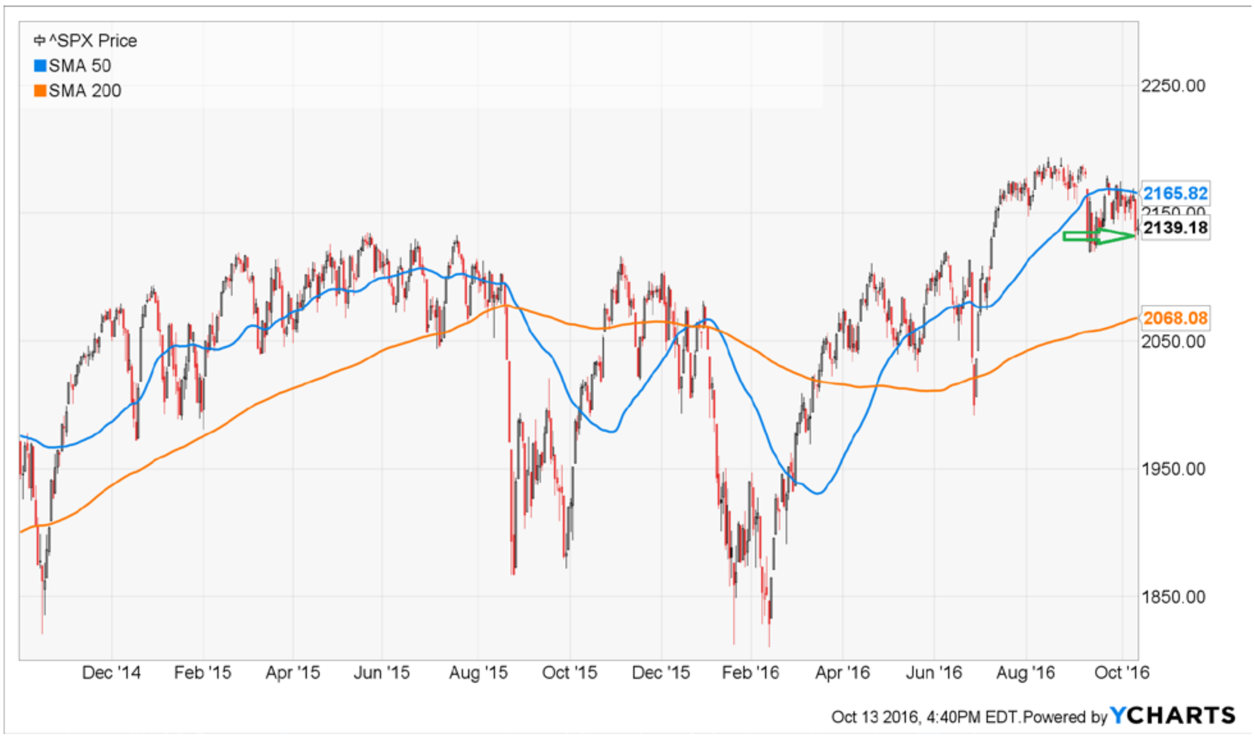
Market Update

October 13, 2016

Markets and the Election

Since my last Market update on September 13, the markets have not regained upward momentum. Many are calling for a further near term 5 to 10% move down from where we are today. The market broke below the 50 day moving average on the S&P 500 on September 9th, which was the day that we saw the markets first 1% downward move since Brexit in June. Since then, we have seen the S&P 500 move between 2120 and 2180. The 50 day moving average is around 2165 while the 200 day is around 2068. Until the S&P can break above the 50 day moving average and stay there for a few days, I see this market staying range bound at best and testing the resistance level of 2120.



Information in this chart above was taken from sources we believe to be reliable; however we do not guarantee its accuracy or completeness.

Before we discuss the election there are four other main themes responsible for the current sluggish markets.

1) A strengthening dollar
2) Rising interest rates
3) Movement out of REITs and Utilities
4) Earnings expected to be seasonally soft.

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All of these forces are linked. REITs and Utilities have seen larger downward movement then most other segments of the market. Both of these sectors tend to be interest rate sensitive because they are often used as a better place to find higher interest rates on investments when bond rates are low. As bond rates move back up, it is natural to see some repricing of these two segments of the market. However, this does not mean that these two areas should be removed from one's portfolio. Depending upon your specific investment profile, lightening up in these two areas or even slowly increasing the amount of shares you own of higher quality assets in these two sectors may be appropriate. Buying a little bit more in increments allows you to buy these sectors at cheaper prices than you may already own them. This is a strategy for investors who have long time horizons.

The Election:

It certainly is starting to look as if Hilary Clinton has the edge on becoming the President of the United States. A few areas that may benefit from her victory are anything related to infrastructure spending and potentially more spending on defense. A few areas that will likely see some headwinds from a Clinton Presidency are BioTech/Pharma and Financials as she has been very vocal about going after prescription drug prices and more regulation in the financial industry. Wall Street seems to like the prospects of a Clinton presidency a little bit more than Trump because the current rules they are all working with are not going to change very much, especially if the Republicans can retain the House and Senate. So a narrow victory from Clinton that signals not much change down ticket in elections seems to be the preferred election outcome for most of Wall Street. Further tax cuts for small businesses and people making under $250,000 a year may increase consumer spending. Larger corporations and wealthy people who may see their tax bill go up may invest less. That could lead to continued sluggishness in the employment recovery, which is slower than most would like, but certainly better than rising unemployment.

Should Donald Trump pull off a victory, which is looking less and less likely, things would be a little bit different. I do not see there being a long term panic sell off in the markets. There maybe a few days of increased volatility, but ultimately the markets will adjust to his economic policies and may even surprise to the upside as things become clearer. He, like Clinton, also wants to increase infrastructure spending and beef up the military, so those sectors should benefit as well under Trump. A lower corporate tax structure does allow for companies to potentially invest more in projects because these projects will have a higher real rate of return on the investments in them after tax. Will those projects create more jobs and further ignite the economy and markets? This is yet to be determined. It depends on if the projects require more labor, then technology that is designed to reduce labor. The immediate expensing of CapEx that he has proposed can also be very positive for business investment and growth. Lastly, allowing for a reduced corporate tax on repatriated profits from overseas has the potential to generate growth opportunities for companies, as they can keep more of their profits, bring the money back on shore and reinvest it the United States, with a more competitive corporate tax structure. There may be some issue with multinationals who get a lot of their profits from overseas however. If Trump is too aggressive in his policies on imports it could make it more difficult for our exports, if a trade war develops. Overall if he can thread the needle and renegotiate some of our trade deals as he suggests he can without having to be too hawkish on tariffs then it could be beneficial and give the markets a boost.

For the remainder of the year, we see the markets remaining soft for the month of October before recovering, staying positive and closing at all-time highs by year-end. Seasonally, Fourth Quarter tends to be one of the best times of the year for the stocks as holiday spending and year end window dressing for fund managers spurs buying activity in the stock market. Unless something very unforeseen should occur, I believe this pattern will repeat itself this year after the Election results come in.

What does this mean for you? We are looking at rebalancing portfolio's to make sure they are in-line with long term strategic asset allocations and we believe this is a good time to look at slowly putting new money to work, as we get some cheaper prices in the equities markets. Market timing is very difficult to predict in order to achieve consistent success. That said, we understand that cheaper prices are good times to buy, but we will not try and pick the bottom. Rather we believe in buying in slowly to capture better pricing.

If you have questions or would like to discuss this further with regard to your personal portfolio please contact me at 310-433-5378.

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