First Trust
Monday Morning OUTLOOK

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November 7, 2016

Don't Time the Election

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Through Friday, in spite of very good earnings reports from companies, the S&P 500 was down nine days in a row, the longest negative streak since 1980. The total decline was just 3.1%, but the decline has been relentless and deflating to investor psychology.

In our view, there are two key reasons for the consistent decline. The first reason is liquidity - a word we use here to mean investor willingness to participate. It appears that many investors view the divergent possible outcomes of this election as a risk. The thinking is that even if stocks are worth buying, the uncertainty of Election Day remains high for many reasons. Instead, the theory goes, why not just wait several more days. Meanwhile, those interested in cutting their exposure to equities had a very good excuse to sell.

The second reason, for the sell-off, and we are only looking at coincident facts to make this statement, was the rising odds that Donald Trump would win the election. On October 24, the day before the losing streak started, Nate Silver's 538 Polls-Plus Model had Trump's odds of winning the election at 16%. During the nine-day losing streak, those odds rose to 36%.

If a 20 percentage point increase in Trump's odds of winning generated a 3.1% decline in equities, then a simple back-of-the-envelope calculation suggests an actual Trump victory (which would boost his odds of winning by an additional 64 percentage points – to 100% from 36%) could result in equities suddenly dropping about 10% below the Friday close, or for the S&P 500, to about 1,880, which would be the lowest level since February.

As we wrote last week, however, we think this would be a great buying opportunity. Think of it like America's version of Brexit. The S&P lost almost 6% in the two days after the Brexit vote but, within two weeks, was hitting new highs.

We think something similar would happen if Trump wins on Tuesday, a very brief equity selloff followed by a tremendous rebound. Our recommendation is not to try to time it or to sell in front of the election. After all, Hillary Clinton could win on Tuesday, ruining a strategy designed to take advantage of a temporary Trump selloff. Instead, the better option for retail investors is to decide before the election that if Trump wins and equities dive they will find places along the way to put cash to work.

Let's say, however, that Hillary Clinton wins. How do we expect the stock market to immediately react? The same simple back-of-the-envelope calculation we used above suggests an immediate market rally of about 5.6% from Friday's close, up to about 2200. (Explanation: If a 20 percentage point reduction in her odds of winning, from to 64% from 84%, cuts equities by 3.1%, a 36 point rise in her odds of winning, to 100% from 64% should boost equities by 5.6%.)

Just look at what's happening this morning. The market is up after the FBI Director made his third market-moving and election-impacting announcement about the investigation in Hillary Clinton's tenure as secretary of state. Now that it looks more likely that Clinton is all-clear legally, at least through Tuesday, the market's assessment of her odds of winning the election are up, and the futures market is up, consistent with recent short-term thinking. We can't explain exactly why the market is more worried about a Trump presidency - if forced to try, we would say it's protectionism.

Either way, whether Trump or Clinton wins, we think equities are a long-term buy and are still trading below fair value. It's also important to recognize that it's highly likely the GOP keeps control of the House of Representatives, which should prevent a President Clinton from fulfilling her campaign pledges to raise taxes, send even more subsidies (via students) to college professors and administrators, and further socialize our health care system.

As economists, we are, in part, students of history. We think countries that keep their governments relatively small, in terms of spending and regulation, as well as tax rates, will provide their residents with an advantage in pursuing prosperity. However, regardless of the outcome of this year's election, we think economic growth will generally continue, even with the policy mistakes the winner may make.

Four years ago, we told investors that equities looked cheap regardless of whether Obama or Romney won the election. Since then, major US stock indexes are up almost 50% and that doesn't even include dividends. Go to the polls tomorrow (if you haven't voted already!) and make sure your voice is heard. But don't let your personal politics cloud your long-term investment decisions.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
11-7 / 2:00 pm	Consumer Credit– Oct	$17.5 Bil	**$18.0 Bil**		$25.9 Bil
11-10 / 7:30 am	Initial Claims - Nov 5	260K	**258K**		265K
11-11 / 9:00 am	U. Mich Consumer Sentiment -Nov	88.0	**87.7**		87.2