{PMFA} Special commentary

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EXECUTIVE SUMMARY

- *The 2016 election outcome surprised markets and defied polling expectations leading up to November 8, as Donald Trump won the electoral vote and will be the next President of the United States. Republicans lost a limited number of seats in Congress, but will maintain control of the Senate and House of Representatives, upsetting expectations for a divided government in which the two major parties share power.*
- *In light of the unexpected outcome, the capital markets reacted quickly last night as results increasingly pointed towards a Trump victory. Safe assets were favored over risk assets. The immediate reaction was sharp, but much of the move in the U.S. dollar, long-term Treasury yields, and equity futures reversed course by the opening bell this morning.*
- *Many are comparing the market's reaction to the aftermath of the Brexit vote, which triggered an immediate selloff in global equities, but was followed by a swift recovery in a matter of just days thereafter as investors absorbed the news.*
- *These types of unexpected events can create short-term volatility in capital markets, but it's critical for investors to maintain a long-term view and a clear picture of what they are trying to accomplish with their investment goals and objectives. While investors cannot control what the market will do – they can choose how to respond. For most investors, the right answer is to stay the course.*

BLOG

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PMFA SPECIAL MARKET COMMENTARY

Markets React to Unexpected Trump Victory

In a surprise to the political establishment, Donald Trump won the U.S. Presidential election despite trailing in most polls heading into yesterday. As a technical matter, the final results in several states were close enough that recounts may be required under state law or requested by the losing candidate. Nonetheless, if the preliminary results hold, Donald Trump has easily secured enough electoral votes to be the next President of the United States, though trailing in the popular vote.

Concurrent with the Trump victory, Republicans maintained control of the Senate and House of Representatives, although their majority narrowed modestly in both.

Markets React

As the early results began to increasingly point to an election that was going to be much closer than the polls indicated, the capital markets reacted. Equity futures and the U.S. dollar declined, while long-term Treasuries and gold rallied. International equity markets also reacted negatively to the incoming results.

However, as the immediate shock subsided, so did the market reaction. Equity futures bounced back (but remained in negative territory at the opening bell), the yield on the 10-year U.S. Treasury bond retraced its steps and edged higher, the dollar trimmed its immediate losses by more than half, and gold gave back part of its gains.

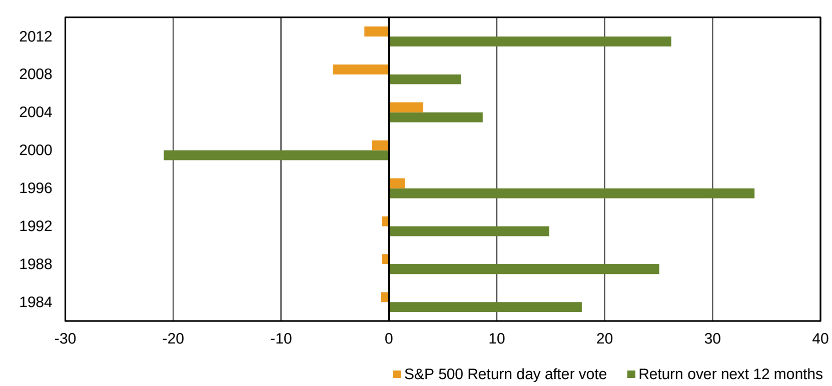
One big issue is the fact that a Trump victory was not the expected outcome, and markets hate surprises. Setting aside the respective policy differences of the two candidates, a Clinton victory – particularly if accompanied by the Republicans retaining control of Congress – was largely viewed as a continuation of the status quo. In addition, the markets have tended to be most sanguine with shared power between the two parties.

The best recent example of a political event accompanied by a market reaction of a similar nature was the surprise outcome of the Brexit vote, when a populist wave within Great Britain surprised everyone with a referendum vote to leave the Eurozone. That prompted an immediate – albeit brief – negative reaction in global equity markets. At the time, global equities sold off about 5% the following day before quickly stabilizing and recovering in a matter of days thereafter.

The history of Presidential elections also provides examples of similarly negative market responses in the immediate aftermath of the vote. Perhaps the best example is the surprise 1948 victory by Harry Truman that gave us the famous “Dewey defeats Truman” headline. That surprise outcome was immediately followed by a 3.8% decline in the Dow. Despite that kneejerk reaction, the market finished the year higher. In fact, it’s not uncommon for an initial selloff to occur in the aftermath of an election, yet stocks have generally been higher one year later, as illustrated below.

The fact of the matter is that the market is not necessarily recalibrating based on changes in expected economic growth or policy specifics, but the introduction of a degree of uncertainty and a change in the status quo. Setting aside the rhetoric that is part and parcel of any campaign, there are still many questions about the full scope of

S&P 500 Returns Post Elections



Source: Standard & Poor’s, PMFA

economic and tax policies that a Trump administration will propose. Moreover, the President Elect has indicated that he intends to work with both sides of the aisle in Congress to get things done. One particular area where there appears to be a high likelihood of an agreement being reached is on expanded infrastructure spending, which could provide a boost to economic growth. He has also spoken of renegotiating trade deals and implementing tax reform among other goals, but it will be some time before those fully take shape.

What does this mean for you?

For many, there are few things that generate stronger feelings than political matters. We cannot – and will not – attempt to discern the full impact of the election any more than we would had Secretary Clinton been elected. We acknowledge that the immediate reaction of capital markets has favored safe assets over risk assets, as they did with the unexpected outcome of the Brexit referendum earlier this year. Markets tend to react and recalibrate quickly to such surprises when they occur.

Conversely, we have seen markets often overreact to surprises. As the immediate impact of the unexpected result is absorbed by investors, markets have a tendency to calm as well. However, it is impossible to predict how long this heightened volatility may last. Every bout of market volatility is different. On the surface, this appears to have much in common with the Brexit vote. The event itself was a surprise to the market, and market reaction was immediate and sharp. Likewise, even as the full impact of the Brexit vote won't be known for some time, it could be several months or longer before President Elect Trump outlines more fully his policy initiatives, and even longer before Congress takes action. In the meantime, it seems likely that the surprise will pass, and markets will refocus on a host of other matters that will also influence market performance and volatility. Economic growth in the U.S. is showing evidence of perking up, labor market conditions remain positive, and corporate profitability is showing signs of improvement as oil prices have recovered and the stronger dollar trend has recently started to ebb.

Most investors have an opinion on the outcome of the election – either positive or negative. But long-term investors should recognize that even this uncertainty shouldn't change their long-term strategy. The periodic transition of power in the United States has been fundamental to our system of government for over two centuries. Elections have not always been pleasant, and the outcome hasn't always been as expected. Even then, our country has moved forward, and the economy and capital markets have as well.

As always, it's critical for an investor to have a clear picture of what they are trying to accomplish by defining their goals, understanding their tolerance for risk, return objectives, and investment time horizon, and implementing a well-devised plan that incorporates all of these. Over the course of time, there will be many surprises that arise that may be specific to the individual or have a much broader impact. The key is to understand how those surprises may impact one's financial plan, if at all. Market volatility may create the need to rebalance one's portfolio, or it might act as a reminder of the need to maintain adequate liquidity in cash. However, it's unlikely to materially change the picture or require changes to one's plan.

As always, we will continue to monitor developments in the coming days and months. In the near-term, we recommend that investors stay the course. As Americans, we have the right to vote. That allows us to join with our fellow citizens to express our voice and influence the direction of the country and the outcome of an election. The outcome is not something that you can control, but we adapt and move forward. Similarly, as investors, we cannot control what the market will do. We can, however, choose how to respond. For most investors, the right answer is to stay the course.