2016 Elections Recap:
What the Results Mean for Investors

MARKET COMMENTARY

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AFTER WHAT FEELS LIKE AN ETERNITY, the 2016 election season is finally over. Donald Trump is set to be sworn in as the 45th president of the United States in January, and Republicans will retain control of Congress. While we now know the results, investors have another important question: What will these results mean for the markets? In the following pages, we discuss some key ideas investors should consider and offer our thoughts for what the election results might mean.

What Happened? And Does this Election Matter?

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At the beginning of the year, we predicted that Republicans would win the White House and retain control of Congress. Up until the night of the election, we thought we would get this one wrong. This election will no doubt go down in history next to the "Dewey Defeats Truman" one as an event that shocked nearly every expert. It seems that in an election season dominated by negatives, more voters felt comfortable with the unknowns associated with Donald Trump than they did with the scandals that would have been associated with a Hillary Clinton victory.

It's going to take some time to digest what a Trump presidency might mean since this is truly a wildcard scenario. From a political perspective, President-Elect Trump's signature issues of immigration and trade will likely be prominent, but it is uncertain how well President Trump and a Republican Congress will work together. There is a world of difference between what we used to call a "mainstream Republican" and Donald Trump. The last weeks of Trump's campaign were marked by infighting between the nominee and leaders of his own party. Now that he is set to become president, it's an open question whether Donald Trump's agenda or Paul Ryan's will dominate legislation. Would President Trump sign a GOP-authored entitlement reform bill? Would Speaker Paul Ryan work to pass a law that overturns NAFTA? Answers to such questions are entirely unclear.

And this lack of clarity is going to be paramount in any discussion of Donald Trump's presidency when it comes to financial markets. Regardless of people's opinions about Hillary Clinton, her economic policies are transparent and offered a measure of certainty. Donald Trump's statements have been vague and inconsistent. Financial markets tend to prefer clarity, so we think equity markets would have preferred a Clinton victory. We expect to see volatility rise, at least in the short-term.

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In any case, predicting how financial markets may react to this election can be tricky. While political and legislative actions can certainly affect market performance, market fundamentals have historically proven far more important. We believe that asset allocation, valuations, earnings and other performance determinants have far more effect on portfolios than election outcomes. With that in mind, we can make observations and suggest possible consequences.

Emotions Shift from Hope to Anger

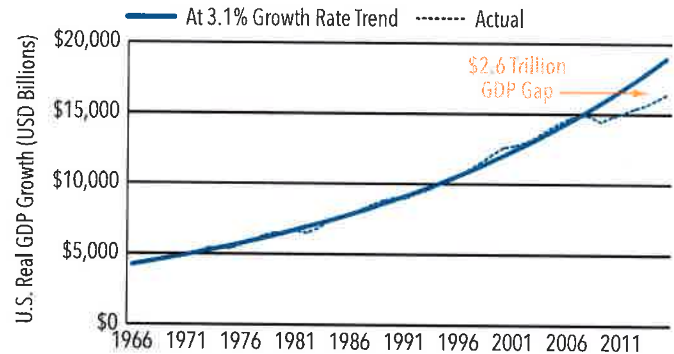
If there is one key theme that ran through this entire elections season, it would be one of anger. In retrospect, Trump's political ascent shouldn't have been so surprising. He successfully captured the mood of a large segment of the American population. The 2008 election of Barack Obama focused on hope in the face of economic catastrophe. In contrast, the 2016 election centers on anger.

Both Trump's rise and the surprisingly strong insurgent candidacy of Bernie Sanders during the Democratic primaries were fueled by anger: Anger at the establishment, anger at corruption (or, in the words of both, anger at a "rigged system") and anger over a stagnant economy.

Both Trump and Sanders were able to tap into a sense of frustration among many Americans. They spoke of and to people who were unable to find well-paying jobs and to those who haven't seen a raise in years.

The American economy has stagnated in recent years and has not fully recovered from the Great Recession. As shown in Exhibit 1, U.S. real gross domestic product (GDP) growth averaged 3.1% from the 1960s until the Great Recession. The sharp recession and ensuing slow recovery caused a $2.6 trillion gap from the continuing 3.1% trend. That disparity represents many new jobs and salary increases that might have existed today.

Exhibit 1: Economic Frustrations Are High as GDP Growth Has Slowed



Data source: Strategas Research Partners. Past performance is no guarantee of future results. Used with permission. GDP: Gross Domestic Product

Anger Changes the Political Landscape

This anger has caused fundamental shifts in the political landscape. During the Democratic primaries, Hillary Clinton was forced to move closer to Bernie Sanders' positions on issues such as trade and financial reform. And Donald Trump consistently advocated a protectionist approach. As a result, neither candidate favored the pro-trade, pro-globalization positions that until recently were relatively core aspects of the Democratic and Republican positions.

This increases the economic and financial post-election uncertainty. Now that Donald Trump has been elected, we will almost certainly see a push toward more protectionist positions. Debates over repealing NAFTA are likely to come to the fore, and the Trans-Pacific Partnership is all but dead.

How might this shift affect the economy or financial markets? A fact that is often lost during presidential campaigns is that no matter who gets elected, the president will need to work with Congress to enact new legislation and make or change trade deals. And as we discussed above, there is likely to be a fractious relationship between President Trump and congressional leadership. Put another way, the GOP House would likely act as a brake on attempts to radically overhaul trade policy.

Key Issues and Sectors Warrant Watching

With that background in mind, we think these key policy questions will affect the economy and financial markets:

Fiscal stimulus: The era of the sequester and fiscal austerity is clearly over. Federal spending has climbed in 2016 and will likely continue. Donald Trump appears to have little interest in shrinking the size of government. And like Hillary Clinton, he did talk quite a bit about the need for new infrastructure spending. We do expect a significant new spending bill that emphasizes infrastructure to be very high on the list of initial priorities. It also seems likely to us that this is an issue that most members of Congress will be willing to consider and we expect a bill to be passed within the first 100 days of the new administration. This could provide a short-term economic boost and benefit industrial and materials market segments.

Corporate tax reform: How will the government pay for this spending? Perhaps through much-needed tax reform that addresses the issue of repatriated earnings. U.S. multinational companies want to bring their overseas profits home, and the government is eager to tax those profits. Many thorny issues remain, including determining specific tax rates and possible restrictions on the use of profits (e.g., companies may benefit from more favorable tax treatment if they fund investment or launch hiring plans). This is an issue that has been important to Republicans in Congress for some time, and we expect President Trump to support reform efforts.

Trade policy: This key wildcard is very difficult to forecast. We believe trade restrictions and a more protectionist approach would be negatives for the U.S. and global economies. Simply put, more free trade leads to a healthier economy. Investors should understand the risks of more restrictive trade practices.

Exhibit 2: Key Sectors May Benefit after the Election

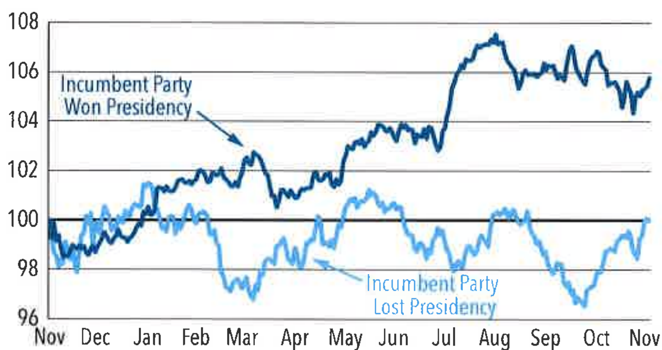
Sector/ Industry	Under President Donald Trump & the New Congress
Energy	Oil and gas companies would likely benefit from increases in production and exploration. This will likely be a less favorable environment for alternative energy-oriented companies.
Health Care	Some sort of full or partial repeal of the Affordable Care Act is highly likely, but what might replace it is completely unknown. Our best guess is that insurance companies would benefit while managed health care companies would suffer.
Financial Services	Despite Donald Trump's criticisms of Wall Street, we think the likelihood of additional banking regulations is low.
Infrastructure	Construction and heavy industry companies would gain from more infrastructure spending, which seems likely to happen.

Elections and Stock Market Cycles

Elections matter for equity markets, but they are less important than the state of the economy, the direction of corporate earnings, valuation levels and stock price fundamentals. That said, investors should understand the historical market trends surrounding election cycles.

There is a lot of data available that shows how different years of a presidency correspond with different results for equity markets, and whether markets tend to do better under Republican or Democratic control. To us, one of the most interesting trends shows that when the incumbent party retains the White House, stock prices tend to move higher over the next year. In contrast, a change in control resulted in a more uneven, sideways market. This is hardly definitive, but it is intuitive: Equity markets dislike uncertainty and seek consistency. And regardless of what investors think about Hillary Clinton, she represented more certainty and consistency than Donald Trump.

Exhibit 3: Markets Tend to Prefer Consistency: S&P 500® Performance in the Year Following Elections



Data source: Strategas Research Partners, 1926-2003. Past performance is no guarantee of future results. Data reflects the one-year performance of the S&P 500 following presidential elections, indexed to 100. Investors cannot invest directly in an index. Used with permission.

The Post-Election Environment

Looking ahead, we also have some thoughts about what the post-election landscape might look like. The nature of this election was particularly unusual. Both Hillary Clinton and Donald Trump were historically unpopular and voting appears to have been fueled more by anger and voting against Clinton or Trump than by genuine enthusiasm for either candidate.

Trump won the election, but the overwhelming negativity associated with his victory may eliminate the traditional "honeymoon" period enjoyed by past presidents. Similarly, he will enter office with several unresolved scandals hanging over his head. This could limit his ability to enact proposals quickly.

Similarly, we may see fragmentation in one or both parties. Will the more progressive Bernie Sanders Democrats push the party leftward or refuse to cooperate with more moderate elements of their own party? And Republicans understand that the old Reagan coalition of social conservatives, foreign policy hawks, working class and pro-business voters no longer exists. Republicans control Washington, but the meaning of the term "Republican" has never been less clear. The uncertain future of both parties will most likely contribute to a messy and confused political environment for years to come. ■

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Prior to joining Nuveen Asset Management, Bob held similar roles at other large asset management firms, including serving as chief equity strategist at BlackRock, president and chief investment officer of Merrill Lynch Investment Managers and chief investment officer of Oppenheimer Funds, Inc. He has 36 years of portfolio management experience, received a B.S. in accounting and a B.A. in economics from Lehigh University and an M.B.A. from the Wharton School of the University of Pennsylvania. He is a Certified Public Accountant and holds the Chartered Financial Analyst designation from the CFA Institute.

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Markets take Trump win in stride

Posted by Brian Nick in TIAA Global Asset Management Insights on Nov 10, 2016 7:42:00 AM

We are now close to 36 hours removed from perhaps the most shocking electoral outcome in U.S. history. Given the unexpected result—Republican Party control of government with Donald Trump in the White House—one might have thought the markets would react with sustained alarm. But they haven't. Instead, following an initial swoon in U.S. equity futures, the stock market swung strongly positive during Wednesday's trading session. Should this recovery and stabilization continue, it will serve as a reminder that presidential elections and political realignments generate headlines but rarely have a lasting material impact on financial markets.

Of course, that does not preclude the election from having created a distinct set of market winners and losers, at least on day one. The array of best- and worst-performing market segments gives us a window into what's expected from Trump's agenda. Starting with the winners, the U.S. dollar appreciated against emerging-market (EM) currencies, likely on speculation that President Trump's hard-line rhetoric on trade deals may hurt EM economies. Within the U.S. equity market, pharmaceutical and bank stocks led the way. Tighter regulation of prescription drug prices and financial firms had been part of Hillary Clinton's platform. Trump, if anything, may roll back existing restrictions on banks and, perhaps, energy companies. Industrials, another outperforming sector today, could benefit from increased business investment in the event Congress passes corporate tax reform or an infrastructure-heavy stimulus bill.

The biggest losers on Wednesday were assets with sensitivity to rising interest rates. In bond markets, this included longer-duration Treasury securities, with the bellwether 10-year yield surging to 2.06% from Tuesday's close of 1.85%. In equity markets, high-dividend sectors like Utilities and Real Estate both fell more than 2% in Wednesday trading. Even gold, which rose sharply late Tuesday night, retraced all of its gains given its strong negative correlation with rates (when interest rates rise, gold prices tend to fall). Much of the move higher in rates seems to be due to perceived inflation risk, which may be tied to expectations of increased fiscal spending (i.e., budget deficit) next year. Supporting that point is the fact that markets have now priced in an 82% chance of a Federal Reserve rate hike next month, virtually unchanged from before vote.

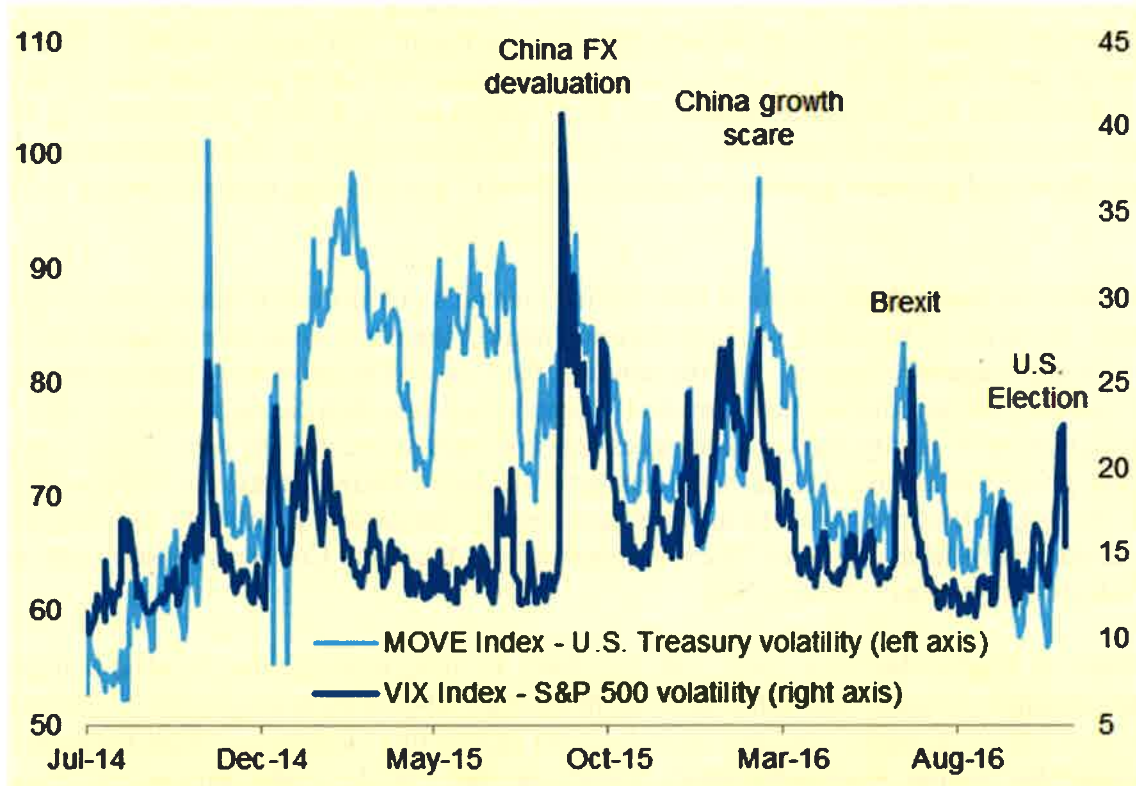
Checking off these market segments and policy issues one by one, it's not hard to see why investors might be optimistic about the possibility of a business-friendly agenda boosting corporate profits and/or economic growth in 2017 and beyond. Yet it's possible that equities may struggle to move materially higher for some time given the untested and (let's be honest) unconventional man voters have just elected to the presidency. Donald Trump, as president, may behave in unpredictable ways either in normal times or during periods of crisis should they arise. We won't know for sure until he's in office.

While it's entirely possible that policies pursued in a Trump administration will have an impact, either positive or negative, on long-run economic growth or fiscal sustainability, such effects are as yet unknown and would likely be priced in gradually over time. By December, the markets' attention will turn to meetings by the European Central Bank and the Fed, both of which must determine the direction of monetary policy. And by January, investors will be focused once again on corporate earnings reports, this time for fourth-quarter results. The occupant of the White House and the balance of political power clearly still matter in America, but they should not be the sole factors upon which investors base their decisions.

U.S. election has not created unusual market volatility

Equity market volatility, as measured by the VIX Index, has plunged to under 15% after reaching as high as 21.5% early Wednesday morning (11/9). Compared to the China growth scare that started the year and the Brexit vote in late June, November's election was a minor event for U.S. stocks (see graph below). Even interest-rate volatility has been muted, despite the pronounced back up in Treasury yields on Wednesday.

Equity and bond market volatility indexes since mid-2014



Source: Bloomberg, as of 11/9/2016.

VIX: The VIX level measures market expectations of near-term volatility on the S&P 500 Index, conveyed by stock index option prices.

MOVE: The MOVE (Merrill Lynch Options Volatility Estimate) is a weighted index of implied volatility on 1-month Treasury options across the yield curve.

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The Fed and President Trump: What lies ahead?

Posted by Tim Hopper in TIAA Global Asset Management Insights on Nov 10, 2016 7:48:00 AM

As the dust settles from Tuesday's election results, it's become apparent that we need to reassess every assumption about U.S. growth going forward. The first question that comes to mind is "What about the Fed?" Will they raise interest rates in December? How should we handicap future rate hikes, and what can we infer about Chair Janet Yellen's tenure or the two current vacancies on the Federal Reserve Board?

The immediate aftermath of the election and the market's response suggest that nothing will change in terms of a potential December increase in the federal funds rate. If Fed officials were planning on hiking prior to the election, they are still on course for that action. Furthermore, rapidly rising market rates in the wake of the November 8 vote—like the jump in the 10-year U.S. Treasury yield, which on November 9 closed above 2% for the first time since January—suggest markets are expecting exactly that result. And indeed, we anticipate a rate hike in December. This is because the Fed's twin goals of full employment and inflation that is rising toward its 2% target are in sight. With relatively stable economic conditions, the timing for a hike is appropriate.

In terms of president-elect Donald Trump's views of the Fed, which have been rather antagonistic, it is too early to assess how he will manage his relationship with Yellen or think about his nominations to the two open Board seats. Board members are nominated by the president and confirmed by the Senate for 14-year terms. The Fed Chair serves a four-year term in addition to having a seat on the Board. Thus, Yellen is in place until at least February 2018, at her own discretion. For now, the market seems to think that the two vacancies will be filled with inflation hawks (based partially on Trump's rhetoric against low interest rates during the campaign). But it's evident the Fed will already be raising rates over the next two to three years; what's not clear is whether raising them faster will necessarily be better for the economy. Consequently, in our view, Trump's eventual nominations may have less impact on this business cycle than on the next one, making them less important when thinking about near-term economic growth.

Lastly, how should we expect the path of rate hikes to progress for the remainder of this business cycle? We will argue in a separate piece that Trump's policies will likely be more inflationary than what would have been expected with a Hillary Clinton presidency or a mixed Congress. This argument is founded on the prospect of higher fiscal spending and incentives for increased infrastructure spending. A stimulative domestic policy driven by a single party will likely lead to stronger growth up front, thereby requiring more and/or more frequent rate hikes. So while Trump's policies, if put into practice, may not change the length of the current business cycle, it's possible they could alter its shape in terms of interest rates for the remainder of the cycle.

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