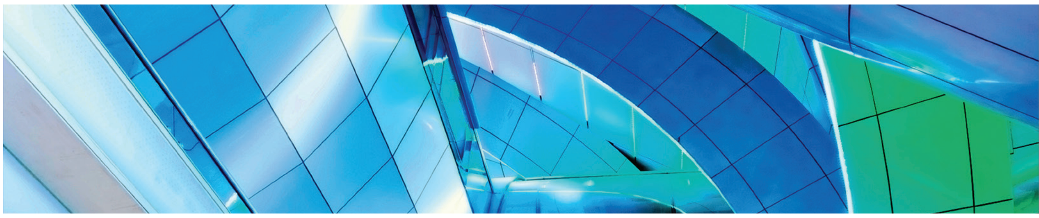

FOCUS

October 2016

PRIMER ON U.S. ELECTION CYCLES

HIGHLIGHTS

— Historically, the strength of the United States economy and the performance of its equity markets have been used to analyze potential outcomes ahead Election Day. While there are numerous predictive patterns that will be painstakingly reviewed, this year is proving to be too close to call.

— Whether Republican nominee Donald Trump or Democratic nominee Hillary Clinton become President, we can use history to take a brief look at how different sectors of the market tend to react.

— Regardless of the outcome, investors should be mindful of the possible scenarios facing them under either party, but remain committed to maintaining a long-term investment approach to meet their objectives.

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"U.S. Election 2016 : could this be another Brexit ?"

CAN WE PREDICT THE WINNER ?

Every four years in November, experts across all industries do their best to try and analyse historical data from which to predict the outcome of the U.S. Presidential Election. Some data proves that the parties switch every eight years which would lead the prediction for 2016 to sway in favour of the Republican candidate (notable exceptions include Roosevelt/Truman and Reagan/Bush). Others will analyse voting behaviour patterns like the weather on voting day.

STRENGTH OF THE ECONOMY OFTEN INDICATES WHETHER THE INCUMBENT PARTY WINS

During times of strength in the economy, history shows the incumbent party has remained in office. This can most likely be attributed to the fact that voters tend to favour the status-quo. In other words, voters embrace an “if it ain’t broke, don’t fix it” mentality.

Since 1900, the five years the U.S. economy has been in a recession at the time of an election, the incumbent party lost (Table 1). Notably, in 1968 the U.S. was not in a recession on election day but entered into a recession later in the month following the election. Using history as our guide and with recession risks low today, some may believe an incumbent party victory is favored.

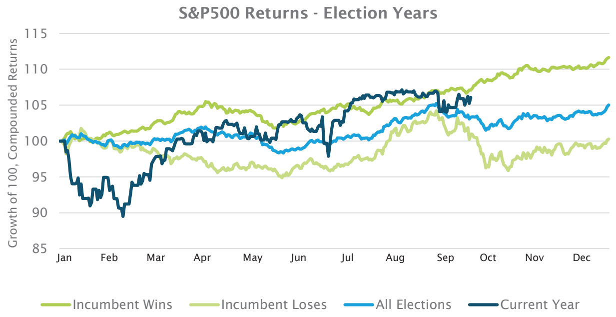
Similarly, U.S. equity markets can also be analysed in an attempt to predict both election results and short-term market tendencies following an election. In fact, looking at historical data, we can generally determine who the winner will be based on results of the S&P 500 Index in the final months leading up to an election. If the final three months leading up to the election are positive, the incumbent party usually stays in office.

Table 1 : U.S. Presidential Elections and Recessions

Election Year	In Recession at time of Election	Incumbent Party Win/Lose
1900	No	Win
1904	No	Win
1908	No	Win
1912	No	Lose
1916	No	Win
1920	Yes	Lose
1924	No	Win
1928	No	Win
1932	Yes	Lose
1936	No	Win
1940	No	Win
1944	No	Win
1948	Yes	Win
1952	No	Lose
1956	No	Win
1960	Yes	Lose
1964	No	Win
1968	No	Lose
1972	No	Win
1976	No	Lose
1980	No	Lose
1984	No	Win
1988	No	Win
1992	No	Lose
1996	No	Win
2000	No	Lose
2004	No	Win
2008	Yes	Lose
2012	No	Win
2016	No	????

Source : NBER

This year, however, the results are less clear. As of September 30, 2016, the S&P 500 Index is showing signs of an incumbent party victory returning 7.8% for the year. However, upon closer look, July and August were not nearly as strong returning 0.14% and 0.02%, respectively. In the remaining days ahead of the election, movement in either direction for the S&P 500 could signal the market pricing in a winner.



Source: Bloomberg

DEMOCRAT OR REPUBLICAN – DOES THE MARKET PLAY FAVORITES?

During an election year, investors are often heard asking how the outcome of the election will affect their investments. Drawing on previous elections, history shows that markets tend to favor, at least initially (Graph 1), the incumbent party keeping power after the election. One can assume that this is due to the certainty regarding policy that remains with an incumbent party victory. Should the incumbent Democratic party win this year, most likely the market will remain flat or rise slightly as investors tend to favor the status quo. Alternatively, if Donald Trump were to be elected, one could expect increased volatility in the market within the weeks following the election due to increased uncertainty among investors. There is the chance, increasingly so in this heated election year, should the incumbent win, poor stock market performance could follow. Most likely this would be the result of investors expressing their disdain with current policy and a dip in performance is the reaction to an election yielding more of the same.

U.S. EQUITIES PERFORMANCE DURING PRESIDENTIAL CYCLES

Which party is better for the stock market is a question without a clear answer. Overall, the S&P 500 has performed better during Democratic presidencies. However, investors should consider the volatility of the stock market within the presidential cycle when assessing which party the stock market favors.

Table 2: Market performance during an Election Cycle

	Year 1	Year 2	Year 3	Year 4 (Election Year)
# of up years	9	11	15	13
# of down years	7	6	2	3
Average return	6.5%	7.0%	16.4%	6.6%

Source: S&P 500 Index

The table below shows that years within the election cycle tend to vary as it relates to stock market performance (based on S&P 500 Index returns since 1950). The data shows that volatility tends to develop in the first year following an election, as the market digests change, then gradually increases to its peak in the second year of the cycle. According to The Presidential Election Cycle theory, developed by Yale Hirsch, markets tend to be weakest during the first year following a U.S. election and strongest in the third year of a presidency.

IMPACT OF PRESIDENTIAL POLICY ON U.S. EQUITY SECTORS

Unfortunately, there is no crystal ball to provide investors a preview into the next four years. As experienced investors implementing a long-term investment process, we tend to try and prepare our portfolios for either outcome. Below we take a look at a few key areas that will be affected by either or both parties this year.

HEALTH CARE

Clinton: A continuation of the Affordable Care Act (ACA) will be a boon to medical service providers and medical device providers. Conversely, pharmaceutical companies will likely be impacted negatively as Mrs. Clinton has called for increased regulation relating to drug prices.

Trump: Most likely a repeal of the ACA which would be to the detriment of hospitals and service providers benefiting from the ACA.

INFRASTRUCTURE

Both candidates have been vocal about making enhancements to U.S. infrastructure a priority. This would mean increased activity in public construction benefitting companies that have strong track records in this area.

ENVIRONMENTAL REGULATION

Clinton: Strong advocate in this area. Believes in the benefits of renewable energy sources and thus should be a boon for the clean energy sector, including solar and wind. Alternative energy stocks should react positively, while fossil fuel companies will likely have a headwind.

Trump: Opposes increased environmental regulation. This should be positive for the energy sector, specifically for manufacturers and refiners, including those companies tied to shale production and the coal industry.

MINIMUM WAGE

Both parties have expressed the need to raise the current USD 7.25 per hour minimum to at least USD 10.00 per hour with Clinton suggesting a higher near USD 12.00 target. Regardless of who wins, companies impacted will be those employing lower cost labor such as restaurants, hotels and retail.

Regardless of the outcome of the election, there will be stocks that can do well under the new President, and we will look to tilt the portfolio towards those names. Our combination of a top-down and bottom-up process lets us take macro forces, such as the political environment, into account when evaluating specific securities.