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Mid-Term Election Update

As the mid-term election season comes to an end and we move forward after a volatile October, I'd like to share some thoughts on the outcome of the mid-term elections and the implications for investment returns in the months ahead.

- Democracy is the big winner this mid-term election as voters came out in record numbers to cast ballots around the country in local and statewide elections. More than 113 million votes were cast this mid-term season which was up by approximately 39% from the last mid-term election. I believe that this was important for the U.S. to remind the world that democracy, with its periods of incivility and apparent disarray, continues to work. Investors large and small can remain confident in the stability and continuity of our country, no matter who occupies the oval office.

- The consensus that the Democrats would re-take the House and Republicans would maintain control of the Senate turned out to be accurate. Back in June, an NPR/PBS NewsHour/Marist poll indicated that this mid-term could have been a "blue wave" of heavy losses for the party in power with the potential to deliver the House *and* the Senate to Democrats. However, as Republican enthusiasm gradually rose, the margin shrunk to only 3% as of the weekend prior to the election, making the outcome too close to call. In the end, Republicans lost 26 seats in the House to Democrats, ceding control to the Democrats, while Republicans took three seats in the Senate, retaining control there.

- From the standpoint of the financial markets, this outcome is the best for investors. For equities, there is very little chance that the corporate or individual tax rates will be repealed; however, as the debt ceiling becomes an issue next year, there is a possibility that the corporate rate could rise as part of a broader negotiation with Democrats. Additional individual tax cuts are unlikely which should keep government bond issuance within range to fund current deficits. Bond yields will move higher if the economy continues to grow and the Federal Reserve continues to raise interest rates.

- While there are not a lot of places where there is common ground between the parties, trade has to be resolved. The administration has already struck a new NAFTA deal, but that will have to be approved by Congress. Given the benefits to the U.S. Auto industry and for American job growth, I believe there is common ground for eventual ratification of a trade deal. Turning to China, negotiations ground to a halt ahead of the election, as Chinese leadership waited to see its outcome. Those negotiations will restart very soon.

- The mid-term election cycle has ended and the President has started his re-election campaign. He and his administration are going to do everything they can to keep the economy growing, which could translate into further stock gains. Historically, returns for the S&P 500® in the 12 months following mid-term elections are quite good, averaging 15.3% since 1950, according to Strategas Research Partners.

- From a sector perspective, I believe that Healthcare is the biggest winner from the election results. With Democratic control of the House, the Affordable Care Act, as well as the National Institute of Health (NIH), will likely see further funding growth. Additionally, several states passed ballot initiatives supporting further Medicaid expansion. However, large cap pharmaceutical companies may be a common target for the President and Democrats, which could limit their drug pricing power and affect profitability. Another sector that could benefit is Industrials, particularly those companies within the sector that are building out U.S. energy infrastructure and companies that are rebuilding aging roads and bridges. Further, Financials, most notably Money Centers and Regional Banks, will benefit from continued regulatory relief.

The Presidential re-election cycle is underway and is typically a good period for equity investors. The recent October sell-off was driven predominantly by the uncertain outcome of the mid-term elections and its potential effect on trade negotiations with China. Those questions were mostly answered and the potential for the post-October rally to continue through the end of the year has greatly improved. The President will be attending the G20 Summit where he will meet with President Xi Jinping of China. While a deal will not be reached at that meeting, a framework for an agreement is possible and will have a big impact on business confidence and capital investment.

Democrats, Republicans, and the President are all claiming victory. While this may be true, it is clear that we are entering a legislative period of gridlock and the markets are responding favorably.

Dan Veru, Chief Investment Officer