CAPITAL ADVISORS

RESEARCH UPDATE
November 9, 2016

Presidential Election Reaction

As of mid-morning on the day after the election, global financial markets have had several hours to digest the surprising outcome. So far, virtually all risk markets have shown a similar reaction – an initial sharp move lower, followed by a retracement of half or more of the initial price change. At the moment, the impact on each of Capital Advisors' seven investment strategies falls somewhere between neutral and positive. This is not a political statement on our part, it is just a reflection of what we are seeing in the markets as this note is being written.

Specifically, stock prices in the healthcare and financial sector are up sharply this morning to the benefit of several positions in the *Managed Equity Growth* and *Managed Equity Dividend* strategies. These gains have been partially offset by downward movements in interest rate sensitive sectors like utilities, real estate investment trusts, and certain industrial and technology stocks. However, on balance our two Managed Equity strategies are higher at this early stage in the digestion process.

Fixed Income markets have shown a more negative reaction to the election so far. After a fleeting flight-to-safety trade overnight when equity futures prices plummeted temporarily, domestic bond markets have subsequently sold off (i.e. bond prices down/bond yields up), presumably reflecting an expectation for fiscal stimulus in a Trump administration. Although the price of most investment-grade bonds is lower today, bonds with shorter maturities are holding up better than longer-term securities, as is typical when interest rates move higher, like today.

We have positioned our fixed income strategies to withstand a rising interest rate environment by keeping the average maturity profile of these strategies relatively short. We would welcome a sustained move higher in interest rates to allow our fixed income strategies to take advantage of the change by shifting further out on the yield curve to capture higher yields.

Our three tactical strategies are also well-positioned for the market reaction we have witnessed so far. The *Tactical Dynamic Allocation* strategy began reducing its risk profile two weeks ago. Real estate was the first sector to leave the portfolio model, which has been a timely trade so far. Following the removal of the international equity sector last Friday the strategy model has shifted 35% of its allocation to fixed income and cash reserves. We are comfortable with this balance because it offers some protection should global risk markets move lower in the coming weeks or months, while remaining exposed to the upside if markets advance from here.

Our two *Tactical Global* strategies (*Global Growth* and *Global Income*) remain fully invested across 10 risk markets at all times. As such, these strategies will drift up and down with the overall direction of asset markets as they digest the transition to a Trump presidency in the coming weeks. As we sit here a few hours into that process these strategies are benefiting from an under-weight position in Japan and an over-weight position in natural resources.

This information is supplement to fully compliance presentations of our strategies available at www.capitaladv.com

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As for specific actions we may take, we hope to use whatever volatility the markets demonstrate in the next few days – including today – to advance the process of buying stocks for client portfolios that are currently in the process of averaging-into the equity markets.

We may see opportunities to deploy excess cash within our two *Managed Equity* strategies, but we plan to be more patient on this front to allow time for greater clarity around the many uncertainties that emerged from last night's election outcome. These uncertainties could lead to higher than normal volatility in the near term.

At this point we feel it is important to highlight that our longer-term outlook for risk markets has not changed materially. We believe most asset markets are currently priced to deliver below-average *long-term* returns from today's starting point. With this outlook in mind, we believe investors are best served with a conservative tilt to portfolio construction for as long as it takes for the menu of investment opportunities to change for the better. In our opinion, the initial reaction to the presidential election has not changed the calculus of risk vs. reward in the asset markets enough to justify drastic action in either direction from investors.

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