October 2016: Post-Election Market Update

Trump Victory Surprises Nation and Markets

Late into the night on Tuesday and early Wednesday morning, the stunning results of the U.S. election reverberated around the world, sending stock futures tumbling. S&P 500 Index futures fell as much as 5.7% before rebounding Wednesday. By the time the U.S. market closed on Wednesday afternoon, investor anxiety had turned to cautious optimism about the potential benefits of the Republican sweep. The swift market reaction and subsequent reversal were reminiscent of the post-Brexit selloff and recovery earlier this year. In both cases, polling data and "the experts" created expectations that proved incorrect. And in both cases, the knee-jerk reaction of investors gave way to a sense that the surprise outcome may not be as negative for markets as initially feared. But the surprise results of both of these major votes is likely to increase investor anxiety in the lead-up to future elections, as the value of predicting outcomes is clearly in doubt.

Post-election Trading Reflects Potential Changes to Come

There are many questions about the implications of a Trump presidency, but investors have begun to price in some of the outcomes viewed as more probable under a Republican government. The finance, energy, health care, and industrials sectors have rallied based on Trump campaign promises that coincide with traditional Republican policies. Trump promised to reduce the burden of regulation that has been a headwind to the finance and energy sectors. He also made clear his intention to reshape the health care landscape. His attempts at undoing the Affordable Care Act would have negative implications for certain players in the industry, but for many others could provide a boost. Hillary Clinton had made clear her intentions to go after pharmaceutical and biotech company drug prices, but the Republican sweep reduced that threat. The energy sector has benefitted from Trump's favorable tone, and industrials companies stand to benefit from any follow-through on promises related to infrastructure and defense spending.

Some Answers, but Still Many Questions

When the new government is installed in January, it will be the first controlled by one party since 2010. The last time Republicans were in control was 2006. But the lack of specifics regarding many of Trump's policy initiatives means there are more questions about priorities and details than there would be otherwise. As with any campaign, some of the promises that were made would be difficult to implement, even with a Republican majority. One of the biggest questions facing investors is how well Trump can work with Congress, especially given the animosity that was evident throughout the campaign. The President is able to enact certain measures on his own, and trade policy is one area with a direct impact on the economy. Trump's negative view of free trade, particularly with China and Mexico, represents a potential headwind to global economic cooperation and growth. Stocks of emerging market countries have fallen since Trump's election as a result.

Investors will also be paying attention to the direction of fiscal policy, and its consequences on the federal budget. Trump's economic proposals generally point to an expanding of fiscal stimulus. This has the potential to boost economic growth, but could weigh on the deficit while pushing inflation and interest rates higher. Trump's ambitious proposals for infrastructure spending would likely heavily rely on tax breaks, but also on private financing and the projected revenues from income taxes on businesses and employees working on the projects. Tax reform is another major policy issue investors will be watching. Expectations for some level of tax reform are higher given the one-party government, but the details of such an agreement are hard to predict, not to mention the impact it would have on growth. Trump has promised to lower tax rates on both individuals and businesses, as well as attempt to bring cash on corporate balance sheets home from overseas through a repatriation holiday.

Meanwhile, the Economy and Earnings are Still Growing

The election has been front and center in the eyes of the public, but meanwhile the U.S. economy continues to grow modestly. Corporate earnings have also improved somewhat after six straight quarters of declines. In the hours after the

Monthly Update (continued)

election results were finalized, odds of a rate hike at next month's Federal Reserve (Fed) meeting decreased, but like stocks, odds have recovered in subsequent days. As of this writing, market odds of a hike stand above 80%, according to Fed Funds futures trading. Even before the election, the Fed had indicated it was likely to make such a move in December. Trump's election probably reinforces such a move. His plans for fiscal stimulus would not only potentially boost growth, but also put pressure on the federal budget, both of which would lead to inflation.

The Fed was designed to be politically independent, and there has always been debate about the extent to which it has remained so. On the campaign trail, Trump sent mixed signals about his views on the Fed and the level of interest rates. Some have speculated that he would ask for Janet Yellen's resignation, but his campaign recently denied such rumors. But Trump is likely to be more vocal than previous presidents about Fed policy. He has commented publicly on the benefits to the economy of a low-interest-rate environment, but has also accused the Fed of creating asset bubbles.

Looking Ahead

The next several months and years promise to be interesting in many respects. The surprise outcome and the shake-up in Washington are likely to lead to significant changes in the economy. As a result, we expect market volatility, the norm rather than the exception, to pick back up. With that said, the stock market does not give an up or down vote on any one political candidate. As always, over the long-term stock prices will eventually reflect the value of the businesses they represent. To the extent Washington policy is able to support economic growth, stocks should benefit. But we are mindful of the fact that the economic recovery and bull market are in their eighth year. As a result, the margin for error for stocks is smaller than before. Valuations are higher in many areas of the market, and increasing interest rates will put pressure on the premium investors are willing to pay for stocks. And while we expect interest rates to move higher, rates will probably remain lower by historical standards. We continue to expect the adjustment to be slower and the peak to be lower than past interest-rate cycles.

Cincinnati
3777 West Fork Road | Cincinnati, OH 45247
P. 513.661.3100 | T. 800.541.0170 | F. 513.661.3160

Columbus
100 E. Broad Street, Suite 2300 | Columbus, OH 43215
P. 614.365.9103 | T. 866.365.4523 | F. 614.365.9943

Dayton
40 North Main Street, Suite 2110 | Dayton, OH 45423
P. 937.461.3790 | T. 800.851.9114 | F. 937.461.2969