What Will the 2016 Elections Mean for Investors?

NUVEEN ASSET MANAGEMENT

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THE 2016 ELECTION SEASON FEELS ENDLESS. Hillary Clinton has essentially been running for president since the 2008 elections and it's been well over a year since Donald Trump made his fateful journey down the Trump Tower escalator to announce his candidacy. Yet, it will all be over in a couple of months. As the transition of power begins, investors will question what the results mean for the markets. In the following pages, we discuss key ideas for investors to consider and offer thoughts for what might happen next.

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How Much Will the Elections Matter?

Predicting how financial markets may react to this election can be tricky. While political and legislative actions can certainly affect market performance, market fundamentals have historically proved to be far more important. We believe that asset allocation, valuations, earnings and the other determinants of performance have far more effect on an investor's portfolio than election outcomes. With that in mind, we can make observations and suggest possible consequences.

Emotions Shift from Hope to Anger

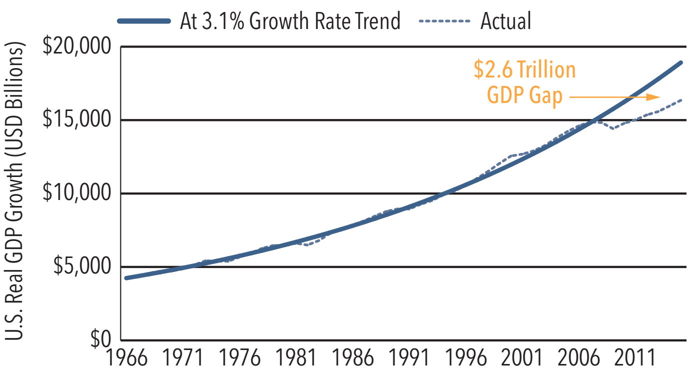
The consensus is that this election may be more significant than others due to the unusual and uncertain political backdrop. Donald Trump is anything but a traditional candidate, and his unexpected nomination complicates political forecasting.

In retrospect, Trump's political ascent shouldn't be so surprising. He successfully captured the mood of a large segment of the American population. The 2008 election of Barack Obama focused on hope in the face of economic catastrophe. In contrast, the 2016 election centers on anger.

Both Trump's rise and the surprisingly strong insurgent candidacy of Bernie Sanders were fueled by anger: Anger at the establishment, anger at corruption (or, in the words of both, anger at a "rigged system") and anger over a stagnant economy.

In many ways, this anger is completely understandable. Both Trump and Sanders were able to tap into a sense of frustration among many Americans. They spoke of and to people who were unable to find well-paying jobs and to those who haven't seen a raise in years. And, in fact, the American economy has stagnated in recent years and has not fully recovered from the Great Recession. As shown in Exhibit 1, U.S. real gross domestic product (GDP) growth averaged 3.1% from the 1960s until the Great Recession. The sharp recession and ensuing slow recovery caused a $2.6 trillion gap compared to the continuing 3.1% trend. That disparity represents many new jobs and salary increases that might have existed today.

Exhibit 1: Economic Frustrations Are High as GDP Growth Has Slowed



Data source: Strategas Research Partners. **Past performance is no guarantee of future results.** Used with permission. GDP: Gross Domestic Product

Anger Changes the Political Landscape

This anger has caused fundamental shifts in the political landscape. During the Democratic primaries, Hillary Clinton was forced to move closer to Bernie Sanders' positions on issues such as trade and financial reform. And Donald Trump has consistently advocated a protectionist approach. As a result, neither candidate favors the pro-trade, pro-globalization positions that until recently were relatively core aspects of the Democratic and Republican positions.

This increases the economic and financial uncertainty of the post-2016 election. Would President Trump engage in trade wars? Would President Clinton completely abandon the Trans-Pacific Partnership? It is difficult to determine what is political posturing versus real proposals, but the country appears to be growing more protectionist.

How might this shift affect the economy or financial markets? A fact that is often lost during presidential campaigns is that no matter who gets elected, the president will need to work with Congress to enact new legislation and make or change trade deals. While the Senate might change hands, the House of Representatives appears comfortably under Republican control. We think it is unlikely that a Republican House will move significantly on trade legislation, regardless of who gets elected president. Put another way, the GOP House would likely act as a break on attempts to radically overhaul trade policy.

Election Forecasts and Predictions

One of our Ten Predictions for 2016 forecasts that Republicans will win the White House and retain control of Congress. When we made this prediction in January, we had no idea Donald Trump would be the Republican nominee. At this point, polls and betting markets are against Trump, suggesting we will get at least half of this prediction wrong.

While the House is unlikely to change control, Senate leadership could shift from Republican to Democrat. The GOP has 24 seats up for grabs, the Democrats only 10. Since the Vice President breaks Senate ties, Democrats need a net gain of only four seats (if Clinton wins) or five seats (if Trump wins) to assume control of the Senate. This seems highly possible.

With that backdrop, we provide our current odds for various outcomes:

Democrats Cheer. *Clinton wins and Democrats retake the Senate (50% chance).* Such an outcome would cause significant changes. Against President Clinton and a Democratic Senate, the Republican House would probably face pressure to pass tax reform legislation and we would very likely see an increase in the federal minimum wage. In such a scenario, Democrats would likely have gained seats in the House, which would boost the likelihood of any changes.

Status Quo Continues. *Clinton wins and Republicans control Congress (25% chance).* A continuation of the current gridlock would probably mean less emphasis on trade issues and reduce the chances of tax reform.

Either "Clinton wins" scenario would create a more certain political environment. Regardless of people's opinions about Hillary Clinton, her economic policies are transparent and offer a measure of certainty. Donald Trump's statements have been vague and inconsistent. Since financial markets tend to prefer clarity, we think equity markets would prefer a Clinton victory.

The GOP Sweeps. *Trump wins and Republicans control Congress (25% chance).* This represents the "wildcard" scenario, since Trump's policies and actions are very unclear. His signature issues of immigration and trade would be prominent, and comprehensive corporate tax reform would be more likely.

It is uncertain how well President Trump and a Republican Congress would work together. Would President Trump sign a GOP-authored entitlement reform bill? Would Speaker Paul Ryan work to pass a law that overturns NAFTA? Such questions are entirely unclear.

Key Issues and Sectors Warrant Watching

With those possibilities in mind, we think these key policy questions will affect the economy and financial markets:

Fiscal stimulus. The era of the sequester and fiscal austerity is clearly over. Federal spending has climbed in 2016 and will likely continue. Regardless of who wins the presidency or controls Congress, we expect a significant new spending bill that emphasizes infrastructure to be passed within the first 100 days of the new administration. This could provide a short-term economic boost and benefit industrial and materials market segments.

Corporate tax reform. How will the government pay for this spending? Perhaps through much-needed tax reform that addresses the issue of repatriated earnings. U.S. multinational companies want to bring their overseas profits home, and the government is eager to tax those profits. Many thorny issues remain, including determining specific tax rates and possible restrictions on the use of profits (e.g., companies may benefit from more favorable tax treatment if they fund investment or launch hiring plans). The odds of reform are probably higher in a Trump administration than under Hillary Clinton.

Trade policy. This key wildcard is very difficult to forecast. We believe trade restrictions and a more protectionist approach would be negatives for the U.S. and global economies. Simply put, more free trade leads to a healthier economy. Investors should understand the risks of more restrictive trade practices.

Exhibit 2: How Key Sectors May Be Affected

Sector/ Industry	President Hillary Clinton	President Donald Trump
Energy	Favorable for alternative energy-oriented companies	Oil and gas companies would likely benefit from increases in production and exploration
Health Care	Managed health care companies and hospitals would benefit as the Affordable Care Act (ACA) would likely remain largely intact	Insurance companies would likely benefit if the ACA is repealed, although it is unknown how it would be replaced
Financial Services	More stringent banking regulations would likely result, especially if Democrats control the Senate	Trump has discussed banking reform, but a GOP Congress would not likely prioritize this issue
Infrastructure	Construction and heavy industry companies would gain from more infrastructure spending, which both candidates have promised	

Elections and Stock Market Cycles

Elections matter for equity markets, but they are less important than the state of the economy, the direction of corporate earnings, valuation levels and stock price fundamentals. That said, investors should understand the historical market trends surrounding election cycles.

Equity markets have predicted with surprisingly accuracy who will win the presidency. A solid correlation exists between strong markets and the incumbent party retaining the presidency. In fact, the three-month performance of the S&P 500 Index in the run-up to the election correctly predicted the winner in 19 of the 22 elections since 1928, as seen in Exhibit 3.

What should we expect this year? Three months before the election, the S&P 500 Index closed at 2,183. Markets have been relatively quiet recently, but stocks have drifted higher since the post-Brexit fallout at the end of June. If that trend holds, it could forecast a Clinton victory. If markets stumble, it could favor Trump.

Exhibit 3: A Strong Market Could Suggest a Clinton Victory

S&P 500 Index Performance Three-Months Prior to Elections

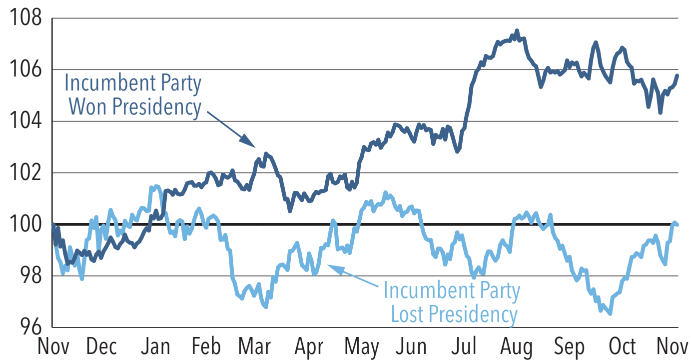
Year	S&P 500 Price Return	Incumbent Party		Year	S&P 500 Price Return	Incumbent Party	
1928	14.91%	Won	✓	1972	6.91%	Won	✓
1932	-2.56%	Lost	✓	1976	-0.09%	Lost	✓
1936	7.92%	Won	✓	1980	6.73%	Lost	×
1940	8.56%	Won	✓	1984	4.80%	Won	✓
1944	2.29%	Won	✓	1988	1.91%	Won	✓
1948	5.36%	Won	✓	1992	-1.22%	Lost	✓
1952	-3.26%	Lost	✓	1996	8.17%	Won	✓
1956	-2.58%	Won	×	2000	-3.21%	Lost	✓
1960	-0.74%	Lost	✓	2004	2.16%	Won	✓
1964	2.63%	Won	✓	2008	-19.48%	Lost	✓
1968	6.45%	Lost	×	2012	2.48%	Won	✓

Data source: Strategas Research Partners. **Past performance is no guarantee of future results.** Used with permission.

A similar post-election trend shows that when the incumbent party retains the White House, stock prices tend to move higher over the next year. In contrast, a change in control resulted in a more uneven, sideways market.

Exhibit 4: Markets Tend to Prefer Consistency

S&P 500 Index Performance in the Year Following Elections (1936 – 2003)



Data source: Strategas Research Partners. **Past performance is no guarantee of future results.** Data reflects the one-year performance of the S&P 500 Index following presidential elections, indexed to 100. Used with permission

It's impossible to explain these trends with any certainty, but we believe they reflect a theme mentioned earlier: Equity markets dislike uncertainty and seek consistency.

The Post-Election Environment

The nature of this election is particularly unusual. Hillary Clinton and Donald Trump are historically unpopular. Voting appears fueled more by anger and voting against Clinton or Trump than by genuine enthusiasm for either candidate.

This is in part why third-party candidates have gained more traction than usual. If current polling holds, Libertarian Gary Johnson will receive more votes than any third-party candidate since Ross Perot, while Green Party candidate Jill Stein will win a few percentage points of the popular vote.

It seems almost certain that Clinton or Trump will win with a plurality rather than a majority, which could imply she or he lacks a mandate. This, combined with their unpopularity, will likely eliminate the traditional "honeymoon" period enjoyed by past presidents and could limit the ability to enact proposals quickly.

Similarly, we may see fragmentation in one or both parties. Will the more progressive, Bernie Sanders Democrats push the party leftward or refuse to cooperate with more moderate elements of their own party? And Republicans understand that the old Reagan coalition of social conservatives, foreign policy hawks, working class and pro-business voters no longer exists. The unclear future of both parties will most likely contribute to a messy and confused political environment for years to come.

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Prior to joining Nuveen Asset Management, Bob held similar roles at other large asset management firms, including serving as chief equity strategist at Blackrock, president and chief investment officer of Merrill Lynch Investment Managers and chief investment officer of Oppenheimer Funds, Inc. He has 36 years of portfolio management experience, received a B.S. in accounting and a B.A. in economics from Lehigh University and an M.B.A. from the Wharton School of the University of Pennsylvania. He is a Certified Public Accountant and holds the Chartered Financial Analyst designation from the CFA Institute.

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For more information, please consult with your financial advisor and visit nuveen.com.

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