EYE ON THE ELECTION – *How the 2020 Race for the White House Affects U.S. Equities*

Most investors view a Trump victory as a bullish event for stocks, a Biden win as a neutral event for stocks, and a victory by another Democrat (Warren) as a negative event for stocks. The impeachment saga and 2020 election developments (Sanders' pause due to health issues, Warren's rise in the polls) are making it tough to disentangle various market influences.

This risk could play out in the equity market well before 2020 Election Day. Though impeachment (unlikely, with a Republican-controlled Senate) is pulling some of the impact into 4Q19, we expect fears of a Warren win to be a headwind for the stock market in the first half of 2020 (particularly 1Q20).

A combination of a Warren White House and a Democratic Congress (unlikely) would be extremely challenging for stocks from a bottom-up perspective. So far, Warren has distinguished herself in the primary through policy (higher corporate taxes, eliminating private health insurance, restoring Glass Steagall, lending restrictions, defense spending cuts, $15 minimum wage, preconditions on share buybacks). The sheer multitude of her plans would leave U.S. equity investors few safe havens.

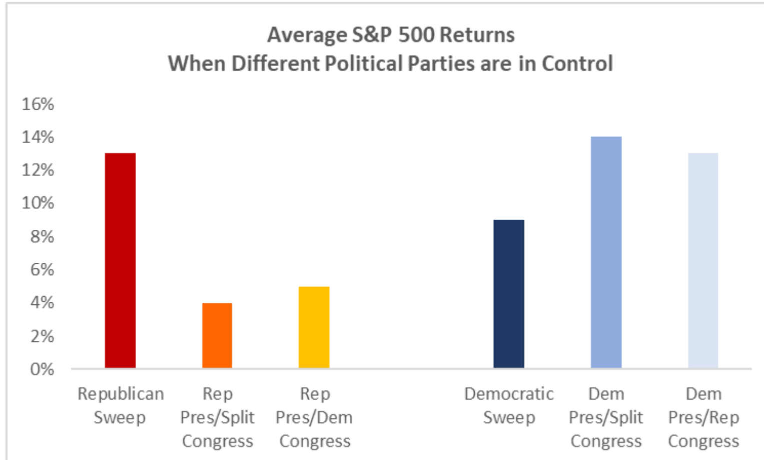
According to a recent interview with RBC industry analysts, the combination of a Democratic President win and a sweep of Congress would be bearish or very bearish for roughly 60% of the U.S. industries (very high risk for Energy and Financials) and positive for just 10%.

Very Bullish	Bullish	Neutral	Bearish	Very Bearish
* Yield Cos	* Forest Products	* Autos & Parts	* Chemicals	* Large Banks
* Alternative Energy	* Internet (ex megacap)	* Beverage, HH & Pers Care, Tobacco	* Coatings	* Biotech
	* Utilities	* Building Pdts	* Ind Power Producers	* Expl & Production
		* Business Services	* Machinery/ Cap Goods	* Managed Care
		* Cable & Telecom	* Med Supplies/Devices	* HC Service Providers
		* Comm Infrastructure	* Electrical Equipment	* Integ Oil & Gas
		* Global Apparel	* Oil Services	* Life Insurance
		* Homebuilding	* P&C Insurance	* MLPs
		* Packaging	* Payment Processors	* Refiners
		* REITs	* Railroads	* Spec Pharma
		* Software	* Semiconductors	* Spec Consumer Finance
			* Regional Banks	
			* Generic Pharma	
			* U.S. Asset Mgrs	

Despite the myriad challenges at the sector level, we envision several investable themes to focus on under a Warren/Democratic sweep. First, the election of a progressive Democrat seems supportive of the already growing popularity of Environmental, Social, Governance (ESG) as an investment approach, since issues like climate change and fair pay could be in the spotlight. Second, dividends seem likely to become a more popular use of cash, since buybacks would be out of favor politically. This benefits the two sectors that we believe have the least direct policy risk (Utilities and REITs) but could also offset some of the pain in Financials and Energy, other major dividend payers which are already deeply undervalued relative to the broader U.S. equity market. Third, Small Caps may have less direct policy risk than Large Caps. Big Tech break ups would be a problem for a select few Mega Cap Internet names (affecting Large Cap Consumer Discretionary and Communication Services) but could be a positive for other Internet names along with Retailers that have suffered from the dominance of Amazon (many of which are Small Caps).

Any pain from a Warren win is likely to be temporary. While the broader U.S. equity market looks somewhat expensive, particularly on non-P/E metrics which have not been pushed down by tax reform, most of the sectors at high risk under a Warren Presidency from a policy perspective (Financials, Energy, Health Care, Industrials) are already deeply undervalued vs. the broader market.

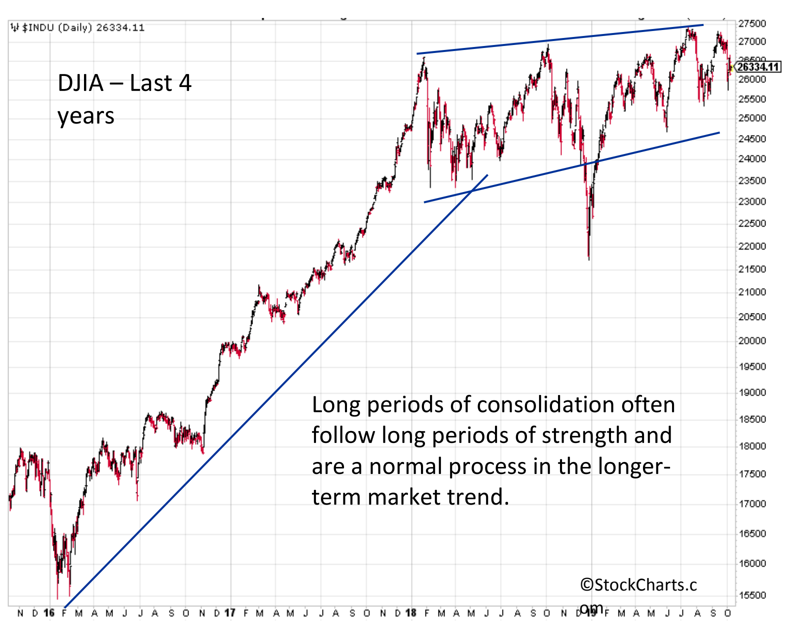
More importantly, the stock market tends to go up over time, regardless of who occupies the White House. Interestingly, the best historical returns in the S&P 500 have occurred with a Democrat in the White House, when Republicans control at least one chamber of Congress. **Ultimately, Corporate America and U.S. equity investors would learn to adapt to new political leadership, as they always do.**



Patience required

The major stock market indexes are struggling to convincingly break out, but this is not so bad, in our opinion, considering the large amount of concern investors have had about what has been going on in the world for this period.

The last two years, we've seen a normal consolidation period, where the markets digest the gains of the previous years of strength. The increased volatility over the past several months is a normal part of process but doesn't make it any easier to be patient.



Many investors are expecting the stock market to sell off. But the indexes have been continuing to trade within 5% of their all-time highs during this period. This leads us to believe that the markets are looking out beyond the current concerns and may mean that any pullbacks that occur could be shallower and briefer than many would expect.

Please let us know of any questions or comments.

♦ ♦ ♦