

Quadrant's regular newsletter that highlights topics we believe will affect markets or are important in understanding them.

"Man is by nature a political animal."
Aristotle

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The QAM word of the month, as defined below by Dictionary.com is:

Rigmarole

[rig-muh-rohl]

1. An elaborate or complicated procedure.
2. Confused, incoherent, foolish, or meaningless talk.

On a related note, the US presidential election process has been going on for well over a year and a half already. The race (marathon) to the Oval Office that began in early 2015 with 17 Republicans and 5 Democrats is now entering the homestretch with the final nominee for each party. On November 8, 2016, America will have to decide between two of the most unpopular candidates in recorded history to succeed President Obama¹.

The apparent rise of populist politics and the ugly rivalries between candidates are symptoms of a seemingly more divided America. In broad terms, an increasing amount of support is being garnered for nationalism, anti-globalization, and anti-establishment views. Income inequality, terrorism, and climate change have become central issues in recent years and these are all subjects in which people have polarized opinions. It is understandable why people, not only in the US, but around the world, may be feeling more anxious or uncertain about the future than usual.

What does this all mean for investors? Is the upcoming election something to worry about?

At the fundamental level, nothing will change on November 8th regardless of who is voted into the White House. The sun will rise the next day, businesses will open at the same time they always do, and global trade will continue. Despite the extreme statements and outlandish promises made by some candidates, Americans and the rest of the world will continue on with their day-to-day lives. In fact, if we all just turned off our TVs, stopped reading the newspaper, and stayed off the internet, it would take most of us months or even years to figure out who actually won the election. One of the reasons that developed, democratic nations like the USA are so stable is that the political system facilitates gradual and incremental change and is fairly resilient to the extreme whims of populist politicians.

At the capital markets level, investors will likely see increased volatility surrounding the event. The capital markets are, in essence, a collection of people around the world making decisions based on their own unique views of the future. During an election year, especially

one in which there will be no incumbent, an additional level of uncertainty is added to investors' forecasts of the future. This increased uncertainty combined with the political emotions of many investors can result in a wider range of speculation within the market – in other words, volatility.

While nobody knows how the market will actually perform in any given year, the charts below can provide some historical perspective on election years.

Dow Jones Industrial Average (DJIA) Performance During Election Years: 1900-2012	
Scenario	Average Return for the DJIA*
Presidential Election Years	7.4%
Incumbent Party Wins	14.6%
Incumbent Party Losses	-4.4%
Democrats Win	4.2%
Republicans Win	10.3%

**Returns represent price performance only and do not include the impact of reinvested dividends.*

Source: MFS Investment Management research report ⁱⁱ

The above chart shows that in prior years, the market has performed better on average when the incumbent party has won the election, regardless of whether it was the Democratic or Republican party. Additionally, stock market gains have been higher on average during years in which a Republican candidate wins the election.

S&P 500 Performance vs. Political Control (President & Congress): 1901-2016	
Scenario	Average Return for the S&P 500
Democratic President / Republican Congress	8.6%
Republican President / Democratic Congress	2.4%
White House & Congress Controlled by Same Party	7.1%
Democratic President / Split Congress*	10.4%
Republican President / Split Congress*	-4.3%

**Split Congress means that one party controls the Senate while the other party controls the House of Representatives.*

Source: MFS Investment Management research report ⁱⁱ

Furthermore, above is a look at historical returns depending on which parties control the Oval Office as well as Congress. According to the data, the stock market (as represented by the S&P 500) has performed the best on average when the president has been a Democrat, but only when the Democrats are not in control of Congress.

It is important to note that these stats are presented just for the sake of interest and are not meant to be predictive of future performance in any way. In reality there are many factors that have a far more significant influence on market returns than US politics does. Valuations, corporate earnings, economic growth, changing demographics, inflation, and interest rates are the real fundamental drivers of market performance. Politicians usually get too much blame for a weak economy and too much praise for a strong economy because most of the fundamental factors driving it are simply out of their control.

While the current election cycle has certainly been unique and emotionally charged, it is our opinion that trying to bet on one outcome or another is not a wise decision. Even if we had the psychic ability to know with certainty who will win on November 8th, our client portfolios and long term investment strategy would remain the same. New presidents are not dictators and they do not have the power to introduce

radical changes with the snap of a finger. The president must work with Congress, which is also elected by the voting public, to introduce changes like new legislation or tax reform. This process takes time, involves compromises, and the real effects of any changes can only be seen over a long time horizon.

Despite what political pundits may be forecasting, the reality is that nobody knows for certain which candidate will be elected, which proposed policies will be turned into real legislation, or what the ripple effects of new policies will be on the broader economy or financial markets. Simple narratives are designed to persuade voters one way or another but are often oversimplified and do not fully explain the complex and changing world we live in. For example, narratives during the 2008 election claimed that electing Obama would put gun-makers out of business and spark a boom in alternative energy. With the benefit of hindsight we see that shares of US gun manufacturers have vastly outperformed the broad market while clean-energy companies have suffered. Jimmy Carter presided during a time of economic stagnation and high inflation (“stagflation”) and left office with a very low approval rating, but stocks still gained significantly during his term (approx. 12% annualized for the S&P 500).

When it comes to investing it is best to focus on things that you have control over. QAM maintains a long term view and focuses its efforts on asset allocation policy, manager selection, systematic rebalancing, and understanding our clients’ individual financial circumstances. Presidents will come and go, business cycles will continue to roll on, and the capital markets will remain a fundamental building block in creating and preserving wealth.

The election rigmarole is almost over. Portfolios should remain depoliticized and focused on their long term objectives.

ⁱ <http://www.langerresearch.com/wp-content/uploads/1144-59ClintonTrumpFavorability.pdf>

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https://www.mfs.com/wps/FileServerServlet?articleId=templatedata/internet/file/data/sales_tools/mfse_elect_sfl&servletCommand=default

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