



Creative Global Investments

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Objectivity
Integrity
Creativity

Political Tail Risks Loom Large

It was just a week ago that we wrote how one can't allow fears of a black swan event to worry oneself into inaction. We acknowledged the political uncertainty hanging over the market, noting that it would be resolved when voters went to the polls on November 8th. But what if it isn't?

FBI Director Comey's letter to Congress last Friday informing lawmakers about a discovery of new emails related to Mrs. Clinton's use of a private server as secretary of state was a bombshell that has clearly impacted the presidential race. Clinton had previously been viewed as a runaway victor by most polls and political pundits. By yesterday the race had tightened considerably with most polls showing a lead of no more than two points and at least one respected poll giving Trump a one point lead.

Trump's improved standing probably means that Republicans are not in as much danger of losing control of the Senate as previously thought. Along with most observers, we never viewed the House majority to be at risk. If this holds, a new uncertainty takes shape given some of Trump's more outlandish statements—**what would President Trump do in office if he were unimpeded by a split Congress?**

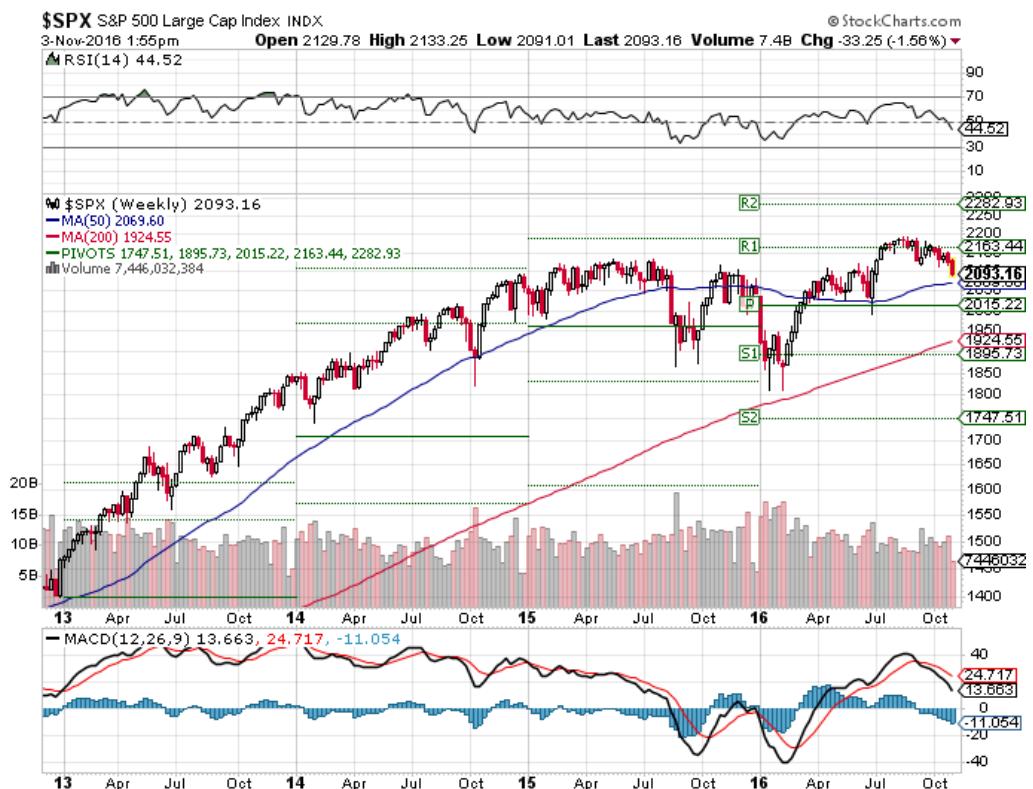
Markets will surely react negatively if a clear winner isn't declared by Wednesday morning. In 2000, the S&P 500 fell by almost 5% by the end of the week. However, we see a very slight chance of such an outcome. More likely, in our view, would be the possibility of Clinton eking out a narrow victory. Under this scenario, Trump narrowly loses several races in key states causing him to challenge them based on any number of issues to dispute the election results. Given Trump's oft-stated claims that the election is "rigged" along with his refusal to state that he'll accept the election results if he loses, it's reasonable to assume that he'll file legal challenges. Unfortunately, the potential also exists for some of his followers to not wait for the courts to express their displeasure and violence could ensue. What often makes for good television makes for bad markets. This could all devolve into an ugly (what about this presidential race hasn't been ugly?) and [more consequential for markets] prolonged series of legal maneuvers and recounts that could keep the official results in limbo for weeks. Remember the Al Gore challenge (who can forget the "hanging chad") of the 2000 election results that wasn't settled until December 12th? And just like Al Gore, we can expect that Donald Trump will not accept any lower court rulings that go against him and settle for nothing less than a Supreme Court ruling.

If elected, we doubt that Trump will repudiate existing trade agreements such as NAFTA in their entirety. However, he will certainly open talks to negotiate better terms. Don't fear a radical protectionist policy that erects a wall of trade tariffs. If Trump doesn't comprehend the consequences of such action, he soon will, once faced with governing. Although a Republican Congress will attempt to pare down their scale and scope, Trump should follow through on his promises to enact fiscal stimulus and tax reform, which would boost the US economy and add to global demand.

Monetary policy likely would continue little changed with an accommodative bias. Ironically, we see a risk that Yellen would resign on principle after Trump insinuated that her decision making was politically motivated. Markets would likely stage a mini-fit unless Trump could convince highly-respected Vice Chair Fischer to assume the reins, if only temporarily.

If Trump wins the presidency, we expect that the S&P 500 could be vulnerable to a sharp 10% to 12% sell off, which would take it down to around the 200-day moving average (1,925) on the weekly chart. Global markets would also be at risk. The Dollar weakens along with the Peso and most emerging market currencies while the Yen and Euro strengthen. The market will likely reverse course just as quickly and rally hard once investors recognize that most of Trump's bombastic statements on the campaign trail aren't likely to be enacted as policy once his agenda evolves once he assumes office.

While the most likely election outcome is still a Clinton win with a comfortable margin of victory, the market could still face a major case of indigestion. A relief rally on the heels of a Clinton victory is the accepted consensus view for the market. What could short-circuit that market rally is the great unknown: what will be uncovered and disclosed in the new FBI investigation that could cause investigators to revisit Clinton's emails? If Republicans retain their majority in Congress, it's a virtual certainty that the Republican leadership will not let this die. This will be recognized as great American theater by the media to be blasted relentlessly into every household across America. It would undoubtedly have a debilitating effect on consumer and business confidence as the country once again watches Washington lawmaking grind to a standstill in the wake of potential impeachment hearings should the basis for criminal misconduct be found to exist. **The recent rise in market volatility should therefore not be dismissed as an aberration since it may only be a taste of what's to come. None of this should be construed as Fait Accompli, but the tail risks just got fatter.**



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