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# GAME CHANGER

When the Chicago Cubs were down three games to one to the Cleveland Indians in the World Series, statistics expert Nate Silver wrote that the Cubs' chance of winning the Series were about the same at that time as Donald Trump's chance of winning the race for President. Silver wrote that he didn't mean that in a condescending way – he said he was trying to hit home for readers that Donald Trump had a real chance for victory.

As it turns out, they both did.

Big events that surprise many people almost always lead to higher volatility in the financial markets. The financial markets were surprised by Brexit (the British vote to leave the European Union) even though polls were tight on the outcome of that late-June vote. Global stocks dove 7% in two days and recovered all of that and more in the following three days. In the middle of the night after it became clear that Donald Trump had won the election, stock futures plunged 5% in a matter of hours. By the morning after the vote, U.S. stocks were close to breakeven and ended the day up 1.1%.

Such important and sudden changes can tempt investors, including professionals, to act quickly and make large changes to their investments. But a look back at the history of election surprises shows that overly quick reactions to such events often can go wrong for investors in a matter of days or months. Consider the following charts, showing the S&P 500 index of large U.S. stocks following changes from the incumbent party to its rival party since 1960:

| President-Elect | Congress | Market Performance (% price change in S&P 500 Index) | | | |
|---|---|---|---|---|---|
| | Senate / House | Election to Inaguration | % Change | One year around election | % Change |
| Kennedy (D) | D / D | 11/07/60 - 01/20/61 | 8.8% | 09/30/60 - 09/30/61 | 24.7% |
| Nixon (R) | D / D | 11/05/68 - 01/20/69 | (1.4%) | 09/30/68 - 09/30/69 | (7.0%) |
| Carter (D) | D / D | 11/02/76 - 01/20/77 | (0.1%) | 09/30/76 - 09/30/77 | (8.3%) |
| Reagan (R) | D / D | 11/04/80 - 01/20/81 | 2.0% | 09/30/80 - 09/30/81 | (7.4%) |
| Clinton (D) | D / D | 11/03/92 - 01/20/93 | 3.2% | 09/30/92 - 09/30/93 | 9.8% |
| G.W. Bush (R) | R / R | 11/07/00 - 01/20/01 | (6.2%) | 09/30/00 - 09/30/01 | (27.2%) |
| Obama (D) | Even / D | 11/04/08 - 01/20/09 | (19.9%) | 09/30/08 - 09/30/09 | 9.1% |
| Trump (R) | R / R | 11/08/16 - 11/09/16 | 1.1% | 09/30/16 - 11/09/16 | (0.7%) |

Nonetheless, we believe that some substantial changes are coming. President-elect Trump has made several of his priorities very clear, including changes to trade relations, the individual and corporate tax systems, the healthcare system, infrastructure spending, and energy policy. Some of the policies will find willing backers in the Republican-controlled Congress. Others may face some heavy "checks-and-balances" opposition even from Republicans in the House and Senate. Any of these changes could have significant impacts to different parts of the global financial markets.

Below is our brief look at each of those potential policy changes:

- Trade. As a candidate, President-elect Trump vowed to stop some trade deals, and be more aggressive in trade negotiations and relations with countries such as China and Mexico. While a full-on trade war would likely lead to high volatility and a roiling of world equity markets, expect to see both some moderation by the new President of his campaign promises and resistance from Congress to changes in trade policy deemed too aggressive. We expect that some trade policy changes will go through, and stocks of some multinationals and non-U.S. export-oriented firms could come under pressure.

- Tax code changes. Plans to simplify the corporate tax code and sharply reduce the top tax rate on companies likely will be a top agenda item for the new administration. Further, members of both parties have been complaining for decades about the complex tax code for individuals. Expect changes on both fronts, possibly with some bipartisan support for such changes, though what form these take is difficult to know at this stage.

- Healthcare. As a candidate, Hillary Clinton vowed to address the high price of pharmaceuticals and to maintain and build on Obamacare. With her loss, biotech and pharmaceutical stocks jumped the day after the election. On the other hand, hospital companies that benefitted from more thorough payments for all patients under Obamacare dropped sharply. At this point, we have not seen Donald Trump's specific plan to repeal or replace Obamacare, but we expect changes on that front.

- Infrastructure and military spending. Military spending had been slipping during President Obama's two terms in office. Expect military spending increases under President Trump, a positive for aerospace and defense companies and their suppliers. In addition, and in a departure from at least part of the Republican Party, Candidate Trump spoke frequently about increasing spending on roads, bridges and other infrastructure.

- Energy policy. Expect reduced regulation of energy companies, allowing for ongoing development of U.S. oil and gas fields. The outcome of that move is unclear because more supply would put pressure on oil and gas prices, pinching energy company profit margins.

In addition to the policy items noted above, the regime change in the U.S. could have some effects on both long-term and short-term interest rates. Economists see a combination of tax cuts and increased spending as being inflationary. While equity markets were higher the day after the election, bond prices fell, and the yield on U.S. Treasury bonds rose. An important near-term catalyst for rates will be the Federal Reserve meeting in early December.

The bottom line is that while a new President can and likely will make some substantial policy changes, the underlying growth of the U.S. economy is good relative to the rest of the world. And it could take years for new policies to start to have a substantive effect on overall economic growth. While there is work to be done in every investor's portfolio, the underlying themes of long-term investments in the stock markets combined with careful and regular reviews of asset allocation plans continue to be the keys to financial success. In a final nod to the victorious Cubs and their wunderkind general manager Theo Epstein, think of it as financial *Moneyball*.

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