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MARKET INSIGHTS

From RiverPoint Capital Management

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Like everything we do, it is designed to bring you talented resources and proactive advice with a single purpose in mind – to help our clients achieve financial security and peace of mind.

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A Political Season To Remember

Our purpose in this piece is to provide an interesting perspective on the 2016 election. Many seem to be of the belief that contested conventions are unprecedented and fear that we are in absolutely uncharted territory…a quick glance at history suggests otherwise. Second, we'll address how we view all of this in the context of economic impact and relevance to managing your portfolios. We conclude that this, like many periods, is an interesting paradigm but not new or uncharted.

Who is Likely to Secure the Party Nominations-The Math of It All

Democratic Party—Just About There
The math to achieve the nomination for President on the Democratic ticket is pretty straightforward and progressing in traditional fashion; their convention should be more of a typical coronation of the front runner. While Bernie Sanders is yet to bow out of the primary race, it is only a matter of time before Hillary Clinton gets the official nomination to represent the Democratic Party based on current delegates and projections going forward.

Republican Party- It Ain't Over 'Til it's Over
The Republican side of the ledger is a different story. Three candidates, Donald Trump, Ted Cruz, and John Kasich continue to battle for the Republican Party's nomination. While Trump clearly is in the lead, Cruz and Kasich may be able to block him from obtaining the necessary delegates to get the nod on the first ballot at the Republican Convention in Cleveland in July. Specifically, in order to automatically win the Republican nomination on the first ballot at the convention, a candidate must secure 1,237 delegates through victories in the primaries/caucuses that take place in each state across the country.

So how does the delegate math outlook stack up right now for the Republicans? It's pretty fuzzy. No doubt, Donald Trump is currently in the lead having won 739 delegates so far; Ted Cruz is in second with 465 and John Kasich is in third with 143. That said, these gentlemen must still duke it out for the remaining 944 delegates to be claimed. To reach the magic number of 1,237, Donald Trump must win 53 percent of these remaining delegates to automatically receive the party's nomination. There's a chance he can do this, but it's no slam dunk based upon his performance so far. To wit, he has only won 48 percent of the total available delegates in the states that have held primary races through March 24, 2016. So, he's going to have to pick up the pace and become more effective in the remaining state contests to secure victory in advance of the convention.
At the same time, it is far more unlikely that Trump's Republican opponents will reach the 1,237 figure. While Ted Cruz can still mathematically get there prior to the convention, he would need 82 percent of the remaining delegates…very lofty indeed! John Kasich will not be able to gain enough delegates to secure the nomination in advance of the convention.

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A Brokered Convention—Rare But Far From Unprecedented

If no candidate gets to 1,237, this means the nominee will need to be selected at the convention in July. This is what has led to references by the media that the Republicans may very well have a negotiated or a "brokered" convention. There is a perception that brokered conventions are unprecedented. This notion implies an uncertain outcome on the political front and has investors a bit unnerved. The reality is, the Republicans have a storied past of brokered conventions where it was not obvious who the nominee would be or should be…some will truly surprise you. Since 1856, the GOP has had 10 conventions in which no candidate had a majority of the delegates leading up to the convention. In seven of those occasions, the leading delegate holder going into the convention did NOT become the nominee. Yet, in six out of seven of those occasions, the ultimate nominee went on to win the GENERAL election. On this measure, brokered conventions are arguably a huge success.

Let's examine a couple of quick examples of brokered conventions for perspective on these situations to help bring history to life:

- 1952 was the last official brokered convention for the Republican Party. Ohio Senator, Bob Taft, captured 35 percent of the delegates going into the convention to Dwight Eisenhower's second place 26 percent. Most delegates preferred Taft, feeling he was the true conservative, but they switched their votes to Eisenhower after the first ballot (on the 36th ballot to be precise…the longest on record in the life of the GOP) due to the evidence that Eisenhower stood a better chance of winning the general election…this proved to be correct.

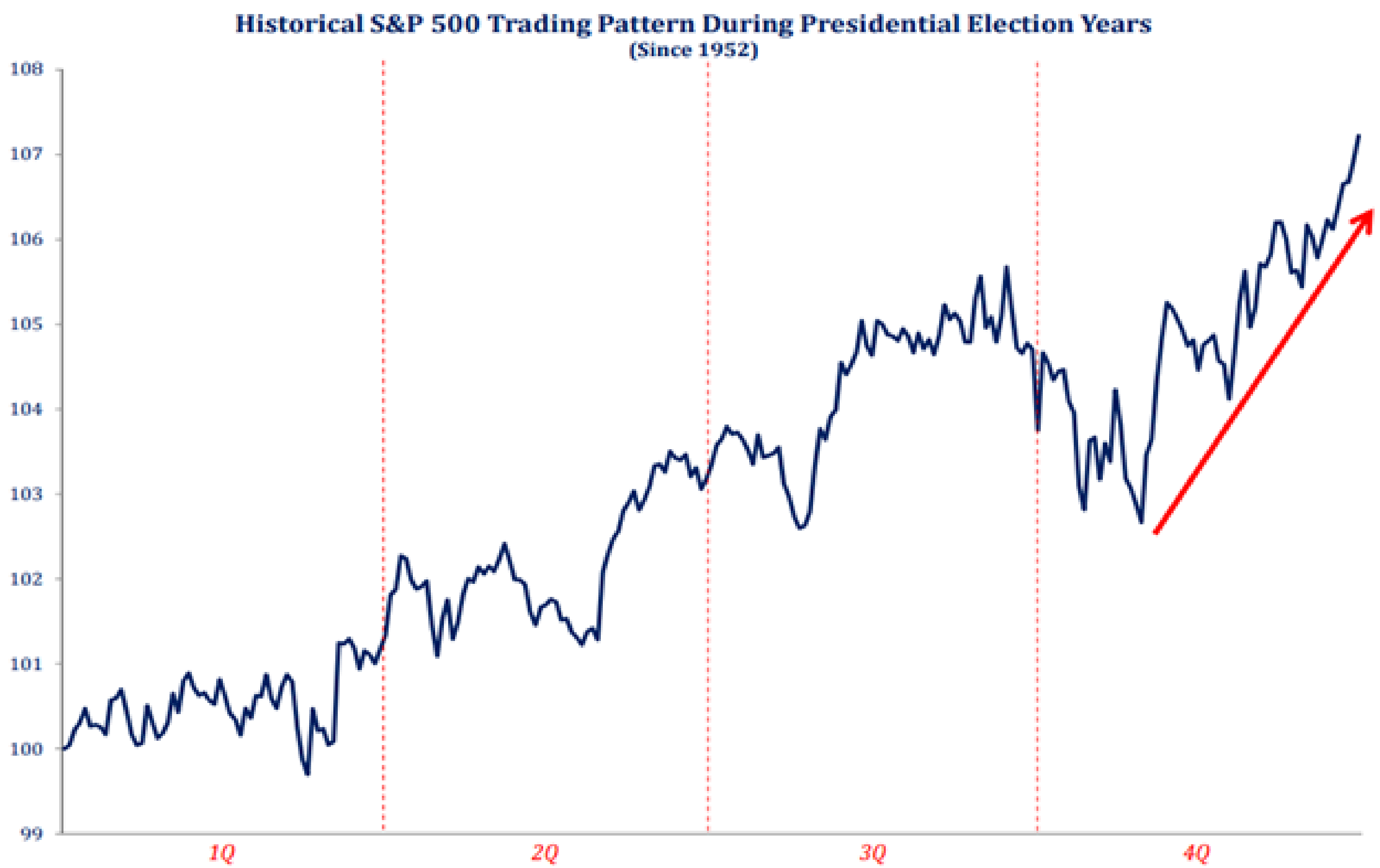
- This next one absolutely fascinated us. In 1860, William Seward, the Republican Senator from New York was the favored choice with 37 percent of the delegates. The convention "settled" on the distant second place candidate—**Abraham Lincoln**—on the third ballot. Must have been a pretty sharp crop of delegates that year!

So as you can see, political conventions have generated major drama in the past; the market has experienced this before.

Enough of History–What is the Investment Impact from All This Political Chatter?

Moving from history to the future we realize a key question on your mind as investors is how might this impact your portfolio? Here are a couple of thoughts to share:

- First, the market doesn't like uncertainty. Not knowing who the candidates are going to be early in the election year can contribute to elevated volatility and less robust market returns in this period. Ditto that as you get very close to the election date in November, particularly if the outcome is less certain and the race is extremely tight. The good news is that post-election, the market generally moves higher as it now knows who is to be our next President and uncertainty lessens.



Source: Strategas Research Partners

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- These points are illustrated in the chart above. The data in the chart looks back to the fourth year of a presidential cycle from 1952 through present day and captures graphically how the market on average has performed during these election years. There is no guarantee of this return pattern, of course, and it is just an observation of average reactions, but as Mark Twain observed, "While history does not repeat, it does rhyme."

- At a sector level, one can look at policy statements of the candidates and analyze what industry groups are likely to benefit or suffer from their articulated positions. For example, Hillary Clinton and Donald Trump have been very open about their desire to lower drug prices set by pharmaceutical companies by letting Medicare negotiate directly with the drug companies. So pharma companies may underperform if legislation were passed to control drug costs in broad fashion (something we view as unlikely). Similarly, former Secretary of State Clinton has implied regulation for fossil fuel companies may only toughen under her administration, so caution would be warranted in traditional areas of the Energy complex if investors become confident she will win. Beneficiaries under her leadership might include infrastructure companies, as she wants to boost federal infrastructure spending and renewable energy companies, such as solar. Under Trump, anticipated winners might include defense and security related companies, while multi-nationals dependent on foreign trade may suffer. The bottom line, though, is that we wouldn't subscribe to making such broad generalizations or acting on them via repositioning the portfolio prematurely. Our experience and research leads us to believe that such speculative "basket stock" trades like this around general elections tend to be temporary moves of several short months that reverse themselves in short order. Investors soon realize that gridlock prevails, and they refocus on true underlying longer term fundamentals. Unless there is a major change in Congressional leadership (as expressed by the Democrats not only winning the Senate back, but doing so in a way where they gain an impactful majority), coupled with a Democratic Presidential victory, we don't envision much change on the legislative front. Stay tuned here as we will monitor this closely.

A Final Thought

While the fundamental economic and market data remains in a positive trend in the U.S., sentiment is quite negative. The current Presidential campaign with the unconventional candidates and associated tough rhetoric seem to be contributing to this somber, fragile mood. Voters are simply disgusted with a lack of leadership and ability to get things done in Washington. This has been a consistent theme throughout the recovery and has resulted in this being one of the most doubted, dis-respected stock market recoveries on record. As we have said many times before, we try to remain focused on the data and the facts in making decisions in your portfolios and strive to remove emotion from our process.

We remain forever vigilant in our assessment of fundamental, valuation and technical conditions and will let you know when we believe adjustments to our positioning are warranted. Please don't hesitate to contact your Wealth Advisor Team, if you have any questions pertaining to the election or your portfolio.