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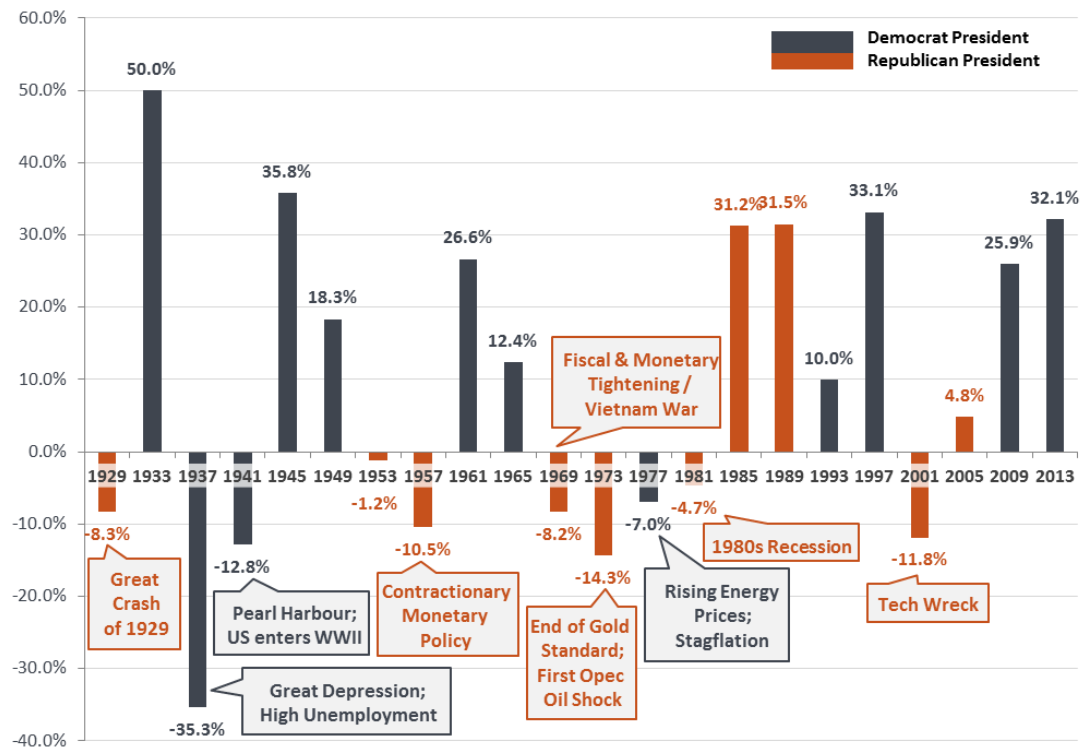


US ELECTIONS – THE WITCHING HOUR APPROACHES

Hallowe'en is fast approaching and while many kids are sharing scary ghost stories, adults are being frightened by a more grown up fear; the dominating Trump vs. Clinton press headlines of the US Presidential Elections. Do investors have something to be afraid of?

The daily headlines suggest that this is one of the most bitter and polarizing presidential elections in US history. And while there will be widely differing views on the two candidates from a policy perspective - foreign policy, social policy, and likely appointments to the Supreme Court, etc.- for investors, the only real concern is what impact the Presidential Election will have on future markets. As the chart below shows, in general, financial markets have performed well in the first year of a new administration with the S&P 500 rising on average about 9%.

S&P 500 Calendar Year Return in Year of Presidential Inauguration

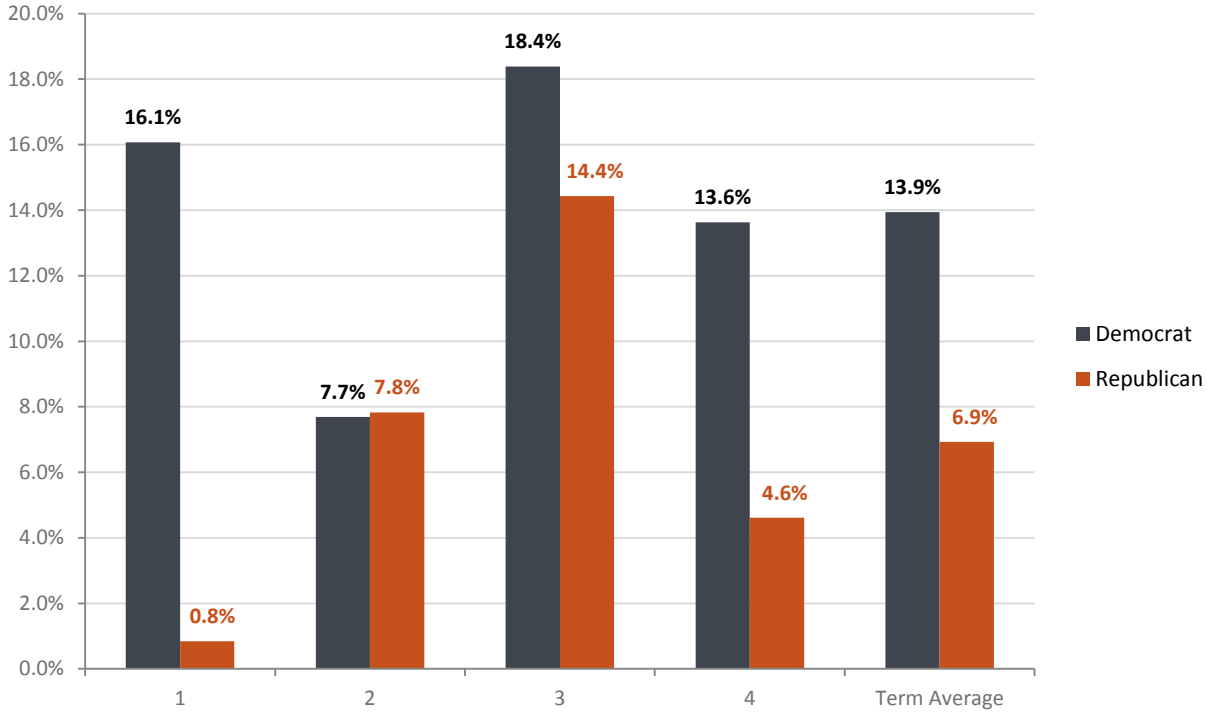


Source: MPW; S&P 500 data from http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

On the flip side, it can be argued that a decline in the stock market has been primarily due to fundamental reasons in the economy as opposed to a change in administration.

Does the party occupying the White House have an impact on stock market returns? The data in the chart below suggests a number of take-aways: (i) that the market, as represented by the S&P 500, has typically done better with a Democratic President, (ii) that the market returns in the inaugural year (i.e. first year) of a Democratic President are significantly better than that of a Republican President, and (iii) that there is significant variation in returns over the Presidential term.

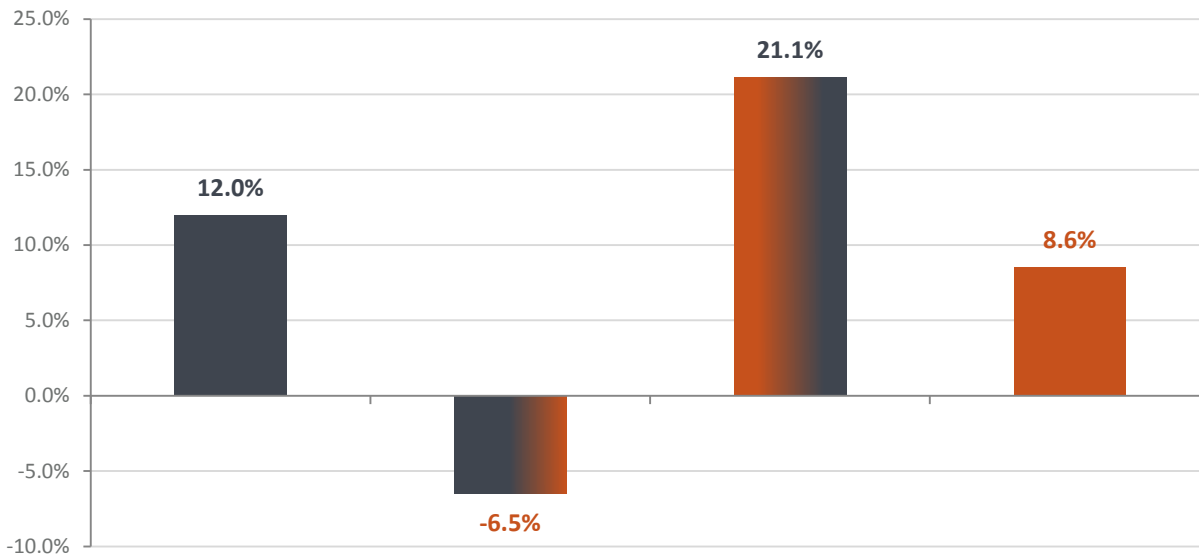
Average S&P 500 Calendar Year Return by Year of Presidential Term



Source: MPW; S&P 500 data from http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

Even more interesting is what happens when there is a change in party in the White House. In all cases, except when a Democratic administration gives way to a Republican administration, the market goes up in the first year of the new administration.

Average S&P 500 Calendar Year Return in First Year of New Administration



Source: MPW; S&P 500 data from http://pages.stern.nyu.edu/~adamodar/New_Home_Page/datafile/histretSP.html

So does this mean that the markets will go up if Clinton wins and go down if Trump wins? The table below shows that since 1929 the same party has simultaneously controlled the House of Representatives, Senate and the White House roughly 50% of the time. In the last several decades, seldom has one party controlled all three for more than a couple of congressional terms. Voting for legislation typically is aligned along party lines. The Republicans currently control both the House and the Senate with a Democrat in the White House. This split has meant political deadlock but the market has taken that in stride as it did in the Clinton and Reagan administrations when the opposing party had control of either the House, the Senate or both.

Democrat-controlled House, Senate & White House

Republican-controlled House, Senate & White House

Congressional Term	House	Senate	White House	Congressional Term	House	Senate	White House
1929	Republican	Republican	Republican	1973	Democrat	Democrat	Republican
1931	Republican	Republican	Republican	1975	Democrat	Democrat	Republican
1933	Democrat	Democrat	Democrat	1977	Democrat	Democrat	Democrat
1935	Democrat	Democrat	Democrat	1979	Democrat	Democrat	Democrat
1937	Democrat	Democrat	Democrat	1981	Republican	Democrat	Republican
1939	Democrat	Democrat	Democrat	1983	Republican	Democrat	Republican
1941	Democrat	Democrat	Democrat	1985	Republican	Democrat	Republican
1943	Democrat	Democrat	Democrat	1987	Democrat	Democrat	Republican
1945	Democrat	Democrat	Democrat	1989	Democrat	Democrat	Republican
1947	Republican	Republican	Democrat	1991	Democrat	Democrat	Republican
1949	Democrat	Democrat	Democrat	1993	Democrat	Democrat	Democrat
1951	Democrat	Democrat	Democrat	1995	Republican	Republican	Democrat
1953	Republican	Republican	Republican	1997	Republican	Republican	Democrat
1955	Democrat	Democrat	Republican	1999	Republican	Republican	Democrat
1957	Democrat	Democrat	Republican	2001	Republican	Republican	Republican
1959	Democrat	Democrat	Republican	2003	Republican	Republican	Republican
1961	Democrat	Democrat	Democrat	2005	Republican	Republican	Republican
1963	Democrat	Democrat	Democrat	2007	Democrat	Democrat	Republican
1965	Democrat	Democrat	Democrat	2009	Democrat	Democrat	Democrat
1967	Democrat	Democrat	Democrat	2011	Democrat	Republican	Democrat
1969	Democrat	Democrat	Republican	2013	Democrat	Republican	Democrat
1971	Democrat	Democrat	Republican	2015	Republican	Republican	Democrat

Source: https://en.wikipedia.org/wiki/Party_divisions_of_United_States_Congresses

If Trump wins the White House and the House and/or the Senate is controlled by a Democrat majority, the markets may anticipate continued political deadlock. The same holds true if Clinton wins the White House and the House and/or the Senate is controlled by a Republican majority. So the bigger question might very well be what happens in the down-ballot races? While forecasts project a possibility that the Senate will shift to a Democrat majority, most are not predicting the same shift for the House of Representatives.

From an investing perspective, it is important to note that markets never behave that predictably and simplistically nor do they move lockstep with political decisions. For example, after the historic Brexit vote on June 23, 2016, where defying all projections, the British voted to leave the European Union, the UK stock market (as measured by the FTSE) surprised everyone and has moved up over 14%!¹

Investors should bear a few points in mind:

1. Election campaign rhetoric usually has no bearing on policies actually implemented. This is especially so in the complicated US system of checks and balances. Any tax or spending legislation needs the approval of Congress. Both Ronald Reagan and Barack Obama discovered that they couldn't always get their policies through Congress. The Supreme Court is an independent defender of the law, irrespective of who appointed them – many Republicans were surprised/disappointed when the right-leaning Supreme Court failed to strike down Obamacare when given the opportunity.
2. With debt levels of US\$19.4 trillion² and record low interest rates, there is probably little alternative to cutting spending and finding new sources of tax revenues, irrespective of which party gets into power. However, as the Occupy Wall Street movement and Trump's core base illustrate, any party that takes a business-as-usual approach post-November is likely to suffer terribly in the mid-term elections in 2018. This election, irrespective of who wins, promises to be a wake-up call for America. Pure partisanship, after 8 years of deadlock, may no longer be an option for either party.
3. Whoever wins cannot ignore the macroeconomic fundamentals – economic policy, the geopolitical situation, etc. Janet Yellen's term as Chair of the Board of Governors of the Federal Reserve runs to January 2018, so radical changes in monetary policy are not likely in the near term. The House of Representatives will still likely be controlled by the Republican party after the election, so no radical fiscal policy changes are expected either.
4. Company fundamentals and general market conditions are improving – certainly employment numbers suggest that the post-2008 recovery is taking hold. A widely anticipated rate increase in December can be viewed as a validation that the economy no longer needs "training wheels". Only about 52% of the annual revenues of S&P500 company sales are from the domestic US market.³ So domestic policies are unlikely to offset strong company fundamentals.

All in all, the 2016 election campaign has entertained, has shocked, and has polarized the world. For long-term investors, however, there aren't very many "tricks" that they should worry about from the US election, no matter who wins in November.

¹ Source: Bloomberg data, FTSE performance from June 24, 2016 to October 14, 2016.

² <http://www.usdebtclock.org/> (as of October 18, 2016)

³ <http://www.marketwatch.com/story/sp-500-companies-generate-barely-over-half-their-revenue-at-home-2015-08-19> accessed on October 14, 2016

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