

Presidential Elections and Stocks

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John Blank

Zacks Investment Research



Boston led the way to independence. Boston, England that is.

And in the very topmost “Leave” vote regions, in the FT list, I see Great Yarmouth and North East Lincolnshire. In Boston, Massachusetts, Yarmouth is down at the base of Cape Cod, not far from Plymouth, where the pilgrims first landed. Lincoln, Massachusetts is now a part of greater Boston, and is a very posh place these days. Europeans first settled Lincoln in 1654 as part of Concord. The Red Sox play by Fenway Park. I notice Fenland, England was a topmost “Leaver” too.

The connections to the Boston, MA uprising in the 1770s is consistent with the ‘Leavers’ of 2016 in England itself. They left England long ago with their own unique way of governing and brought it to the North American colony of Massachusetts.

UKIP – United Kingdom Independence Party...the targets

Boston	75.6%
South Holland	73.6%
Castle Point	72.7%
Thurrock	72.3%
Great Yarmouth	71.5%
Fenland	71.4%
Mansfield	70.9%
Bolsover	70.8%
East Lindsey	70.7%
North East Lincolnshire	69.9%

Source: FT

It's unmistakable. Nigel Farage's UKIP knows its English history...

The Remain Story in the UK-1

Let's turn to the "Stay" area of England in 2016. Wow, here I find some biggest, proudest England names.

The two great English university towns of **Oxford** and **Cambridge** are in the "Stay" camp. I have been to Oxford, England but not Cambridge, England. Oxford is ancient and absolutely gorgeous. Yale in the U.S. state of Connecticut is sort of like Oxford in style, with its enclosed colleges.

Edinburgh, Scotland is one of the big "Stay" players in 2016. Edinburgh is the capital city of Scotland and one of its 32 local government council areas. Recognized as the capital of Scotland since at least the 15th century, Edinburgh is home to the Scottish Parliament and the seat of the monarchy in Scotland.

The Remain Story in the UK-2

The City of London itself is a big “Stay” player. The City of London is a city and county within London. It constituted most of London from its settlement by the Romans in the 1st century AD to the Middle Ages, but the metro agglomeration has since grown far beyond the City's borders. This is effectively where modern London's financial system was set up, though Canary Wharf is where the big modern banks are these days. Islington is a London borough. So too are Hackney and Haringey. Lambeth is a London borough in south London, England, which forms part of Inner London.

Gibraltar is the leading “Stay” player. Gibraltar is a British Overseas Territory on the south coast of Spain known for the Rock of Gibraltar, a 426-meter limestone ridge at its center. Gibraltar occupies 7 sq. km of a peninsula bordered to the north by the region of Andalusia. First settled by Moors in the Middle Ages and later ruled by Spain, the outpost was joined to Britain in 1713.

Importantly, Northern Ireland is also a big “Stay” player.

The Remain Areas of the UK

Oxford	29.7%
East Dunbartonshire	28.6%
Southwark	27.2%
Cambridge	26.2%
East Renfrewshire	25.7%
Edinburgh	25.6%
Camden	25.1%
Wandsworth	25%
Islington	24.8%
City of London	24.7%
Haringey	24.4%
Hackney	21.5%
Lambeth	21.4%
Gibraltar	4.1%

Source: FT

1. What insurgency campaigns like those of Donald Trump and Bernie Sanders mean to the election process?

- Trump and Sanders are dependent on support from younger voters and anti-establishment types who tend to turn up less reliably than the party faithful backing Clinton and the more traditional Republicans.
- *“It’s quite simple,”* said Sanders as he made a final rallying plea to volunteers at campaign headquarters in Des Moines before hitting the road for a weekend of frantic rallies.
- *“If the voter turnout is high, we’re going to win. If turnout is low, we are going to be struggling.”*

2. What insurgency campaigns like those of Donald Trump and Bernie Sanders mean to the election process?

- No matter how much you dislike Donald Trump and his effect on the Republican presidential primary race—and there are many, many good reasons to do so—

You have to spare a little grudging admiration for the sheer madcap genius of Trump's ability to disrupt, unsettle, and exploit the primary system.

– Air Force Fighter Pilot Dan McLaughlin

3. What insurgency campaigns like those of Donald Trump and Bernie Sanders mean to the election process?

- It has been my contention for the last few years that we are living in an Interregnum.
- The Italian philosopher, Gramsci defined the concept well: *"The old is dying and the new cannot be born; in this interregnum many morbid symptoms arise."*
- There is a sense of being trapped between a dying establishment and a new order that is not quite formed.

-- Jonathan Taplin, Director, USC Annenberg Innovation Lab

S&P 500 Operating Earnings Over the Last 25 Years, plus ZRS Forward Outlook (Source: ZRS)



Price Change	(%)	Diff SP5	Estimates	2015	2016	2017	Key Statistics		
Intraday	0.26%	0.00%	Mean Estimate	118.45	125.42	134.66	Revenue TTM (\$Mil)		
1 - Week	-2.25%	0.00%	Change Y/Y	5%	6%	7%	Market Value		
4 - Weeks	-6.97%	0.00%	High		128.00	140.97	Shares Out (Mil)		
QTD	-8.00%	0.00%	Low		124.00	130.00	20 Day Daily Vol. (Thou)	0	
YTD	-8.00%	0.00%	Total	5	5	3	20 Day Daily Vol. (\$)	0	
2015	-0.73%	0.00%	#Up (4 weeks)		0	0	Dividend Estimate (\$)		
2014	11.39%	0.00%	#Down (4 weeks)		3	2	Payout Rate	42%	
2013	29.60%	0.00%					Retention Rate	58%	
Last Rpt FYE	Dec-2014	EPS	113.02	PE Intraday	15.9	15.0	14.0	Indicated Dividend Yield	2.41%

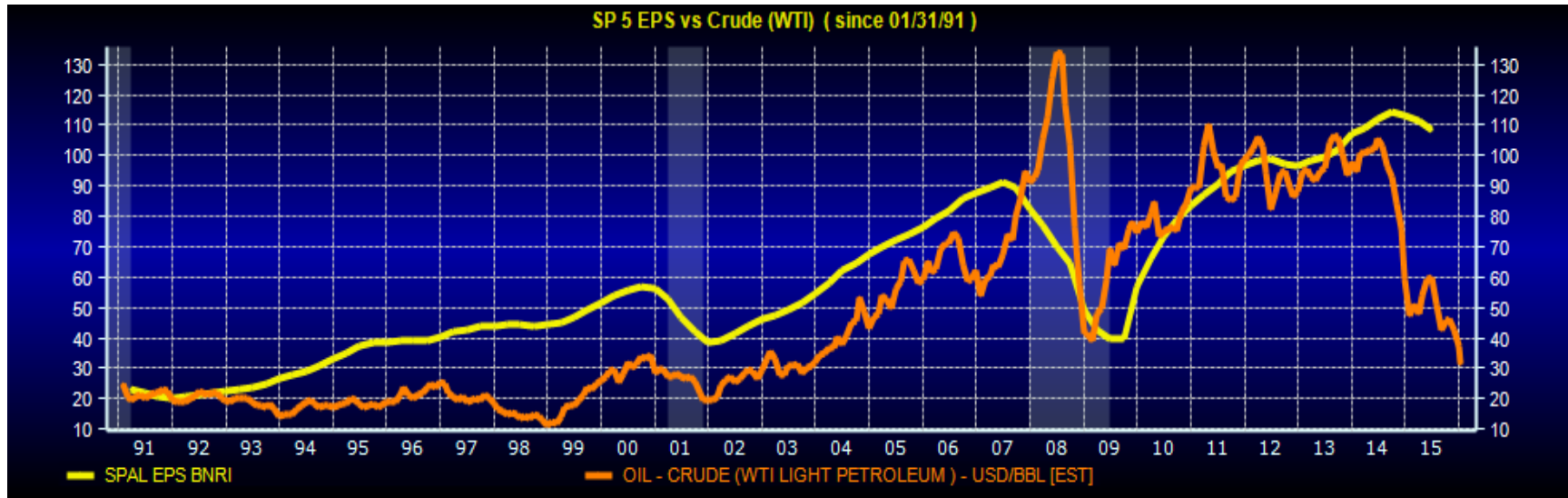
How stock markets typically perform in election years

- Let's bust one myth: namely, Republican presidents are better for stocks. It is not true. ***“In election cycles since World War II, the Dow Jones industrials have posted bigger average returns under Democratic presidents”*** -- Stock Trader's Almanac.
- In "Presidential Cycle," Ned Davis Research notes the S&P 500 posted its weakest returns in the first year of the four-year election cycle.

Since 1900, stocks have gained

- **+3.4% on average in the post-election year,**
 - **+4.0% in the midterm year,**
 - **+11.3% in the pre-election year and**
 - **+9.5% in an election year.**
- How about showing the S&P 500 index return for each election year since 1928? At a glance, you see that of the last 21 election years there have been only 3 years where the S&P 500 index had a negative return during an election year.

S&P 500 Operating Earnings over the past 25 years vs. WTI Oil prices (Source: ZRS)



Title	HI	LO	MD	CU	CR	AR	SD	ED
SPAL EPS BNRI	114.51	20.40	51.72	108.31	372.97%	6.52%	03-31-1991	06-30-2015
OIL - CRUDE (WTI LIGHT PETROLEUM) - USD/BBL [ES	133.93	11.31	32.12	31.42	24.68%	0.88%	01-31-1991	01-11-2016

1. Which sectors may benefit the most under a variety of primary and general campaign scenarios

- There are a few areas of the market that generally benefit no matter who gets elected, especially given the focus on middle classes voters. This means:
 - Infrastructure spending (A new kind?)
 - Health care, (Drug prices, Tax inversions, TPP Trade Pact)
 - Financial companies (Break up SIFIs? Glass-Steagall returns? A captive Treasury and SEC?) and
 - Defense spending (Less? More? Where?) could be all hot topics.
- Media companies are also likely to be impacted. A huge media spend will support the negative and positive rhetoric of candidates as they appeal to middle-class voters.

2. Which sectors may benefit the most under a variety of primary and general campaign scenarios

BNY Mellon (the home team): We are bullish on the US economy and the equity market longer term – although we do believe the election and the Fed's ultimate normalization of interest rates are likely to lead to considerable volatility over the next year.

Equity strategies that emphasize dividends look likely to offer advantages in this environment.

- The 2.2% yield of the S&P 500 is attractive relative to fixed income yields globally and dividends typically grow over time. With higher-yielding equities, the incremental yield is a cushion to returns in a flat or weaker market, while dividends are also a powerful driver of returns.
- With ageing populations in many developed economies, we believe demand for income will remain strong and that companies will respond with a growing stream of dividends.
- However, not all dividend strategies are created equal, and valuation matters.

Some high-yielding sectors that behave like bonds, such as utilities, are expensive, have limited earnings growth potential, and are susceptible to rising interest rates.

- If you go back and look at history, it is clear that the stock market as a whole does not do badly when rates rise. It is the bond proxies, like utilities, that frequently do not fare well.

On the other hand, we believe financials could offer good value.

- There is real skepticism about financial stocks (even those that do not have risk from negative political rhetoric), but they are in better shape than they have been for many years.
- Since the financial crisis, for example, banks have been making some of their best loans and have very strong capital levels. As the year progresses, we believe they will benefit.

3. Which sectors stand to benefit the most under a variety of primary and general campaign scenarios

Zacks Sector/Industry Calls FEB 2016

Info Tech got an upgrade to Very Attractive.

Semiconductors, followed by **Computer Software-Services**.

Consumer Discretionary got an upgrade to Very Attractive.

Publishing, Auto/Tires/Trucks, Leisure Products, Non-food Retail/Wholesale, and **Appliances** are Attractive.

Utilities got upgraded to Very Attractive. **Water Supply & Electricity** look good.

Health Care stayed Attractive.

Focus on **Medical Care**. **Medical Products** got a slight upgrade. **Drugs** stayed at Market Weight.

S&P 500 Earnings Yield 1995 to the Present (Source: ZRS)



How the pace of U.S. economic growth in the first half of 2016 might inform voter preferences

*We provide a test of **the impact of voters' political ideology on economic growth** and of the **role of preferences for government size as a transmission channel**. We focus on France from the beginning of its stable democratic experience in 1871.*

- A move of voters' ideology to the right increases economic growth over the total observation period. However, the growth effect of ideology is mediated by voters' preferences for government size only during the post-World War II period.
- For reverse causality concerns, we use the political ideology of other historical democracies as an instrument variable for France's ideology.

A solid empirical result is that voters reward governments for recent economic prosperity.

- New evidence that the electoral fate of governing parties is also associated with the electorate's wider 'subjective well-being'.
- Policymakers who want to win should focus on a broader range of factors that matter to the quality of people's lives.

10-Yr. Treasury (yellow) vs. S&P500 Equity Risk Premium (green) Over 25 Years (Source: ZRS)



What to expect in 2017 based on who wins in November 2016

How have stocks fared from Election Day to year's end?

Bespoke Investment Group says.

- When a Democrat wins, stocks have lost 1%.
- They rise +4% if a Republican wins.

As seen in data from 1945-2004, in the Pepperdine Graziadio Business Review, published in 2004.

- Three of 16 bear market lows occurred in year 1 of the presidential term,
- 12 in year two,
- One in year three, and
- None in year four (the election year).

Mutual Fund Flows

Equity (yellow) vs Bond/Hybrid (orange)

Jan 2013 – Jan 6, 2016 (Source: ZRS)

