NOVEMBER 2018

SPECIAL BULLETIN: THE 2018 MIDTERM ELECTIONS

In today's fast paced and high-tech world, 24/7 media coverage is available quite literally at your fingertips. For anyone with social media, it should be no surprise that voter interest in the midterm elections have surged to record highs within both parties. Currently, the House of Representatives, Senate, and presidency are all within Republican control. However, with all 435 seats in the House of Representatives and 35 of 100 Senate seats up for grabs this year, Congress could (and polls show may) change control. After a year of further economic gains and strong equity market performance, the midterms are being scrutinized for the potential impact that they may have on fiscal policy and the economy. Let's take a look at what the midterms may mean for the markets (politics aside).

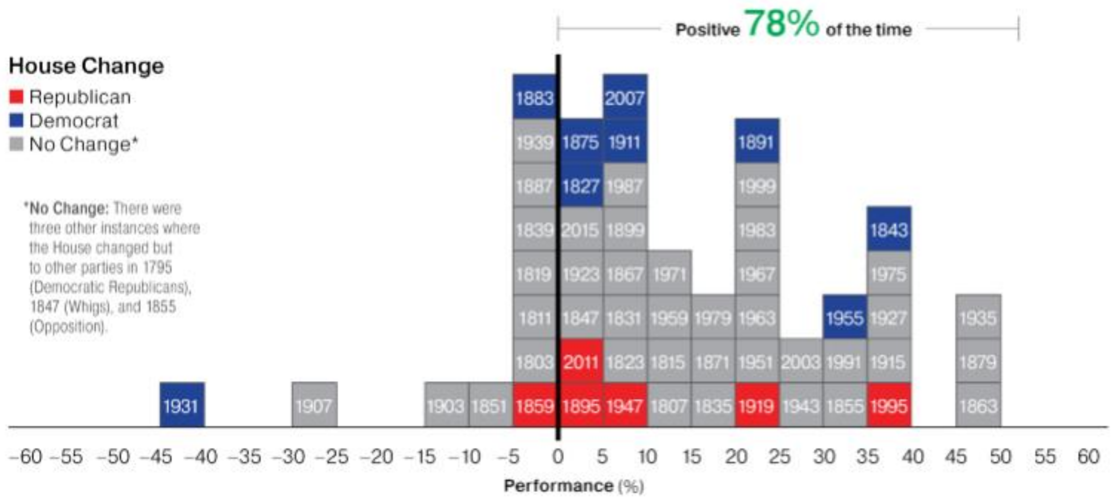
MIDTERMS GENERALLY BODE WELL FOR THE STOCK MARKET, REGARDLESS OF THE OUTCOME….

When looking at history, Financial Advisors are programmed to say "past performance is not indicative of future results." In this instance, we prefer (and hope for) Mark Twain's perspective, "history doesn't repeat itself but it often rhymes."

The Standard and Poor's 500 Index has not declined in the year after midterm elections since 1946. In fact, domestic equities have risen in the year after the midterms 78% of the time and on average it has climbed 15%, regardless of which party won or lost control of Congress.

Markets Still Tend to Perform Well, Regardless of the Outcome

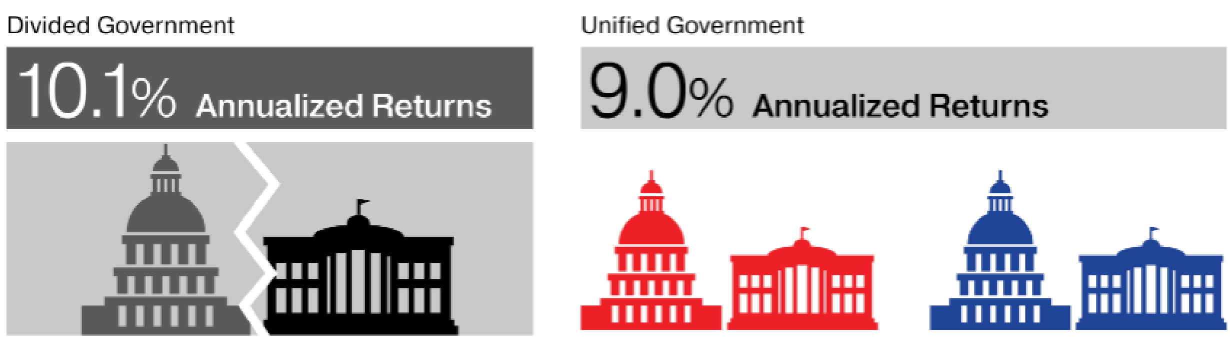
S&P 500 Index Performance for the Year After the Midterm Elections (1800–2018)



Source: Global Financial Data, U.S. Congressional Records, 8/31/18. **Past performance does not guarantee future results.**

Current polls point towards Republicans maintaining control of the Senate and Democrats gaining control in the House. History shows that a divided government, though it may bring volatility due to gridlock and uncertainty, is good for equity markets. Since 1901, the Dow Jones has returned 10.1% per year on average in years when Congressional control was divided, but only 9.0% in years when Congress was controlled by one party.

Gains for Stocks (Dow Jones Industrial Average (DJIA, often referred to as the Dow)) 1901–2017



Source: Bloomberg, 12/31/17. **Past performance does not guarantee future results.**

TAXES

The President's tax plan has undoubtedly been a supportive fiscal policy that has been reflected in corporate earnings and applauded in equity market returns. If Republicans maintain control of both the House and Senate, we could potentially see a second wave of tax cuts. The Republicans have hinted that their "Tax Reform 2.0" would be to make the individual tax cuts permanent (they are currently set to expire in 2025), but they would need 60 seats in the Senate to do this, the likelihood of which is small. If Democrats gain control of one (or both) chambers of Congress, we would likely see heightened volatility and no additional tax cuts. A rollback of the President's Tax Cuts and Jobs Act would be unlikely in any election scenario as the President would veto any such action by Congress, and it is very unlikely Democrats can gain a supermajority.

Trade Wars, Tariffs, and the Emerging Markets

Though the framers of our Constitution granted Congress the power to regulate commerce with foreign nations, that responsibility continues to shift to the President and the Executive Branch. Whether Republicans gain control of Congress, or Democrats take control of one, or both, chambers, the President can continue to influence policy on trade through executive order. Tariffs and other actions that the President implements do not require congressional approval. However, new trade agreements would require Congress. As it pertains to NAFTA, the current deal reached in October would likely move forward regardless of the outcome of the midterms. As it pertains to China, we expect to see further volatility in the emerging markets from continued posturing between Trump and Chinese President Xi Jinping. Ultimately, we see China and the US coming to the table and hammering out a deal within the next year.

Interest Rates and Monetary Policy

Interest rates and the Federal Reserve ("the Fed") have found their way into headlines in recent weeks as President Trump criticized the Fed calling them "loco" for raising the target Fed Funds rate too quickly. History says otherwise as many economists have criticized the Fed for keeping loose monetary policies for too long and not taking advantage of the strength of the economy to tighten policy faster. JPMorgan's Chief Economist and Market Strategist David Kelly likens the 2008 economy to a sick hospital patient who has been getting well. He has said that the economy has been on a morphine drip from the Fed and it is long overdue to be weaned off the drugs before becoming totally dependent. The Bond markets have largely priced in that short-term rates as set by the Federal Reserve (Fed Funds Rate), will rise three times in the coming year (once in December, and two more times in 2019).

Impeachment

The potential of an impeachment may come to the forefront after the midterms. If Democrats win control of the House of Representatives (which polls are leaning to being a likely outcome), it raises the distinct possibility for a vote to bring articles of impeachment against the President. While an actual impeachment seems unlikely, as a supermajority would be needed, an impeachment process would likely be accompanied with volatility. History suggests that if there were a vote for impeachment it would come with volatility and potential short-term market declines, but likely not an extended decline that could threaten the current bull market. When Richard Nixon was impeached markets saw a maximum decline of 39%, and when Bill Clinton was impeached, markets saw a decline of 19%. In both instances, the markets went on to rally even higher.

So what does this mean for investors?

The bottom line is, politics and investing don't mix. Political surprises and events may have short-term effects on the market (and we do anticipate that we will see increased volatility in the coming year, especially if control of Congress is shared). However, throughout history, political surprises have proven to be mere blips in the long-term advance of the equity markets. While it is exciting to talk politics, forecast outcomes, and even hypothesize about how current events are exceptional and different from the past, the political climate should not influence your long-term investment decisions.

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