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FEDERAL STREET

ELECTION FLASH REPORT

November 2016

KEY TAKEAWAYS

- One of the most contentious and hotly debated presidential election in U.S. history is finally over. Unfortunately for investors, the outcome leaves more policy questions than answers. In the heat of the moment, the somewhat surprising outcome may seem poised to have a huge impact on investors. If you have heard it once, you have heard it a million times—markets hate uncertainty. We recommend staying calm, evaluating the situation, and not taking any drastic actions.
- Markets will ultimately put this event into perspective. Administrations come and go, while secular economic trends are often longer lasting. Corporate earnings growth, monetary policy, inflation, and valuations are far more important to stocks in the long run, and Presidents have little control over them.
- As Benjamin Graham once said, "In the short run, the market is a voting machine but in the long run, it is a weighing machine." As we have recently seen in Britain and the U.S., voters can be a fickle bunch and occasionally do the unexpected. Near-term increased volatility in stocks (as we saw in futures markets overnight) would not be surprising. Statistically speaking, it is very likely there will be a correction in the next year or two for one reason or another. Many worry election uncertainty will be a catalyst, and a drop is coming sooner rather than later. Unfortunately, trying to avoid ordinary corrections is a fool's errand (you have to be right on timing twice—getting out and getting back in).
- Bear markets, on the other hand, are usually accompanied by economic recessions. Given the way cycles work, there is potential for a downturn of some sort—especially considering the Fed has embarked on a tightening path, even a recession is possible during the next President's reign regardless of who is in office. For now, however, earnings are on a rebound, interest rates remain low, inflation is contained, and valuations, while elevated, are still reasonable. An immediate u-turn in the business cycle, which is just entering the latter stages of a slow-growth expansion, seems unlikely as a result of the election.
- That said, the rule of thumb is that markets seem to prefer a divided government, which limits the prospects of big game-changing initiatives coming out of Washington. There is also data to suggest a Republican President and Congress isn't so bad—though there is limited data to draw any robust statistical conclusions on the matter. Regardless, Republicans are in control (if they can form a consensus). Given campaign rhetoric, trade restrictions may be one of the biggest policy worries.
- Given the Republican President-elect's tough talk about Mexican immigrants and a potential border wall during the campaign, most believe that a Trump White House will hinder Mexico-U.S. trade relations, as well as the Mexican peso. A re-evaluation of emerging markets exposures in general may be in order.

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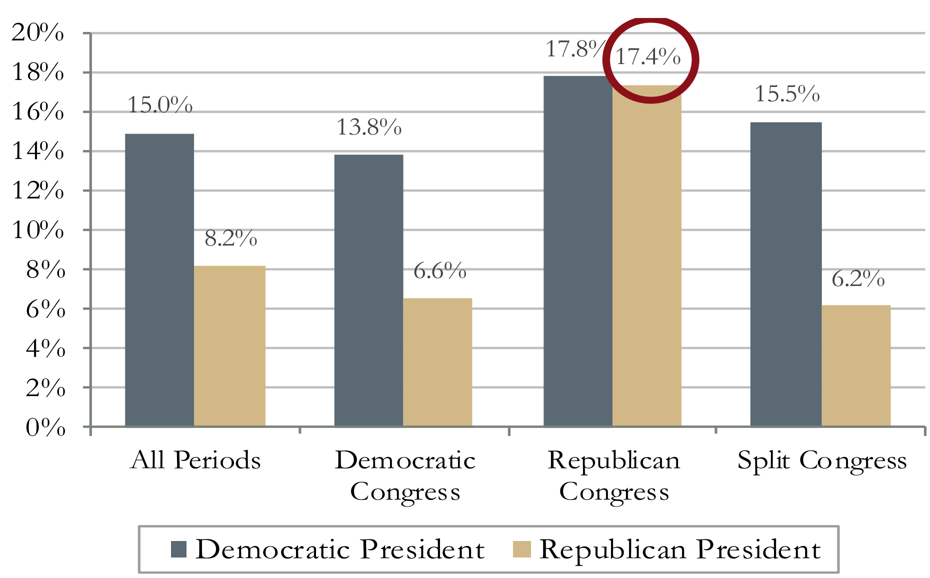

Sources: Bloomberg, Morningstar

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