The Long & Short of It
Quarterly Newsletter
Fourth Quarter 2016

White House Party Changes: Looking Deeper

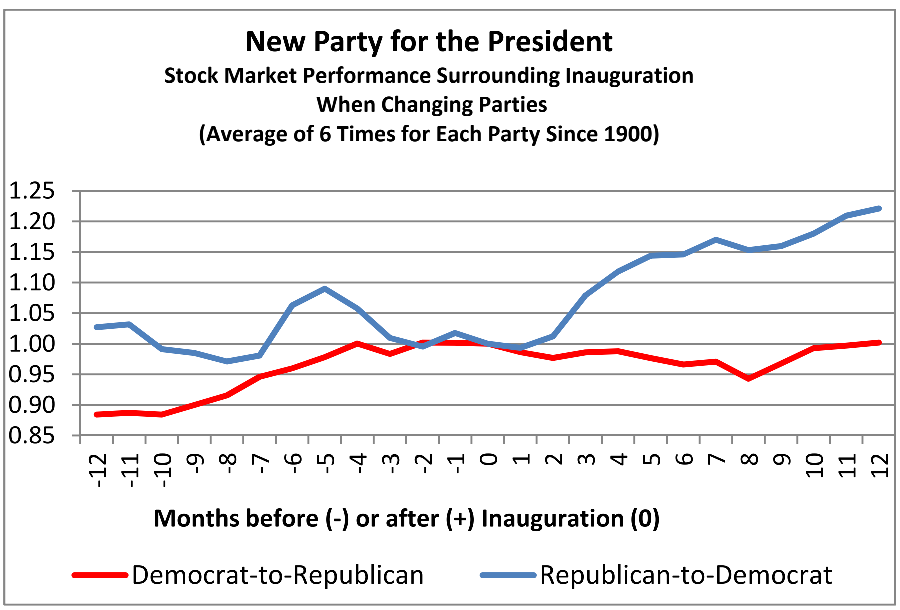
With the post-election stock rally, hopes are running high for the Trump administration. Investors anticipate reduced taxes and regulatory burdens along with increased spending in the form of an infrastructure bill—one that ironically would have been more modest if the government remained divided. Indeed, it is unusual that investors expect Republicans to spend more once completely in charge and no longer beholden to a considerable Democratic influence. After all, measured from inauguration to inauguration, the stock market historically fares better under Democratic administrations than their Republican counterparts. The cause often cited for this anomaly is Democrats' more liberal and stimulating fiscal policies. Is there more to this story?

DJIA Returns Under US Presidents Since 1900

President	Start	End	DJIA Percent Change (%): Change as President	DJIA Percent Change (%): Annualized Return
T Roosevelt	9/14/1901	3/4/1909	21.6	2.7
Taft	3/4/1909	3/4/1913	-1.3	-0.3
Wilson	3/4/1913	3/4/1921	-6.9	-0.9
Harding	3/4/1921	8/2/1923	17.4	6.9
Coolidge	8/2/1923	3/4/1929	255.9	25.5
Hoover	3/4/1929	3/4/1933	-82.8	-35.6
FDR	3/4/1933	4/12/1945	194.4	9.3
Truman	4/12/1945	1/20/1953	81.7	8.0
Eisenhower	1/20/1953	1/20/1961	120.3	10.4
JFK	1/20/1961	11/22/1963	12.2	4.1
Johnson	11/22/1963	1/20/1969	30.9	5.3
Nixon	1/20/1969	8/9/1974	-16.5	-3.2
Ford	8/9/1974	1/20/1977	23.4	8.9
Carter	1/20/1977	1/20/1981	-0.9	-0.2
Reagan	1/20/1981	1/20/1989	135.1	11.3
Bush I	1/20/1989	1/20/1993	45.0	9.7
Clinton	1/20/1993	1/20/2001	226.6	15.9
Bush II	1/20/2001	1/20/2009	-24.9	-3.5
Obama	1/20/2009	12/31/2014	124.1	14.5
Average			**60.8**	**4.7**
Average Republican			**44.8**	**3.0**
Average Democratic			**82.7**	**7.0**

Source: Bespoke

Since 1900, six Republican presidents have succeeded Democrats and six Democrats have succeeded Republicans. When switching from Democrats to Republicans, the stock market gained an average of 13.1% during the election year and then essentially remained flat (underperforming the normal rise) over the inauguration year. Conversely, when transitioning from Republicans to Democrats, the stock market was flat during the election year and rallied approximately 22.1% during the inauguration year. Republicans have historically been considered more prudent and business-oriented than Democrats. It follows that these rallies in anticipation of a new Republican president appeared to help returns credited to outgoing Democratic presidents; meanwhile, underperformance in anticipation of Democratic presidents hindered returns associated with outgoing Republican presidents. Looking to historical precedent, the uptick in the stock market that took place post-election might have happened even earlier in the year if the polls had suggested a Republican president in 2017.



Source: Robert Shiller, Irrational Exuberance

Going forward, history suggests that the anticipatory rally will now give way to the stable-but-underperforming returns typically associated with a Republican presidency.

But Is This Time Different?

This year's transition will undoubtedly be unique. After decades of dominant political influence and strong economic growth rates, America has seen relative decline as the last several presidents pursued global-oriented policies. This will certainly change under Trump, but to an unknown degree. Indeed, the degree to which growth has been or will be influenced by those policies is also uncertain.

After the attack on Pearl Harbor, Japanese Naval Marshal General Isoroku Yamamoto said, "I fear that all we have done is to awaken a sleeping giant and fill him with a terrible resolve." Since then, America the giant has grown more global cosmopolitan, and gray-haired. This aging giant, having rested through several administrations of monetary melatonin and other regulatory schemes, is finally waking. Whether it will be angry or happy, groggy or energetic is uncertain. Whatever burst of energy the economy might exhibit must be understood in light of our aging population and infrastructure. The slower growth economy is naturally more stable, which makes the Feds who administer the monetary melatonin appear to have greater expertise than they really do. This should become evident after the giant fully rouses from its slumber. Whatever speculation exists, one thing seems certain: the predictability of the giant's behavior is likely ending. Uncertainty should reign.

On the other hand, there have been numerous politicians with "popular mandates" who go to Washington only to find the town is not so easily impressed or moved. Existing rules and regulations are hard to dismantle. Consensus is elusive and fleeting. The aging demographics of our country are certainly not going to change in the next four years to give us a faster-growing economy. Since we are late in this economic cycle, there is wisdom in the view that added economic growth from this point forward will impact inflation more than it adds to real wealth creation. If inflation does make an appearance, it should be a mere cameo as many macro-deflationary forces stay in place. The risk remains that the Fed might over-tighten when required to address rising inflation pressures.

"We the people" of the United States grow a bit numb to the existing political environment when a president holds office for two terms. Consensus then finds itself shocked by the changes brought forth in a new administration. Going from Barack Obama's last eight years, as well as 28 years of increasingly global-oriented presidents, to Donald Trump and "Make America Great Again" should be a dramatic change and likely many times more unpredictable. Until the dust settles, how can one protect wealth? When levels of policy uncertainty begin to rise, volatility will come and with it, opportunities to win or lose. As policy decisions firm, some certainties will emerge and new trends will form. A different set of winners and losers will be chosen in Washington. We will be attuned to both the uncertainty cycle and new directions as they take shape. Our careful research and defensive approach to the selection of individual investments should continue to provide investors with good, solid risk-adjusted returns.

Thank you for the opportunity to serve your family and your portfolios.

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