victory leaves investors with several unanswered policy questions. The election results are unlikely to have a material impact on total economic growth, but markets will be in more of a “reactionary” mode than usual due to the need for policy clarity and priorities from the new administration, which will be assembled in the coming weeks. In short, while we continue to evaluate this election’s implications, aggregate capital market risks have moved higher in the very near term due to a largely unexpected outcome and the need for more clarity on domestic and foreign policy priorities. At the same time, a Republican sweep could lead investors to look past some of the policy uncertainties and conclude that potential tax reform and a Federal Reserve (Fed) remaining on hold could be bullish for riskier asset classes, so while risks may have gone up, so have opportunities.

The longer uncertainty lasts, the greater the impact this election could have on capital markets and portfolios. At this point, we do not see a need to alter the path forward for well-diversified portfolios. We traditionally learn more about a president-elect’s agenda when it is presented to a joint Congressional session in February, but due to the unconventional nature of Mr. Trump’s election, the time table for additional policy discovery may differ. Should our views change about this administration’s market impact between now and then, we will keep you informed.
Pre-election expectations

One way to gauge financial market implications is to assess what was “priced in” by investors before these results. Capital markets are forward-discounting mechanisms — investors buy and sell securities at prices that factor in future expectations. If investors expect a company to sell a lot of its products in coming months and those sales will translate into earnings, investors will express that optimistic view by paying more for said company’s stock in advance of actual earnings. If earnings results are consistent with expectations, the stock may not react much, but, of course, if earnings disappoint, the stock may fall in sympathy with a different reality than expectations. Just as investors have expectations about earnings results, they also have expectations about election results. Elections can have significant impacts on trade, industry dynamics and on fiscal (spending and taxation) and monetary (interest rate and money supply) policy, all of which can impact capital markets.

Two tools are instructive for understanding expectations. First, popular polls (such as those released by ABC and Fox News or the Pew Research Center) provide updates on general elections from a survey standpoint. These polls’ margin for error tends to be wide and polling has become increasingly challenging, but irrespective, they provide some useful data. As indicated by analysis from FiveThirtyEight — which tracks 998 national polls — at the time of the election, Clinton had a 4 percent lead over Trump.\(^1\) The four-way national poll showed Clinton with a 2.2 percent margin of victory the day before the election, which is less than the margin of victory the “remain” camp had ahead of the Brexit vote that ended with a “leave” result.\(^2\)\(^3\)

Prediction markets, where participants can invest money based on a certain outcome (including political elections), also provide helpful insights. While prediction markets face criticism about how limited activity within these markets can be, they have emerged as a very additive tool for analysts. Prediction market researchers at Predictwise reflected a mere 9 percent chance that Trump would win, reversing dramatically as the election results poured in.\(^4\)

From a Congressional standpoint, ABC News predicted a virtual dead heat in Congressional elections.\(^5\) Prediction markets assumed a 67 percent chance of a Democrat-leading Senate heading into the election and that Republicans had a 76 percent chance of securing at least 218 House seats.\(^6\) Thus, prediction markets only correctly assessed the House outcome, resulting in poor predictive outcomes from both popular polls and predictive markets.

Perhaps more importantly, ahead of the election, capital markets seemed to price in a Clinton victory. As Trump’s popularity picked up in the weeks leading up to the election, riskier asset classes sold off, only to regain ground as Clinton’s popularity firmed. However, as the Electoral College votes came in last night favoring Trump, equity indices resumed their downward move and safe havens, like bonds, shot up in price. Interestingly, as U.S. equity markets opened for trading on November 9, those dramatic stock declines reversed and safe-haven bonds sold off, indicating a market in full digestion mode.

\(^1\) http://projects.fivethirtyeight.com/2016-election-forecast/national-polls/
Accessed 11/9/16.

Accessed 11/7/16.

\(^3\) Clifton, Dan. “Strategas – State of the Presidential Race: One Day Out.”

\(^4\) http://predictwise.com/politics/
Accessed 11/9/16


Immediate market impact
The capital markets may absorb the Trump victory with a “sell first, ask questions later” mentality. Since a Trump administration and policy set is considerably less telegraphed than would have been realized under Clinton, a lot of the sector-specific implications (especially within Healthcare and Defense) will play out over time. However, we think the market’s bias will be for lower equity prices, tempered by the notion that a Republican sweep could lead to lower taxes and a Federal Reserve that is more on hold. As mentioned earlier, the bond picture is a little more mixed. While the intuitive response would seem to be higher bond prices as investors seek safe-haven assets, investors may become more concerned about the potential for inflation to emerge as they await more details with respect to monetary and fiscal policy, foreign policy/trade, healthcare and taxes and how successful those policies may be given the current congressional landscape. However, we do expect that riskier asset classes will eventually stabilize as the Trump victory is highly unlikely to shake monetary authorities’ (the U.S. Federal Reserve and their global equivalents) dominance over capital markets. After the immediate reactions subside, a Trump presidency could be perceived as more market friendly from both a monetary policy and general industry standpoint, but it could take a few weeks for market sentiment to shift.

Outlook for year-end and 2017
Our thesis is that global capital markets remain highly dependent on central bank action since policymakers have attempted to stoke demand coming out of the 2008-09 financial crisis. Demand remains sluggish in key areas like China, Japan, Europe and the United States. With the Trump victory, we expect markets to remain on edge during the lame duck period, recognizing a key event in a few weeks — a U.S. Federal Reserve policy meeting and press conference. The Fed is poised to raise interest rates again for the first time in a year this December, and doing so while other major central banks are standing pat or implementing other stimulus programs presents capital markets with a lot to digest in terms of the potential for additional tightening measures, as well as implications across a range of asset classes. We believe the U.S. and global economy will continue a pace of slow growth into 2017 while acknowledging that political uncertainties associated with the new administration may increase the risk to growth over the next couple of years as well as Fed policy responses.

- **Equities.** Following the Trump victory, we expect equities to likely drop heading into year-end before stabilizing into 2017. We do not see a looming recession or ramping inflation.
  - A Trump presidency, with a Republican Congress, potentially means more policy action. We expect that inflation and wage gains will be moderate and future Fed rate hikes will be deliberate given tepid global growth. In the long run, growth-oriented sectors and companies that are growing revenue, generating high returns on invested capital and have thematic appeal are more likely to be among the best performers.
  - We continue to regard global central bank liquidity, valuation and earnings growth as being the primary drivers of equity prices into the new year.
  - Equities offer a reasonable alternative to other asset classes. Roughly 50 percent of S&P 500 companies offer dividends yielding above the 10-year Treasury yield, affording investors with both income and appreciation potential over the longer term.

- **Fixed Income.** Fixed income appears expensive, in our view. However, we believe the near-term risks are modest due to easy global central bank monetary policies, moderate pace of nominal global growth and structural rise in risk aversion amongst market participants.
  - Factors impacting returns of fixed income securities for the next year include the speed of Fed short-term rate normalization, appetite for credit exposure and inflation expectations. A Republican sweep could be interpreted as more pro-inflationary than other potential election outcomes.
SITUATION ANALYSIS:
The Post-Election Investment Landscape

- Our base case is for a rate increase at the December 13-14 Federal Open Market Committee (FOMC) meeting, but our views on additional rate hikes will depend on administrative changes with the new presidency.
- Higher-than-normal levels of cash, coupled with increased diversification within bond portfolios, appear warranted given that further political surprises are still possible, equities appear fairly valued and there is continued uncertainty surrounding global central bank policies.

**Commodities.** Volatility among commodities has remained high throughout 2016. With commodity-related fundamentals still in a rebalancing phase, we see limited price gains into 2017.
- Oil prices are likely to remain range-bound into year-end, with prices impacted by inventory levels, supply/demand balance, OPEC production agreements and political winds of change from fossil fuel to energy alternatives. We anticipate the price of West Texas Intermediate crude oil in 2017 ranging between $45 and $65 per barrel.
- The price of gold has weakened recently, reversing gains in the wake of Brexit. It seems likely that gold prices will trend commensurate with the direction of election-related uncertainty over the coming days and act as a buffer against uncertainty.

**Real estate.** Demand for real estate is likely to remain relatively high, bolstered by job and wage growth, as well as low mortgage rates. Inventories appear limited, which should lead to higher prices and further gains in home building. Commercial real estate appears to be later in the cycle than residential, and we are mindful that real estate is vulnerable should interest rates start to migrate higher.

**Conclusions**
Our overall view is that these election results will have a meaningful short-term capital market impact, but like most elections, the results are not likely to markedly alter capital market prospects over the next two to three years. Most of the policy specifics that will emerge in the coming months will likely lead to some sector-specific impacts, perhaps most notably in the healthcare arena. We will continue to watch developments as they emerge, with the early February joint Congressional session a key milestone. Our focus remains on the upcoming Federal Reserve meeting and guidance, along with ongoing data from corporate earnings and consumer data points heading into the holiday season. We see the glass as “half full” with respect to diversified portfolio asset growth, and we will keep you abreast of any changes to our thinking pending further updates on policy or, more importantly, growth prospects across the globe. As always, please do not hesitate to let us know if you have questions. Thank you for your trust and confidence.
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Past performance is no guarantee of future results. The S&P 500 Index consists of 500 widely traded stocks that are considered to represent the performance of the U.S. stock market in general.

Equity securities are subject to stock market fluctuations that occur in response to economic and business developments. Investments in fixed income securities are subject to various risks, including changes in interest rates, credit quality, market valuations, liquidity, prepayments, early redemption, corporate events, tax ramifications and other factors. Investment in fixed income securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term securities. Investments in lower-rated and non-rated securities present a greater risk of loss to principal and interest than higher-rated securities. International investing involves special risks, including foreign taxation, currency risks, risks associated with possible differences in financial standards and other risks associated with future political and economic developments. Investing in emerging markets may involve greater risks than investing in more developed countries. In addition, concentration of investments in a single region may result in greater volatility. There are special risks associated with an investment in commodities, including market price fluctuations, regulatory changes, interest rate changes, credit risk, economic changes and the impact of adverse political or financial factors. Investments in real estate securities can be subject to fluctuations in the value of the underlying properties, the effect of economic conditions on real estate values, changes in interest rates and risks related to renting properties (such as rental defaults).