How Should Investors Position FOR THIS YEAR'S ELECTION?

YOU'RE ASKING THE WRONG QUESTION.

These direct excerpts from the full article authored by Benjamin Lavine CFA,CAIA are being provided by Scott D. Morrison of Morrison Nordmann & Associates. The full article can be viewed athttps://www.3dadvisor.com/news-insight/how-should-investors-position-years-election/ Mr. Lavine is the Chief Investment Officer of 3D Asset Management, one of the investment managers utilized by Morrison Nordmann & Associates.

How Should Investors Position for this Year's Election? You're Asking the Wrong Question.

Benjamin Lavine, CFA, CAIA

With elections just around the corner amidst an environment punctuated by populist sentiment, it is no surprise to see numerous investment-related articles advising investors on how to position for particular electoral outcomes.

Rather than asking how I should be positioned for a Trump or Clinton outcome, the investor should ask, "Am I comfortable with my current risk positioning given the air of uncertainty surrounding the current political climate?"

Investors Feeling Edgy This Year?

Money Magazine wrote a more thoughtful perspectivepiece [1] on not letting emotions surrounding this year's election spill over into your investment decisions. For instance, they cite a 2012 paper, "Political Climate, Optimism, and Investment Decisions,"[2] on how investors from the party controlling Washington tend to take greater market risks while investors from the opposition party tend to "grow restless and trade securities more frequently." And, too frequently, the investment narrative surrounding electoral candidates tend not to play out as expected. Consider this excerpt from that 2012 paper just prior to the election:

"INVESTMENT NARRATIVES FORM quickly in election years. Right now, for instance, market opiners are advising you to buy shares of clean-energy companies, defense contractors, and multinationals in the event of a Clinton victory. A Trump presidency, on the other hand, should be a windfall for coal miners, small-company stocks (because their sales are mostly in the U.S.), and, of course, shares of construction companies that specialize in erecting walls. It all seems so simple…But remember the assumption in 2008 was that Obama would put gunmakers out of business, turn health providers into wards of the state, and usher in a golden era for alternative energy. Tell that to Smith & Wesson, whose shares have trounced the market by 35 points a year for the past five years. Or to the health care sector, which has outpaced the broad market by more than two points a year in this administration. Or to clean-energy stocks, down 47% so far under Obama."

Now the investment narrative under President Obama, who won the Nobel Peace Prize immediately after taking office, was to avoid defense-related stocks as investors and pundits expected a new 'peace' dividend under Obama who would undo much of the 'neocon' foreign policy initiatives of his predecessor. However, the narrative didn't exactly play out as expected. Defense spending as % of GDP actually rose to higher levels. Not only did budget commitments to defense spending remain higher under Obama than Bush, A&D stocks as a group were able to outperform the market over Obama's terms just as they had under Bush.

The fact is that investment narratives assume a static response by the industry participants, and that is not the reality of our capitalistic economy.

Asking the Right Question

The Money Magazine article also made this astute point: regardless of the outcome, nearly half the country will be miserable over the outcome, but life will move on as the political and economic establishments will help keep both candidates' powers in check to some degree.

The right question investors should be asking is "Am I comfortable with my current risk positioning given the air of uncertainty surrounding the current political climate?" Check to make sure your political biases are not unduly affecting your investment decisions. Revisit your time horizon for making risky investments such as equity investing. If it is less than 10 years, then your investments may not be able to ride out the volatility that can come from risky investments. If the markets do sell off, it will be more likely due to forces beyond which presidential candidate prevails in November. Third, consider diversification. The U.S. market is not the only stock market to invest in – there are plenty others, particularly in regions less susceptible to populist movements.

Will the U.S. cede its leadership to foreign markets after such a strong run? If the current U.S. political environment is giving you angst, reconsider the merits of global diversification.

[1] http://time.com/money/page/2016-presidential-election-clinton-trump-affect-finances
[2] http://papers.ssrn.com

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