NOVEMBER 10, 2016

Post Election—We Maintain Our Balanced View

Surprised by the U.S. Presidential election outcome, with a Clinton victory priced into many asset classes on election eve, global capital markets are repositioning themselves in the wake of Donald Trump's unexpected win.

Before getting into specifics of "what's next", it is worth remembering the following: while the occupant of the White House is considered one of the most powerful humans in the world, let alone the United States, the position comes with many checks and balances. As such, national power in the United States is relatively diffused across the executive, congress and the judiciary, and further dispersed across state and local governments. This makes it very difficult for one person—the President—to single-handedly dictate the future path of the country.

That said, and in a nutshell, here is what we believe investors can expect over the near and medium-term as we weigh the balance between the potential for higher growth through fiscal stimulus measures and higher yields/rates and elevated uncertainty around global trade:

Short-term market environment:

- Increased volatility given the upswing in uncertainty
- Asset repositioning most likely to occur in the next couple of weeks as investors re-assess risk tolerances
- Dollar strength versus Emerging Market (EM) currencies but stable to the Yen and Euro
- Longer-dated yields up and curves to steepen
- EM assets most vulnerable given the trade uncertainty
- Subtle increase in high quality exposure in equities
- Healthcare and Biotechs to rally as pressure is released
- Yield-proxies in equities continue to be vulnerable as yields rise

Medium-term:

- Asset reflation continues as curve steepens
- Pro-cyclical winds continue to blow as the mid-cycle slowdown fades
- Higher probability of fiscal action and pro U.S. growth policies
- Potential for corporate tax reform and infrastructure policy stimulus
- Consumer spending remains firm off of continued job growth
- Expect the business cycle to extend well into 2018
- Still slow growth but upside for improved growth with fiscal reform
- Wage inflation and inflation generally higher in 2017
- Fed hike probability in December has dropped but still see an increase at the next meeting and general patience over the next twelve months
- Growth in the next quarter or two could be lower as capex crunch extends given the short-term rise in uncertainty

Asset Allocation:

- Volatile swings in the next few weeks as market repositioning occurs
- Investors over-exposed to low volatility equities and longer dated bonds. These areas are still vulnerable.
- Market swings should be expected. Any S&P 500 material downside in the world represents a buying opportunity given the pre-election view that growth was slowly improving.
- Position for cyclical rebound heading into 2017 as late cycle unfolds.
- Remain balanced and risk neutral with a slight overweight to equities
- Favor U.S. high quality large caps and EM growth assets over twelve months

- Increased risk is on longer dated bonds as yields rise still underweight
- Dollar range bound but stronger versus EM currencies
- Steeper curve to benefit financials
- Technology, defense and infrastructure beneficiaries favored
- Healthcare and Biotechs should undergo relief rally as both become very oversold
- Have rebalancing plans ready each quarter as asset class and sub-asset class swings occur
- Valuation still fair to a slight premium in equities so potential still in the mid to high single digit area over twelve months

Concerns:

- Future trade policy
- Geopolitical risk
- Potential Fed chair change in 2018
- Potentially more hawkish Fed as inflation gathers momentum
- Further capital expenditure pull-back heading into 2017 as business uncertainty looms
- Potential for rising budget deficit and debt.
- Potential for margin pressure as yields rise

Political changes past and present

The negative reaction of global markets in the immediate aftermath of the election result mirrors the response from investors to similar political surprises around the world over the past 18 months, notably the Brexit vote this past June. It has been typical for equity markets to sell off after these events, only to recover their losses over following weeks/months.

Looking back over recent U.S. presidential elections, a similar pattern has been evident. In the trading day after the past 10 elections, the S&P500 has posted losses on seven occasions, but was higher after six months on four of these and was higher after 12 months on five. In total, six of the last 10 elections have been followed by a higher market after six months, and seven have been followed by a higher market after 12 months (see chart 1).

Furthermore, the newly elected configuration of the legislature and executive branches has historically been positive for stocks. In the post-war period, Republican control of the White House, House and Senate has produced higher average returns than any other combination (see chart 2), though we would caution that this has only applied to six out of the past 70 years and typically under more conventional election cycles than the one we have just witnessed. We would not suggest

Chart 1: S&P 500 returns and Presidential election

Price return following election day (last 10 elections)

Election	President	+1 day	+6 months	+12 months
1976	Carter	-1.1%	-2.9%	-12.0%
1980	Reagan	1.8%	-0.5%	-3.3%
1984	Reagan	-0.7%	6.4%	13.1%
1988	Bush	-0.7%	12.0%	22.9%
1992	Clinton	-0.7%	6.1%	10.3%
1996	Clinton	1.5%	14.6%	32.0%
2000	Bush	-1.6%	-10.3%	-22.1%
2004	Bush	1.1%	1.7%	7.4%
2008	Obama	-5.3%	-4.8%	4.1%
2012	Obama	-2.4%	16.0%	24.0%

Source: Bloomberg, U.S. Trust, Bank of America Private Wealth Management. Data as of 2016

Chart 2: White House/Congress makeup and average market returns

Government Configuration*		S&P500 total return*		
President/House/ Senate	Number of years	Average	Maximum	Minimum
DDD	22	14.8%	36.3%	-10.0%
RRR	**6**	**18.6%**	**52.3%**	**-0.9%**
DRR	8	16.3%	37.6%	-9.1%
DRD	4	16.1%	32.4%	2.1%
RRD	2	-17.0%	-11.9%	-22.1%
RDD	22	8.6%	43.1%	-37.0%
RDR	6	16.0%	31.7%	-4.9%

Source: Bloomberg. U.S. Trust, Bank of America Private Wealth Management. Data as of 2015. *For election cycles from 1945 to 2015.

this should be expected this time around given so much uncertainty but rather this is a point of reference.

Getting back to basics

While we acknowledge the magnitude of the surprise result and fully expect risk assets to remain in a see-saw pattern in the near term, our central case remains for the market to continue its uptrend in the next twelve months as the business cycle moves forward. As we have consistently emphasized, the economic expansion (though now more than seven years old) does not appear to be extended and we still expect a cyclical improvement in 2017. This matters a great deal for investors because economic expansions typically go hand in hand with rising markets, and markets tend to rise on a trend basis until recession is around the corner. And though the Federal Reserve may yet proceed with an interest rate hike next month, a pause cannot be ruled out (as we saw after the Brexit vote) should uncertainty and market volatility persist over the next few weeks. This would further support the case for a prolonged economic cycle.

Given the relatively high current market multiple, the outlook for corporate earnings will also remain critical in the election aftermath. And this too appears to be improving. Around 90% of the S&P500 has now reported earnings for Q3 and the earnings recession that began last year now appears to have ended, with year-on-year EPS growth for the broad index turning positive for the first time in five quarters. The improvement in the earnings picture has been driven in large part by a less negative contribution from the energy and materials sectors as resource prices have recovered. And it has also been helped by the lower drag from foreign-sourced revenues as the dollar has stabilized. This return to positive earnings growth should persist as we move into next year. On current consensus projections, the S&P500 is expected to deliver fourth quarter earnings growth in the mid-single digits. And full-year earnings growth for 2017 is currently expected to register over 12%, led by a continuing rebound in energy and materials. EPS growth of close to or in the double-digits is also expected in technology, financials and healthcare and this fundamental support should help the broad market to continue its advance (even if consensus forecast is lowered).

A number of areas will nonetheless bear close watching as the incoming administration outlines its policy priorities over the months ahead. The three main themes of the Republican campaign were increased fiscal support from lower taxes and more domestic spending, greater restrictions on international trade and less regulation in areas such as healthcare, energy and banking. Should it be implemented, this policy mix would have a range of likely implications—both potentially positive and negative—for the economy overall and for individual sectors. Cuts to income and corporate tax rates combined with an increase in infrastructure spending should be tailwinds for economic growth, but could see Treasury yields continue to break higher on budget and inflation risk as they have already begun to do in the wake of the result. Concerns are also likely

to increase over protectionism, which should remain a weight on the exchange rates of close U.S. trading partners such as Mexico and Canada. And on a sector basis, oil, gas and coal are likely to be supported by looser environmental regulations; healthcare (outside providers) is likely to benefit from the possibility of fewer controls on drug prices; while banks should benefit from a near-term steepening of the yield curve. We summarize the likely sector implications below (see chart 3).

Chart 3: Election 2016—likely sector implications

Sector	Implications of Republican policy agenda
Healthcare	Repeal of Affordable Care Act positive for device makers, negative for providers. Allowance for insurance plan purchases across state lines negative for insurers.
Energy	Promotion of traditional energy sources, including use of federal lands, and looser environmental regulations supportive for coal, oil and gas.
Financials	Banks potentially helped by easing of some Dodd-Frank regulations.
Technology	Earnings repatriation holiday at 10% tax rate could boost investment, share buybacks or dividend payouts.
Consumer Discretionary	Tax cuts across income brackets to boost disposable income and consumer spending.
Consumer Staples	Tax cuts across income brackets to boost disposable income and consumer spending. Potential for more trade restrictions a risk for staples firms dependent on imports.
REITs	Lower tax rates a support for retail and residential REITs. Reduced provider volumes a headwind for healthcare REITs.
Industrials	Pledged increase in infrastructure spending a tailwind for industrial machinery, engineering and construction. Support for fossil fuel industry to boost railroads. Pledge to end sequestration, grow navy, air force and marine corps to support listed contractors. Focus on boosting cyber offense capability.
Materials	Construction material manufacturers to benefit from more infrastructure spending.
Telecoms	Looser FCC rules on content delivery a relative support for internet service providers.
Utilities	Less stringent regulation on carbon emissions a relative tailwind for traditional utilities.

Source: U.S. Trust, Bank of America Private Wealth Management. Data as of 2016. Based on official campaign websites.

Conclusion

Prior to the election, we had a balanced and diversified view across all asset classes with a recent switch to emphasize a more pro-cyclical stance as we are seeing a move toward a late cycle phase. Post election, we maintain this stance and expect a slow pickup in growth and therefore we favor both U.S. Large Caps and Emerging Markets. We continue to believe high wage growth and a pickup in inflation should place upward pressure on yields which puts pressure on longer dated fixed income, which we are de-emphasizing. We expect the pro-growth wind to blow in the coming months but with multiples at elevated levels. Equity indices are not likely to get too far ahead of themselves early in 2017. Continue to focus on rebalancing portfolios toward a diversified balance during weaker than normal periods given our view that the business cycle can be extended through next year.

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