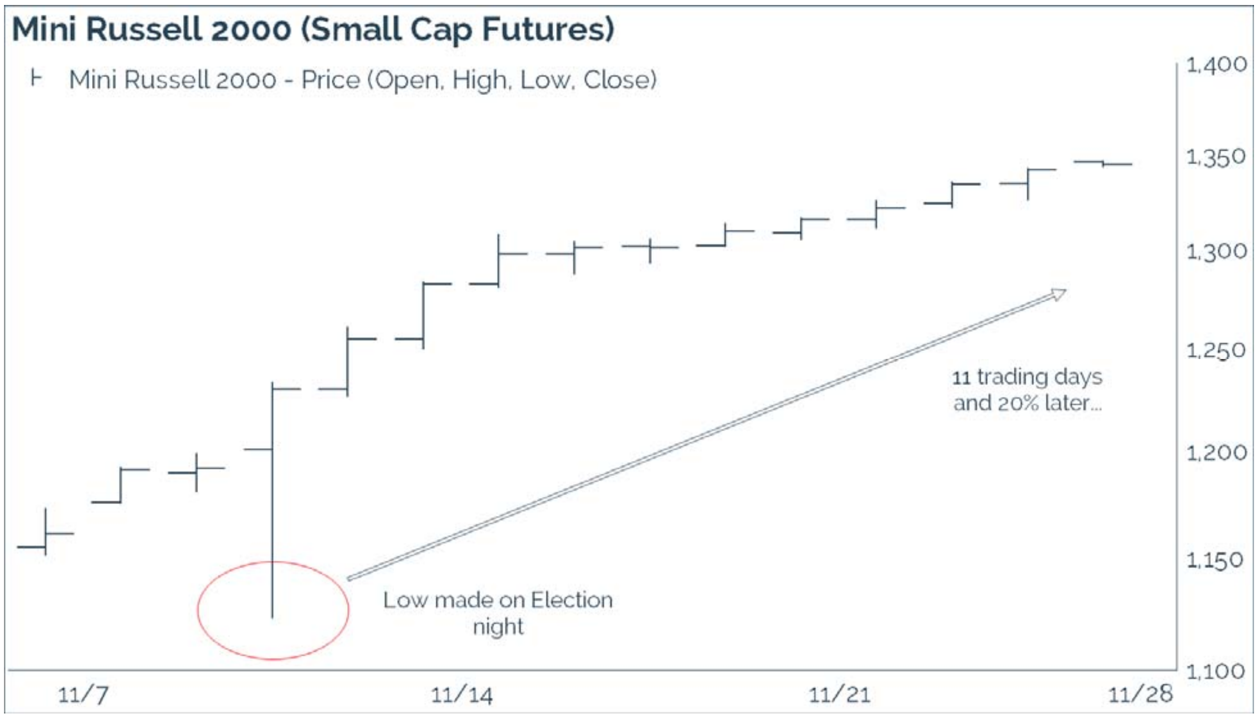
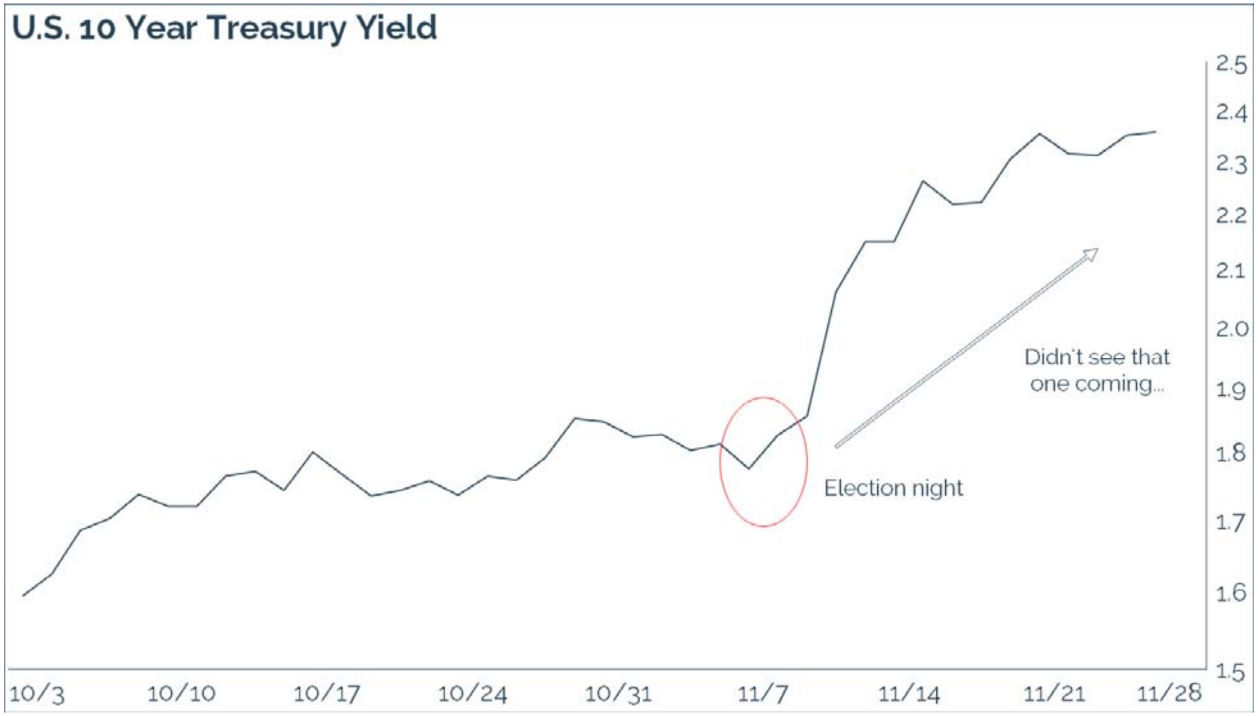
Life After the Election

It's over – finally! I'll be honest, the conclusion of the Presidential election could not come soon enough. For those who know me very well know I can't stand politics. So, you're in luck, I will not be discussing politics or specific policies. My job is not to opine on who is more fit to be the 45th U.S. President, but rather to grow and protect your capital regardless of who lives in the White House. My world consists of numbers and probabilities. And, I use this information to guide our investment decision making.

For the most part, anyone invested in U.S. equities has thoroughly enjoyed the past couple of weeks. The Dow, S&P 500, Nasdaq, and Russell 2000 have traded at all-time highs. The last time this happened was December 31st, 1999. That was a long time ago! In the short-run, this type of market action is not a bearish sign at all. In fact, it is quite bullish and comes at a perfect time of the year. You can't underestimate the power of momentum and seasonality. Many traders were not positioned for a sharp move higher in equities and a spike in interest rates. Rather, many traders came into the election short equities and long fixed income. They were right for about six hours and then the markets reversed on a dime. Therefore, those positions needed to be unwound and boy were they ever.



Source: Factset



Source: Factset

Since election night, the Russell 2000 futures are up nearly 20% and the 10 year U.S. Treasury has increased by 70 basis points, which equates to more than a 10% loss in price. These are massive moves in such a small amount of time! In the very near future, you should not be surprised to see equity prices give back some of its gains. The equity markets are extremely over-bought, but any sell-off should quickly be met with a flood of buyers not wanting to miss an end-of-the-year Santa Claus rally. Barring an unforeseen market shock, the path of least resistance is higher into year-end.

However, do not forget why the market rally may continue for the next few weeks. I believe it is a momentum, short covering, and chase for performance rally. Last month I touched on the declining rate of growth in the monthly non-farm payrolls job report and the inevitable reversion to the mean between asset prices and GDP. This along with company fundamentals and already high valuations have not changed over the past couple of weeks. According to Factset, of the 105 S&P 500 companies issuing guidance for the next quarter, 71 of these companies have issued negative guidance. That type of corporate guidance doesn't exactly inspire too much confidence.

One of the hardest things to do as a portfolio manager is to balance short-term momentum with longer-term trends. Traders makes a living exploiting short-term price movements. They don't necessarily care about valuations or rate of change for specific economic data points. All they need to do is get the direction of asset prices correct and they make money. A tax efficient portfolio manager is looking at the bigger picture and uses short-term price momentum to set up the portfolio for longer term investment opportunities or to preserve capital. Either way, it is very hard to not get caught up in the noise and focus on the bigger picture.

The same pundits who predicted a severe market decline as a result of the election now can't see how the market will ever decline again. Economic policies that were supposed to lead us into a depression now look to be setting our economy up for hyper-growth for the indefinite future. I'm exaggerating a little bit, but honestly not really that much, as depression turned into euphoria quickly across market participants. Instead of blindly following the herd, it is important to maintain perspective and stay grounded during highly emotional times.

As a side note, since 1909 there have been 11 two-term Presidents, with some Presidents completing the entire second term and others not able to do so. In every instance except one, the President following a two-term Presidency has either inherited a recession or entered a recession within their first 12 months in office. The one exception was President George H. W. Bush, who was lucky enough to hold out until the 16th month before a recession began.

There is no doubt you've heard these famous last words – this time might be different. Hopefully, it will be different. If history is any guide, a better buying opportunity might be right around the corner. Therefore, guarded optimism may be in order after this recent market rally.

--Billy Little, CFA

"It requires a great deal of boldness and a great deal of caution to make a great fortune, and when you have it, it requires ten times as much skill to keep it." ~ Ralph Waldo Emerson