POLITICS DOMINATES THE INVESTMENT CONVERSATION
Looking at the Economic Environment Leading Up to the Election

As investment advisors our main responsibility is to develop portfolios, select investments and understand markets. Part of understanding markets is to be cognizant of the fact that politics does play a role in investor psychology and outlook, as to the future. So as we enter the final months leading to the 2016 presidential election we thought we would take a look at some of the more important aspects being discussed in this election cycle and which may impact your investment portfolio. The following comments are not meant to favor one candidate over another but rather to look at the election and some of the issues being discussed purely from an investment perspective.

Is one political party better than the other with respect to the stock market?
The following two charts provided by Merrill Lynch show the average annual return for the S&P 500 (1928-present and post WWII average) based on control of the White House (Chart 16) or the White House and Congress (Chart 17). As the data indicates, the stock market performs better with a Democratic president. The data further indicates that the highest returns for the stock market are achieved when Congress is controlled by the Republicans and the White House is controlled by the Democrats or as some would call it, “divided government”.

To take a deeper drive into the data, Merrill Lynch points out that returns historically have been the strongest in election years with a leadership change but not a political party change. A Clinton win would represent a leadership change with no party change. On the other hand they point out that both a leadership and a party change, as would occur if Donald Trump was elected, historically has resulted in the lowest returns. (See our on-line version of this newsletter for graphics on this topic.)

Is one candidate better than the other with respect to the stock market?
The one thing we know about the stock market is that it likes clarity and it wants to be able to understand where the economy will be in the next 6-12 months. Candidate Trump creates a great deal of uncertainty for the stock market, and, as such, it would be our opinion that the stock market is pricing in a Clinton victory at this time.

In a recently published piece, the widely respected equity strategist Robert Dole of Nuveen Asset Management framed his answer to this question in the following manner and we quote...”At this point, Hillary Clinton seems to hold the edge in the race for the White House. Compared to Donald Trump, Clinton’s policies offer more clarity and continuity, which would be a net positive for equities. Nevertheless, it appears she would push for more government regulations, and both candidates have adopted anti-globalization and anti-free trade policies. That’s not great news for stocks and given globalization has been a major deflationary force for decades, it also isn’t good news for bonds.”

(Over)
POLITICS DOMINATES THE INVESTMENT CONVERSATION (continued)

Is the United States economy really in as bad of shape as the politicians indicate?
From our perspective, as investors, this is the one area with the biggest disconnect. As we have spoken about in this newsletter over the last few years it would be our position that US economy is doing okay, in fact, better than most of the economies around the world. It goes without saying that things are not perfect but here are some important factors to consider as you think about the current state of the US economy:

The Stock Market – US equity markets are near all-time highs with valuations, while not being cheap, are nowhere near bubble territory of 1999. The stock market is telling us the economy is okay for now.

Household Net Worth and Personal Income – Household net worth is at an all-time high and the household debt service ratio (debt payments as % of disposable net income) is as low as it has been since 1980. US personal income hit an all-time high in 2015. While there is no economic statistic that is 100% accurate, these numbers tell us that the majority of consumers in the US are doing okay.

Manufacturing and Industrial Production – It might be hard to believe given everything you may have heard on this topic but the value of manufactured products and industrial production in the US both hit all-time record highs in 2015. This is not “rust belt” manufacturing. This is high tech and high value manufacturing which requires skilled labor.

Employment – During the “Great Recession” we lost 8.8 million jobs but since 2010 the US economy has added 14.6 million jobs or a net gain of 5.8 million jobs. According to recent statistics, the US unemployment rate is 4.6% and job openings in the US are now at recovery highs. These numbers tell us there is a skills gap that needs to be closed.

Is the North America Free Trade Agreement (NAFTA) as bad as it is made out to be?
As investors we believe that free trade has contributed to higher global GDP growth and, consequently, a rising US equity market. Access to consumers and suppliers around the world helps make US corporations more profitable. The Council on Foreign Relations estimates that the value of US trade, in goods and services with Mexico and Canada, has gone from $230 billion in 1993 to $1.2 trillion in 2015. This is an 18% annual growth rate over the 23 years NAFTA has been in existence. As investors, we understand that no trade agreement is ever perfect and there are always winners and losers. But we need global trade to enhance portfolio values in the years ahead.

Is this election somehow more important to my investment portfolio?
From our perspective, this election is no different than those of the past, even though the media makes it out to be different and more important. Bottom line is that every election matters to your investment portfolio. But after the election results are in, then the only thing that will matter to your portfolio is how the economy is performing.

In closing, as investment professionals it is our job to understand both sides of any issue that can impact our clients’ portfolios. We understand that politics is a “hot button” right now. But we want our clients and readers to understand that no matter what the outcome of this election, our primary responsibility is to adjust and adapt our investment portfolios to best suit the current environment and generate a solid return for our clients.

For additional supporting data on this newsletter please see the “Communications” section of the Buena Vista Investment Management website.

BUENA VISTA INVESTMENT MANAGEMENT LLC
LONG-TERM MARKET INDICATORS
Buena Vista Conservative Buy/Sell Discipline: Positive (turned positive – 04/2016)
Leuthold Major Trend Index: Bullish (turned bullish – 07/2016)
InvesTech Negative Leadership Composite: Bullish (turned bullish – 04/2016)
S&P 500 Stock Index: 2,168.27 (6.08% thru 09-30-16)
MSCI World Market Index: 1,725.66 (3.78% thru 09-30-16)

Important Disclosure – The performance numbers contained on this page are provided for informational purposes only. Contact Buena Vista Investment Management LLC for more specific information concerning performance and market data. Do not rely on this information to make investments.

BUENA VISTA INVESTMENT MANAGEMENT LLC          P.O. Box 1206 Wisconsin Rapids, WI 54495-1206
715-422-0700         buenavista@buenavistainv.com
Seven ways the election matters to equity investors
With the US presidential election less than two months away, we identify key election issues and their implications to equity investors, from fiscal policy to the Fed to taxes.

This article is an excerpt from the report: Election 2016: the equity investor’s guide 16 August 2016. Please see the full report for a more detailed discussion, including an in-depth look at the impact on many industries.

Broad issues with significant implications for equity investors include:

1) **Uncertainty shock**: Amid heated rhetoric, a lack of clarity on many policy issues, and a newcomer running against a seasoned politician, the uncertainty factor is arguably heightened in the 2016 US presidential election. While uncertainty creates longer-term opportunities, in the near term it could both crimp growth and derail the S&P 500 uptrend. On growth, if companies adopt a wait-and-see attitude, this could slow the economy. And uncertainty is generally a negative for equities: policy uncertainty is strongly correlated with equity volatility.

2) **Split government**: A split Congress would limit the likelihood of more significant policy proposals of either candidate and may mitigate some policy uncertainty. And a split Congress could be a positive scenario for the S&P 500 given that the index has historically seen strong returns during Democratic presidencies with a split Congress – though there is not much historical precedent for this given this has only occurred in four prior years since 1928 (Chart 17). The next most positive scenario for markets has been a Democratic president with a Republican Congress, which has occurred in 10 years since 1928.

3) **Fiscal policy**: With monetary stimulus in the US seeming to have run its course, expectations have shifted. Fiscal spending has progressively increased over the past several years, becoming a positive contributor to real GDP growth in late 2015. But our Global Fund Manager Survey indicates a record net 44% of investors think global fiscal policy is still too restrictive, suggesting broadening support for additional fiscal spending initiatives.

   The risk: expectations for fiscal stimulus are already at a post-crisis high, suggesting potential for disappointment relative to investors’ expectations. Both candidates are pro-stimulus via infrastructure spending and tax reform, but proposals – especially on taxes – differ significantly.

4) **Protectionism**: Brexit may be a sign of increasingly protectionist attitudes, and has been echoed in the US by Trump’s popularity among the working class, where he has won support from Americans who feel like they have lost out due to globalization and immigration. The post-crisis recovery has lifted the wealthy through stock market and real estate reflation, but has so far failed to induce a broad-based economic recovery, and the psychology of the US voter base may reflect that.

   We view the impact of protectionism on the S&P 500 as negative in the short term, given the globally oriented nature of the benchmark (one-third of sales come from overseas). And longer term, margins are at risk: even without the benefits of labor arbitrage, effective taxes rates for the S&P 500 have fallen dramatically over the last 20 years, as companies generated more profits abroad where tax rates are lower. This has contributed an estimated 100bp to net margins over the same period.
5) **Tax treatment of income**: This could drive a divergence in desirability across asset classes. Current law favors income from equities and municipal bonds over corporates and Treasuries. Under Trump’s proposals, the equity vs bond advantage would likely narrow, while under Clinton’s proposals, advantages of equities and municipals over corporates and Treasuries could be diminished.

6) **The Fed**: In the very near term, political concerns will likely rule out a hike at the November meeting, and is one of the reasons that our economists forecast a December rate hike. Longer term, a key question is whether Fed Chair Janet Yellen will be reappointed at the end of her term in 2018. Presidents have generally opted for continuity, allowing chairs and vice chairs to serve multiple terms. And given that Yellen was appointed by a Democratic president, we would expect Clinton to offer Yellen reappointment.

   Trump may be more likely create a break in Fed policy, as he has said he would replace Yellen at the end of her term. While Trump has made some comments that would suggest he is in favor of a more hawkish stance (low rates, in his view, have created asset bubbles), other comments have suggested he is a proponent of low rates. But risks of a more hawkish Fed are likely elevated under Trump, which could have a significant impact at a sector level – in particular, Financials, levered sectors and those with higher dividend yields. And bigger picture, discontinuous Fed policy could roil the already fragile recovery.

7) **Health Care**: The sector has been in the crosshairs this election year, de-rating significantly on political risk. Our analysts note significant differences between the two presumptive US presidential nominees’ positions on health care reform – which influences hospitals and managed care companies – as well as other health care issues, including drug pricing – where comments from Clinton around drug pricing have pressured Biotechnology and Pharmaceuticals stocks. We think this valuation overhang represents an opportunity, and are overweight Health Care.

**History suggests strongest returns under Dem administrations**

Historically, the economy and the health of the corporate sector have been much bigger drivers of S&P 500 returns than politics. Based on data since 1928, S&P 500 returns have been stronger under Democratic presidents than under Republicans (though the initial post-election market reaction was historically more positive under Republicans). When considering the make-up of Congress, the market has seen the highest returns under a Democratic president with a split Congress, but we note that this has occurred in only four years since 1928, with the next-highest returns under a Democratic president with a Republican Congress (which has occurred in 10 years since 1928).

**Historical trends: elections vs. stocks**

The profits cycle historically has been a more important determinant of S&P 500 returns than the political cycle (Chart 15). But below we provide historical context on market returns under various political scenarios.

- Based on data since 1928, S&P 500 returns have been stronger under Democratic presidents than under Republicans (Chart 16).
- But the initial post market reaction (from October-January of election years) was modestly higher for Republicans (Table 6).
- When considering the make-up of Congress, the market has seen the highest returns under a Democratic president with a split Congress, but we note that this has occurred in only four years since 1928, with the next-highest returns under a Democratic president with a Republican Congress (which has occurred in 10 years since 1928 – see Chart 17.)
• Returns historically have been strongest in election years with a leadership change but not a political party change (Chart 18 and Chart 16). A Clinton win would represent a leadership change with no party change.
• Both a leadership and a party change, as would occur if Trump were elected, historically has resulted in the lowest returns.

Chart 15: Percentage of years from 1928-2015 where returns were positive based on political party and S&P 500 profits cycle

Note: based on total returns 1936-present and price returns prior to that (1928-1935)

Chart 16: Average annual S&P 500 returns based party in control of the White House, 1928-present

Note: Based on 41 years of Republican control and 48 years of Democratic control since 1928 (or 36 and 33 years, respectively, post WWII). Total returns 1936-present and price returns prior to that. Excl. 2008, avg. under Republicans was 8.2% (11.1% post-WWII)—still weaker than under Democrats.

Chart 17: Avg. annual S&P 500 returns based on control of White House & Congress, 1928-present

Note: Excluding 2008, average for Republican President, Democratic Congress is 10.2% (still the second-weakest period). Total returns 1936-present and price returns prior to that.
Chart 18: Average annual S&P 500 returns during presidential election years (1928-present) based on various scenarios

Note: Of the 23 elections since 1928, based on 9 where there was a leadership and party change (8 post WWII), 4 where there was a leadership change with same party (2 since WWII), and 10 where President was re-elected (8 since WWII). Total returns 1936-present and price returns prior to that. Excl. 2008, avg. for Leadership & party change is 8% (and 11% since WWII)—still the weakest period.

On average, the market has been up 11% in election years (Chart 20 and Chart 18)—the second-best return year of the presidential election cycle. During all presidential election years, the market has been up in 88% of those years (Table 5) versus up 73% of the time in general (based on annual returns since 1928).

Chart 20: Average S&P 500 total returns by year, 1928-2015

Table 5: S&P 500 returns during presidential election years

Staples fares best under Republicans, Tech fares best under Democrats

Consumer sectors, Materials, Telecom, Utilities and Energy have outperformed on average during years when a Republican was in office, and underperformed during Democratic presidencies. Tech, Health Care, Industrials and Financials have outperformed during Democratic presidencies.
Post-election S&P reactions initially favored Republicans

We also looked at the historical market reactions to election outcomes from the start of October prior to the election through the following January (four months). In contrast to the performance during historical administrations, we found that the initial market reaction to Republican presidential victories was modestly higher than for Democratic victories. Elections resulting in split Congress still had better performance, although not in the one instance when a Democrat was elected president. It is important to note that the sample size of elections since 1936 is quite small (20) and becomes even smaller when adding in additional criteria. For instance, the strongest market performance was reported during the three elections that resulted in Republican sweeps (1952, 2000, 2004), although returns were still negative in one of those three instances.

Table 6: Median S&P 500 total returns from Oct preceding elections to the following Jan (1936-present)

<table>
<thead>
<tr>
<th></th>
<th>All</th>
<th>Presidential Election</th>
<th>Democratic President Elected</th>
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<tr>
<td></td>
<td></td>
<td>Yes</td>
<td>No</td>
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<tr>
<td>All</td>
<td>5.9</td>
<td>5.4 6.0</td>
<td></td>
</tr>
<tr>
<td>Democratic House Elected</td>
<td></td>
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<tr>
<td>Yes</td>
<td>9.8</td>
<td>4.9 14.7</td>
<td></td>
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<tr>
<td>No</td>
<td>6.2</td>
<td>6.6 5.9</td>
<td></td>
</tr>
<tr>
<td>Democratic Senate Elected</td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Yes</td>
<td>9.5</td>
<td>4.9 14.3</td>
<td></td>
</tr>
<tr>
<td>No</td>
<td>6.4</td>
<td>7.9 5.9</td>
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<td>House change (elec)</td>
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<td></td>
<td></td>
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<tr>
<td>Yes</td>
<td>8.3</td>
<td>4.8* 8.3</td>
<td></td>
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<tr>
<td>No</td>
<td>5.8</td>
<td>5.4 5.8</td>
<td></td>
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<tr>
<td>Senate Change (elec)</td>
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<tr>
<td>Yes</td>
<td>6.2</td>
<td>4.9 7.2</td>
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<tr>
<td>No</td>
<td>5.8</td>
<td>5.9 5.8</td>
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<td>Split Congress Elected</td>
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<tr>
<td>Yes</td>
<td>9.8</td>
<td>4.9 18.0*</td>
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<tr>
<td>No</td>
<td>7.9</td>
<td>5.9 14.0</td>
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</table>

* Indicates less than three instances

U.S. equities rallied again last week, with the S&P 500 Index climbing 1.2%. Investor sentiment improved due to generally dovish tones from the Federal Reserve and Bank of Japan. Real estate and utilities led the week's rally, while energy lagged despite an increase in oil prices.

Weekly Top Themes

1. **The Fed signaled a likely rate hike in December.** To no one's surprise, the Fed did not raise rates at its meeting last week. But it clearly indicated that a hike is coming soon, provided economic growth remains on track and the global financial system does not endure an additional shock. The Fed statement included this new, unambiguous statement: "The Committee judges that the case for an increase in the federal funds rate has strengthened but decided, for the time being, to wait for further evidence of continued progress toward its objectives."

2. **U.S. inflation is slowly creeping higher.** The core Consumer Price Index climbed 0.3% in August and is up 2.3% year-over-year.

3. **2017 economic growth may look similar to 2016.** At the beginning of the year, we expected U.S. growth to remain slow but avoid a recession. At this point, we expect to see a similar environment next year, but we think it is possible we may see even slower levels of growth.

4. **U.S. equities appear more attractive than international stocks.** Compared to overseas alternatives, we believe the U.S. market features better economic growth, stronger earnings trends and more supportive monetary policy. If global trade levels increase, our view would be more constructive toward non-U.S. equities.

5. **The U.S. political environment looks to be a mixed bag for equities.** At this point, Hillary Clinton seems to hold the edge in the race for the White House. Compared to Donald Trump, Clinton's policies offer more clarity and continuity, which would be a net positive for equity markets. Nevertheless, it appears she would push for more government regulations, and both candidates have adopted anti-globalization and anti-free-trade policies. That's not great news for stocks, and given globalization has been a major deflationary force for decades, it also isn't great news for bonds. One silver lining is that we see growing prospects for increased infrastructure spending and possible corporate tax reform.

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**Robert C. Doll, CFA**
Senior Portfolio Manager, Chief Equity Strategist
Bob Doll serves as a leading member of the equities investing team for Nuveen Asset Management, providing reasoned analysis through equity portfolio management and ongoing market commentary.
The Conference Board Consumer Confidence Index broke out to a new cycle high at 104.1 (Jan 1985 = 100), indicating a growing belief by consumers in the state of the economy. The headline index arguably understates the improvement since it is held back by mediocre Future Expectations at 87.80 while the Present Situation index rose to a 9 year high at 128.50. The latter is generally the more important measure to follow since it is sensitive to actual real time conditions rather than rather nebulous “expectations” that vary much less over the course of a cycle.

At its current level the Present Situation index is close to the peaks registered in the late 1980’s (141) and mid 2000’s (139), although far below the much stronger readings recorded in the late 1990’s bonanza (187). We doubt that confidence will match the dot-com frenzy this time around and so we are possibly approaching “peak confidence” for the current cycle with the peak to be recorded at some point in the next few months. We are not yet at the point that confidence is “too good to be good”, but we are nearing this milestone with the current reading.

It is important to note that the improvement in overall confidence has started to be expressed in the labor market indicators. Respondents claiming that Jobs are Hard to Get fell to an 8½ year low at 21.6% while the Jobs are Plentiful response rate rose to a 9 year high at 27.9% (this indicator peaked at 30.3% in 2007). The net “Job Differential” rose to 6.3%, its highest since August 2007 and now looks to have moved
S&P 500 Price Index

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<td>Index level</td>
<td>1,527</td>
<td>1,565</td>
<td>2,099</td>
</tr>
<tr>
<td>P/E ratio (fwd.)</td>
<td>27.2x</td>
<td>15.7x</td>
<td>16.6x</td>
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<tr>
<td>Dividend yield</td>
<td>1.1%</td>
<td>1.8%</td>
<td>2.3%</td>
</tr>
<tr>
<td>10-yr. Treasury</td>
<td>6.2%</td>
<td>4.7%</td>
<td>1.5%</td>
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Source: Compustat, FactSet, Standard & Poor's, J.P. Morgan Asset Management.
Dividend yield is calculated as consensus estimates of dividends for the next 12 months, divided by most recent price, as provided by Compustat.
Forward price to earnings ratio is a bottom-up calculation based on the most recent S&P 500 index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future returns.

U.S. manufacturing and industrial production reached all time highs before pulling back amid the global slowdown.

U.S. Manufacturing (Value of Shipments in $ Billions)

Industrial Production — United States

U.S. Manufacturing data as of 04/29/16; Industrial Production data as of 05/31/16.
Source: FactSet
Global Trade

Economic growth fuels demand for imports, aggravating the trade deficit, which plummeted in the great recession as demand dwindled. Exports have faced recent headwinds due to the strong U.S. dollar.

Data as of 04/29/16.
Source: FactSet
Consumer as Game Changer

At about 70% of GDP, the U.S. consumer is the game changer in economic growth. Consumption, income and retail sales have achieved all-time highs.

U.S. Personal Income

U.S. Personal Consumption Expenditures

U.S. Retail Sales

U.S. Personal Income and U.S. Personal Consumption as of 05/31/16; U.S. Retail Sales as of 05/31/16.
Source: FactSet
Economic growth and the composition of GDP

Real GDP
Year-over-year % change

10%
8%
6%
4%
2%
0%
-2%
-4%
-6%
0' 65 '70 '75 '80 '85 '90 '95 '00 '05 '10 '15

Average: 2.8%
Expansion average: 2.1%

Components of GDP
1Q16 nominal GDP, USD trillions

$19
$17
$15
$13
$11
$9
$7
$5
$3
$1
$1

3.6% Housing
12.9% Investment ex-housing
17.8% Gov't spending
68.6% Consumption

- 2.7% Net exports

Source: BEA, FactSet, J.P. Morgan Asset Management.
Values may not sum to 100% due to rounding. Quarter-over-quarter percent changes are at an annualized rate. Average represents the annualized growth rate for the full period. Expansion average refers to the period starting in the second quarter of 2009.
Labor market perspectives

Employment – Total private payroll
Total job gain/loss, thousands

-1,000 to 600

8.8mm jobs lost
14.6mm jobs gained

Labor force participation rate decline since 2007 peak*
Population employed or looking for work as a % of total, ages 16+

Net job creation since Feb. 2010
Millions of jobs

Source: BLS, FactSet, J.P. Morgan Asset Management.
(Bottom right) Info. fin. & bus. svcs. = Information, financial activities and professional and business services; Mfg. trade & trans. = Manufacturing, trade, transportation and utilities; Leisure, hosp. & other svcs. = Leisure, hospitality and other services; Educ. & health svcs. = Education & health services; Mining and construct. = Natural resources mining & construction. Gov't. Government. *Aging effect on the labor force participation rate is the estimated number of people who are no longer employed or looking for work because they are retired. Cyclical effect is the estimated number of people who lose their jobs and stop looking for work or do not look for work because of the economic conditions. Other represents the drop in labor force participation from the prior expansion peak that cannot be explained by age or cyclical effects. Estimates for reason of decline in labor force participation rate are made by J.P. Morgan Asset Management.

World Economy — Gross Domestic Product (GDP)

Global economic growth has more than doubled in the last 12 years driven by growth in emerging and developing economies.

<table>
<thead>
<tr>
<th>% of World GDP</th>
<th>2003</th>
<th>2008</th>
<th>2015</th>
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<tr>
<td></td>
<td>$38.1 Trillion</td>
<td>$56.8 Trillion</td>
<td>$75.0 Trillion</td>
</tr>
<tr>
<td>Advanced Economies</td>
<td>80%</td>
<td>72%</td>
<td>60%</td>
</tr>
<tr>
<td>Emerging and Developing Economies</td>
<td>20%</td>
<td>28%</td>
<td>40%</td>
</tr>
</tbody>
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Advanced economies: Comprised of 36 countries. Developing economies: Comprised of 153 countries.

Source: International Monetary Fund (IMF) as of 2014