Wealth Management Market Commentary

REGIONS ASSET MANAGEMENT

November 9, 2018

Apolitical Post-Election Forecast: History Suggests Gridlock, Turbulence, And Higher Stock Prices

We attempt to avoid taking sides when it comes to politics, and make every effort to block out what often turns out to be little more than noise – this is much easier when allocating investor capital with a longer-term time horizon in mind. With that said, the political backdrop impacts markets, and we can't bury our heads in the sand and hope that who controls what fails to matter. Which sectors of the economy/market are likely to be in/out of favor over the coming quarters/years due to how control of Congress shook out? What additional levers might the President pull to spur growth/investment amid a divided Congress? These are just a couple of questions investors and traders are likely to ponder on the heels of this week's mid-term election. We attempt to address these questions below.

With a divided Congress, the potential for additional economic stimulus has dwindled as gridlock is expected to take hold, but stocks have historically fared quite well with this backdrop. Based on data from Strategas, since 1933, under a Republican President, Republican-controlled Senate and Democrat-controlled House, the average S&P 500 return has been 10.8%. Not bad at all! Since 1950, the S&P 500 has rallied over the 12 months following a mid-term election every time – 17 observations, with an average return of 15.3%. History is on the side of the bulls, but we're cognizant of how often we've seen this strong historical performance statistic pop up in the popular press this election cycle. We rarely, if ever, enjoy being on the side of the consensus or herd, but the same could have been said if you attempted to buck the trend the year after the prior 17 mid-term elections as well. There are no sure things in investing, but unless you're a staunch proponent of gambler's fallacy, it will likely behoove you to maintain exposure to equities over the coming year.

Coming out of the 2016 presidential election, markets weren't sure what to expect or how to react, as results went against what everyone thought they knew going into election day. President Trump won, after polling leading up to the event gave him little chance to do so, which called into question the accuracy and viability of polling done pre-election as we entered into the voting booth this week. Betting odds and pollsters were largely in agreement leading up to the election that the Democrats would likely take control of the House of Representatives, while the Senate was likely to remain under Republican control, with probabilities rising into November 6 that the GOP would potentially pick up 2-5 seats. At this stage, that appears to be exactly how things played out. Ultimately there were very few surprises from this week's mid-term election, which has, so far at least, boosted equity prices, while yields on long dated Treasuries have remained contained – again, so far.

On the equity front, domestic markets rallied sharply post-election on hopes that President Trump's pro-growth agenda won't be derailed by a divided Congress as the President struck a conciliatory tone when asked if he was willing to work with House Democrats. One long held belief has been that both Democrats and Republicans could both agree on an infrastructure spending bill, but with industrials and materials underperforming the broader S&P 500 in the wake of the election, significant skepticism abounds surrounding this idea, and rightfully so. We're already running a budget deficit that isn't palatable to many on both sides of the aisle, so perhaps hope for a large infrastructure spending bill is misplaced, at least that's what price action may be telling us. A smaller bill focused on highways and roads may materialize as it could be a quick "win" for House Democrats, but if it must be paid for by corporate tax increases then corporate margins and economic growth projections for '19 would be called into question. This would be a negative for S&P 500 earnings if it comes to fruition.

Year-to-date winners – information technology, consumer discretionary, health care – that had been sources of funds throughout much of October's sell-off, caught bids over the past couple of days. It's typical for leaders to become laggards as 3Q wraps up and profit taking takes hold, but it is welcome to see these sectors reassert themselves. One potential reason for the rally might be that with the House being controlled by the Democrats, perhaps President Trump's bargaining power with China on trade might be diminished somewhat, and a trade deal with China would benefit information technology specifically. The rally in info tech is even more interesting when we consider that the President and Democrats both share a desire to regulate social media companies. Twitter, Google (Alphabet), and Facebook have been in the political crosshairs – all three posted gains the day after the election. Strong returns out of tech post-election were likely driven by short covering and investors facing the realization that tax reform 2.0 and other sources of additional economic stimulus were now about as probable as winning the lottery without buying a ticket. In an environment where economic growth is slowing, investors are again more willing to pay-up for growth.

We have been projecting 2.6% economic growth for the full-year 2019, and election results don't alter that estimate. The FOMC will be closely monitored early next year as any movement lower in the dot plot or a less hawkish tone would be notable. We expect another hike in December and three in 2019, but the path forward will depend on whether the economy slows more than is currently anticipated or whether inflationary pressures subside soon. After initially selling off post-election, the U.S. Dollar Index (DXY) rallied into the close Thursday. Should U.S. economic growth expectations trend lower and/or our trading partners ramp up their own fiscal stimulus efforts, we would expect a weaker U.S. dollar, all else equal. The DXY topping out would be a positive for international stocks, specifically emerging markets, as debt servicing costs would come down, allowing for more investment. Emerging markets appear attractively valued to us, and are finally garnering investor interest into year-end.

With regard to fixed income, the yield curve is likely to flatten as growth and inflation expectations move lower, while short-term rates move higher as the FOMC remains on course. Gradually lengthening portfolio duration might be advisable over the coming quarters, but we would still maintain a duration profile short of one's chosen benchmark for now as economic growth at 2.6% is respectable and more than enough to prop-up longer-term rates over the next few quarters. Riskier pockets of the bond market, specifically high yield and floating rate, along with investment-grade corporates to a lesser degree, remain viable options for diversification and additional yield over Treasuries, but right-sizing those positions is crucial at this juncture as we're closer to the exit than the entrance in those areas. Election results will alter our asset allocation very little as there remains a litany of unknowns in the wake of mid-terms. Stay the course and make sure your risk tolerance aligns with your allocations. No matter one's political affiliation or leanings, now that mid-terms are behind us, perhaps we can all agree on at least one thing – that we're glad the dog and pony show is over for a couple of years!

Source: Bloomberg, Strategas

	Price/Yield	Total Return (%)					
	11/8/2018	1 Week Ago	1 Month Ago	Year to Date	1 Year	3 Years	5 Years
Dow Jones Industrial Average	26191.22	3.33	-0.93	7.98	13.81	16.30	13.41
S&P 500	2806.83	2.50	-2.53	6.70	10.34	12.43	11.93
NASDAQ	7530.89	1.37	-2.57	10.07	12.14	14.80	15.28
Russell 2000 Index	1578.21	2.18	-3.07	3.83	7.88	11.07	8.95
MSCI World ex US	1853.13	1.48	-2.86	-6.74	-4.68	5.68	3.16
MSCI EM	993.53	1.58	-0.11	-12.10	-9.97	8.11	2.72
Bloomberg Barclays US Aggregate	3.66	-0.29	-0.05	-2.58	-2.47	1.24	1.96
Bloomberg Barclays Global Aggregate	2.27	-0.20	0.03	-3.37	-2.09	2.23	0.60
Bloomberg Barclays US Corporate Index	4.31	0.04	-0.31	-3.67	-3.05	2.82	3.19
Bloomberg Barclays 10-Year Muni Index	2.94	-0.05	-0.20	-1.38	-1.63	1.97	3.24
Bloomberg Barclays High Yield Index	6.70	0.59	-0.50	1.61	2.04	6.96	4.88

	Price/Yield						
	11/8/2018	1 Week Ago	1 Month Ago	12/31/2017	1 Year Ago	3 Years Ago	5 Years Ago
1 Month LIBOR (rate)	2.32	2.31	2.28	1.56	1.25	0.19	0.17
30 Year Mortgage (average rate)	4.82	4.70	4.78	3.86	3.73	3.82	4.26
2 Year Treasury (yield)	2.97	2.84	2.88	1.88	1.64	0.90	0.31
10 Year Treasury (yield)	3.23	3.14	3.23	2.43	2.32	2.33	2.75
30 Year Treasury (yield)	3.42	3.38	3.40	2.76	2.78	3.09	3.71
WTI Crude (closing price)	60.68	63.67	74.27	60.46	56.82	44.32	94.56
Brent Crude (closing price)	70.63	71.25	84.22	66.73	63.96	46.09	104.04
Gold (NYM $/oz)	1222.90	1236.00	1184.40	1306.30	1281.60	1087.60	1284.50

Source: FactSet

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