PART ONE

NOW WHAT?

Deciphering election results from an investment management perspective.

"IT AIN'T OVER 'TIL IT'S OVER." BUT FINALLY, IT'S OVER.

Regardless of political leaning, all Americans (and investors) can be thankful for the conclusion of the U.S. presidential election. This cycle began earlier and seemingly dragged on forever, with more than a few unexpected turns along the way. The rhetoric was coarse at times, and some policy positions put forth were unconventional at best. Perhaps this simply reflects a higher degree of economic uncertainty and our collective struggle to fully digest this unprecedented era of globalization, which is creating a slew of new economic winners and losers.

Victory Capital and its portfolio of independent investment franchises have been closely following the political winds. Obviously, the pollsters and pundits don't always get it right, but our investment professionals have been thinking about the various outcomes.

To help investors move ahead, we have compiled a series of portfolio manager viewpoints on the state of the markets, the economy, and specific industry sectors now that the election is behind us.

This is the first in a two-part series and features insights from four of our Chief Investment Officers, all of whom remind us to let history be our guide to keep perspective.

Victory Capital is an integrated multi-boutique asset management firm with approximately $51.4 billion in assets under management, as of September 30, 2016. Comprised of 11 autonomous investment franchises, each with an independent culture and investment approach, we're focused on empowering specialist managers to meaningfully advance client outcomes.

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Keep calm and carry on

Scott Tracy, CFA,
is Chief Investment Officer, *RS Investments Growth*.

Remember that opportunities for investors are likely to abound, no matter who occupies the White House.

Election season has dominated the headlines, and we've been told that this was the single most important election in the history of the United States. Some pundits have suggested that this election posed the single largest threat to financial markets in recent history. Consider these pithy quotes:*

> *"We have had many important elections, but never one so important as that now approaching."*

> *"The Republic is approaching what is to be one of the most important elections in its history."*

This type of feverish rhetoric sounds like it's from cable TV. However, these quotes are actually from elections that took place well over 100 years ago in 1864 and 1888, respectively. So while the decisions we face today may loom large, it's important to remember that our country has survived 56 presidential elections over the course of 240 years.

In terms of the true impact on the financial markets, it's hard to make generalizations. Market performance under a Democratic or Republican president has been surprisingly mixed, which is encouraging for investors. Markets should reflect the economic environment, and we have had Republicans and Democrats in the White House at varying points of economic cycles.

The average stock market gain under a Democratic president has been higher than under a Republican president going back to the 1940s. But the best stock market performance of any president came during Republican President Gerald Ford's tenure. And while the second-best stock market performance came under Democratic President Bill Clinton, the bulk of that strong performance came with a Republican-controlled Congress.

With the election behind us, let's turn our attention to what we can control. And as growth-oriented investors, we are committed to:

> Maintaining discipline and following the same, proven investment process that has driven strong relative and absolute returns over time.

> Allocating capital to companies with high-quality growth stories and priced at reasonable valuations.

> Focusing on companies with strong balance sheets, healthy cash flows, and what we view to be long-term growth candidates supported by competitive advantages.

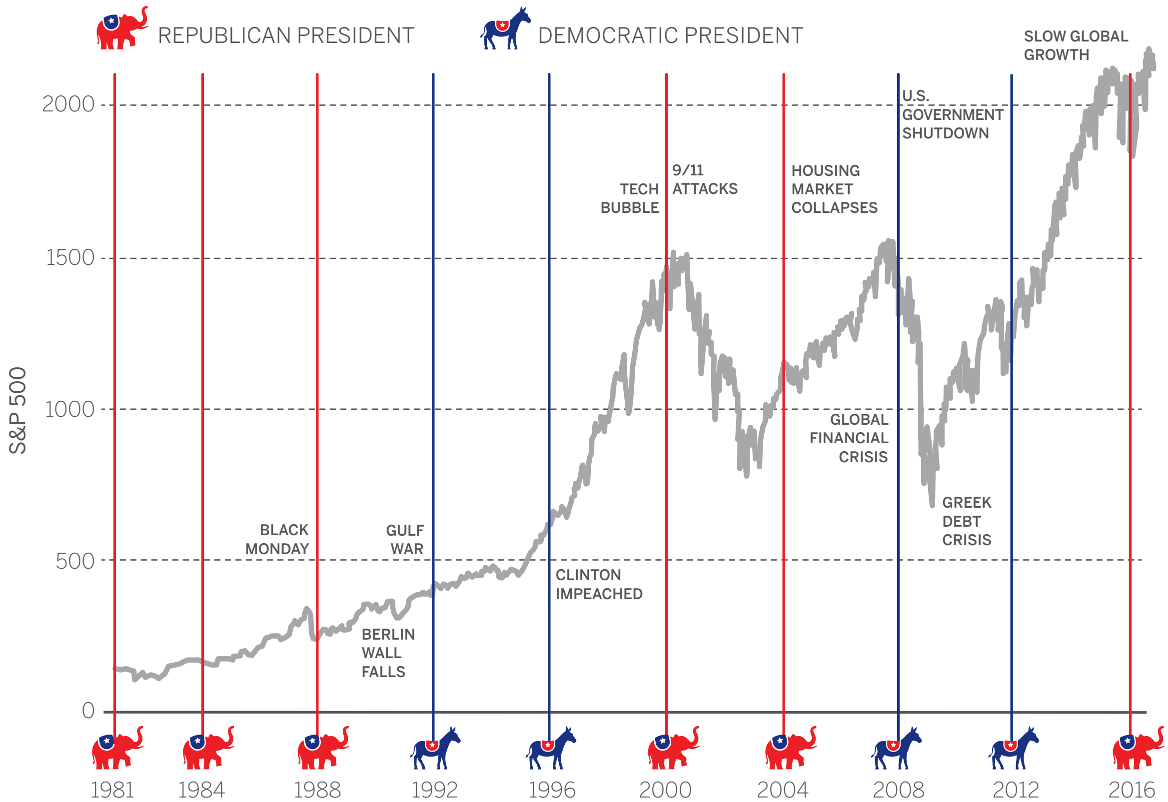
> Taking advantage of near-term volatility to add to our holdings in some of our favorite investments at what we consider attractive prices.

So if you're ecstatic or upset about this week's outcome, remember that opportunities for investors are likely to abound, no matter who occupies the White House.

** Source: "The Most Important Article in Our History," The New York Times, September 5, 2004.*

ELECTIONS MATTER, BUT THEIR IMPACT ON FINANCIAL MARKERS IS MINIMAL

S&P 500® Index price returns, from January 1981 to October 2016.



Source: Fidelity.

Focus on what matters most

After all the rancor and posturing of this election season, it's important to remember that electoral outcomes typically take years to impact the domestic economy. And truth be told, the immediate impact on markets is often overestimated. Our system of checks and balances requires negotiation and causes policy to move slowly. It will take considerable time to decipher forward policy direction. Thus, we remain focused on what matters most, and we are uninterested in basing investment decisions by speculating on the post-election legislative agenda. Rather, we recommend investors ignore the temptation for an emotional response and focus on the two factors most likely to continue driving markets: 1) consumption and employment activity; and 2) the path of FOMC interest rate policy in 2017.

Remember, the change in leadership coincides with a period in which the impact of monetary policy seems to have reached its limit, both in the U.S. and around the globe. The Fed's most recent economic forecast of

Ed Goard is Chief Investment Officer, *INCORE Capital Management*.

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longer-run growth in real GDP was a mere 1.8%, down from 2.0% in its June forecast. Eight years of easy money has resulted in a shallow recovery and meager growth.

It's likely that fiscal and tax policy will begin to take precedence over monetary policy going forward, with a particular emphasis on infrastructure spending. Deficit spending to fund infrastructure projects will need to be balanced with long-term entitlement restructuring. Failure to do so will likely be greeted by the bond market with higher long-term interest rates. The size of the deficit that the Republican Party is willing to accept is currently unknown and will require negotiation by all factions.

In the short term, we expect that the FOMC will implement a December rate hike. This assumes continuing employment gains, an improving labor participation rate, and an ever-resilient consumer who has been the cornerstone of our current expansion. We also expect the Fed to keep to its stated objective of a gradual normalization of interest rates, but it won't be without its challenges. Complicating the Fed's ability to move is a struggling global economy, evidenced by much of the developed world drowning in negative yield.

We've been calling for the expected terminal fed funds rate (the point at which the Fed will stop hiking this cycle) to settle close to or below 2%, which is lower than the Fed's current forecast of almost 2.9%. The possibility of massive deficit spending has the potential to devalue the dollar and reprice inflation expectations. Depending upon how the legislation proceeds, we may need to revise that expectation higher.

Finally, Donald Trump used aggressive rhetoric against low interest rates and the ineffectiveness of monetary policy during the campaign. While we expect he will soften that rhetoric, he may choose to nominate more hawkish Fed governors with two open seats on the Board. Additionally, it is likely he will nominate a different Chair at the end of Janet Yellen's term in February 2018.

Will the globalization train roll on?

Mike Reynal is Chief Investment Officer, *Sophus Capital*.

Uncertainty is the enemy of risk assets. But even now that the U.S. electorate has spoken, we wonder if global equity markets can move ahead. President-elect Trump has been outspoken with his anti-globalization rhetoric throughout the election season and, as investors, we need to assess just how much political risk remains.

The key question is whether President-elect Donald Trump will legitimately pursue an isolationist agenda. He has been outspoken on the North American Free Trade Agreement (NAFTA) and the Trans-Pacific Partnership (TPP), and his language has been combative on the topics of trade, tariffs and immigration.

From our perspective, the key risks facing global equity markets are threats of greater protectionism, including unilateral tariffs and re-writing our trade agreements. These actions could boost inflation and act as a brake on the global economy. If anti-trade sentiment turns into new legislation, the initial reaction from a financial market perspective will be negative for risk assets and, especially for export-oriented companies and countries. Mexico could be among the hardest hit.

China will likely suffer on trade as President-elect Trump has claimed during his campaign to bring trade cases against China for unfair subsidies. Chinese equities could also come under pressure if China devalues its currency to support exports. On the other hand, President-elect Trump opposes the Trans-Pacific Partnership (TPP), which would be beneficial to China if that agreement was stymied. It is important to note that if any tariffs are placed on China or Mexico, other emerging market countries may benefit.

The costs of a trade war could land on the American consumer, as well. Inflation might skyrocket, and nearly everything would be more expensive. Consumers would also face fewer consumption choices.

Despite the surprising election outcome, it's important to remember that what is said on the campaign trail might be immaterial in terms of new policy. According to a report by Morgan Stanley (U.S. Election 2016—Fighting the Fear of the Unknown), going back to 1933 and looking at elections in years when there was no incumbent on the ticket, winning candidates were not very successful enacting radically different policies in their first year in office. Furthermore, the success rate appears to be declining, a testament to rising political polarization.

Nevertheless, the new president could attempt to unilaterally withdraw from NAFTA, giving six-months' notice under Article 2005 of the agreement. Although Trump has alluded to that possibility if he is unsuccessful in amending NAFTA, it is unclear whether Senate approval (even one controlled by the Republican Party) would be needed or even feasible. In our opinion, the likelihood of any truly radical action on trade and tariffs appears to be slim, though we are closely monitoring the situation.

As global investors, we continue to believe that the generational trend toward economic liberalization and the removal of capital controls to encourage economic development and globalization is too big to derail. But as realists, we also know that political risks have been ratcheted up slightly even as the election has been settled.

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Dissecting the data

Tony Dong is Chief Investment Officer, *Munder Capital Management*.

While we continue to believe the new normal implies a lower-for-longer growth curve, we also think investors should enter 2017 with full awareness of the historical first-year downside bias after an election.

The presidential election of 2016 was arguably the most controversial and negative race of the last century. The good news, however, is that we have finally settled a large dose of uncertainty for both Main Street and Wall Street. Investor attention is certain to shift to other economic and/or political issues—and hopefully to individual stock fundamentals.

Given all the fervor of this election season, we decided to step back and look at the historical data to consider if the election cycle holds predictive power for the economy and stock market, a concept termed the Presidential Cycle Theory. Simply put, this theory states that presidents make tough decisions and get the bad news out of the way early in their terms in order to set up a favorable election-year economy. The data itself shows that nine out of the 14 recessions we've experienced since and including the Great Depression began during the first year of the presidential cycle (one began in the second year and the remaining four began in year four).

While this theory is simplistic in nature, we must admit that there could be other behavioral/structural forces around the election that might reinforce a pattern of more active legislation in the early years of a new presidential term. This could influence the backdrop that ultimately shapes the economy and the markets.

What immediately stands out to us is that 90% of all the recessions since 1929 began either during the first year or the fourth year of a presidential cycle. Does that mean an imminent recession is likely in late 2016? Not in our opinion, especially given the improving economic data in the third quarter and the Fed's clear messaging around modest rate increases.

That said, history suggests that 2017 is more of a wild card, as 40% of the time we've been in a recession during year one of a presidential cycle. Stock market returns reflect this economic history, with the S&P 500® managing positive returns only 53% of the time during year one of a new presidency versus 72% using all calendar years since 1929. Furthermore, after seven years of economic expansion, the business cycle is looking tired, and the Fed has signaled further interest rate increases are on the horizon. While we continue to believe the new normal implies a lower-for-longer growth curve, we also think investors should enter 2017 with full awareness of the historical first-year downside bias after an election.

Investing involves risk. Principal loss is possible.

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