HBK Wealth Management
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WEEKLY MARKET COMMENTARY

A Candid Look into the Current State of the Markets

August 2016

Our roads to success may have twists and turns and ups and downs; together we can navigate a course and enjoy the scenery along the way.

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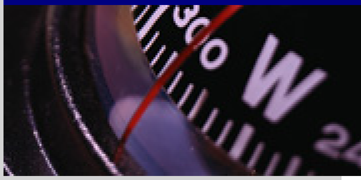
In This Issue



Weekly Market Commentary | Week of August 22, 2016

HIGHLIGHTS

- This week we look at what stocks may be telling us about the presidential election.
- The relative lack of volatility this summer may indicate increasing odds the market is assigning to a Clinton victory.
- We also look at what some politically sensitive industry groups may be telling us about the election outcome.

WHAT THE MARKET IS TELLING US ABOUT THE ELECTION

Election years have historically been good for stocks, and this year has been no different, although with less volatility than we would expect during the summer of an election year. That relative calm may partly reflect that the market is increasingly pricing in greater certainty that would come with a Hillary Clinton victory, as her support has climbed in the polls. This week we look at what the stock market and some politically sensitive industry groups may be telling us about the potential outcome of the presidential election in November.

WHERE'S THE ELECTION YEAR VOLATILITY?

Election years have historically been good for stocks, though with some volatility, as we wrote in our election themed *Weekly Market Commentary* back in May ("What Might Trump the Election Year Pattern?"). That volatility during election years has historically come during the middle and late summer months--in other words, about now. Although each cycle is different (especially 2008), in recent decades we have observed that the volatility tends to subside, and a late-year rally ensues, when markets have more clarity on the candidates' platforms and start to price in a winner.

So where has the volatility been this summer? As shown in Figure 1, the S&P 500 has gone up in nearly a straight line since mid-February, with a very short-lived interruption for Brexit before continuing its advance. This year's gains have exceeded the average election year's gain going back to 1952 (6.6%) and are on track to outgain the average election year, even if 2008 is excluded (9.6%).

Certainly improving economic conditions have played a key role in the stock market's steady gains over the past six months. But we believe the market has begun to price in strong odds of a Clinton victory as her lead in the polls has increased, which brings more predictability than a Donald Trump administration. There is still uncertainty to clear up in terms of both candidates' agendas, as well as what they could actually get through Congress, which could lead to more volatility. The Senate could go either way at this point, while some nonpartisan, and even right leaning political pundits acknowledge that the Republican's House majority may even be at risk in the event of a Clinton landslide victory.

Click here to view Figures 1-5.

THE STOCK MARKET'S VOTE

We can speculate that recent stock market gains partly reflect greater certainty under a Clinton administration. But polls can be wrong (case in point: Brexit). It's possible that the market's strength has little to do with the election. So perhaps a better question to ask is: Do strong stock markets predict elections?

It appears at this point that the stock market's vote is aligned with the polls. Since 1928, a stock market increase over the three months leading up to the November presidential election has an 82% success rate at predicting the winner [Figure 2]. In 18 of the 22 election years going back to 1928, the gain or loss in the stock market over August, September, and October accurately predicted which party won. For years in which the election followed a two-term president (1940, 1944, 1960, 1988, 2000, and 2008), the track record has been perfect, but granted, this covers a limited number of occurrences.

The exceptions to the "vote of the stock market" are 1932, 1956, 1968, and 1980, when the challenger won despite stock gains, or when the incumbent won despite a stock market decline over the period. No market indicator is perfect for every election; however, the stock market's vote has been fairly predictive over the years and suggests that the stock market and the polls are in agreement, at least for now.

The performance of the U.S. economy, and specifically income growth, is also a good predictor of election outcomes, as we noted in the *Midyear Outlook 2016: A Vote of Confidence*. This indicator is suggesting a slight edge for the Democrats.

ARE POLITICALLY SENSITIVE GROUPS AND POLLS ALIGNED?

The broad market's performance may be telling us something about the November election, but what about some of the most politically sensitive industries? If the market was pricing in a Clinton victory, certain industries where her platform may not be as supportive would be expected to lag the market (and vice versa). We looked at the relative performance of several politically sensitive industry groups to see if they were aligned with a market-based version of a presidential election poll to determine if their performance might be telling us something about the potential outcome in November.

Financials

Clinton is likely to be much tougher on bank regulation that Trump. She has supported tough financial regulation under the Dodd-Frank law, while Trump has indicated his interest in dismantling the law. Clinton has indicated that she would be willing to break up financial institutions deemed "too big to fail." She would propose a risk fee for big banks and financial institutions based on their size and their risk of contributing to another financial crisis. Both Clinton and Trump have included reinstating Glass-Steagall as part of their platforms, which prohibits commercial banks from engaging in investment banking.

What is the market saying? As shown in Figure 3, from mid-May (when the two nominees became clear) through the end of July, the odds of a Clinton victory tracked the (inverse) relative performance of bank and capital markets stocks. We believe prospects of a continued tough regulatory environment, including the anti-Wall Street rhetoric (even if Glass-Steagall faces very long odds of being reinstated), played a role in the relative weakness of these groups during that time.

But during the last couple of weeks, as Clinton's odds of winning increased in the polls, financial stocks did well. Gains in these stocks in August likely reflected the move in interest rates, from 1.46% on the 10-year Treasury at the end of July to just shy of 1.60% late last week, which may have overwhelmed politics. **Alignment between market and polls: Good.**

Healthcare

Clinton is a strong defender of the Affordable Care Act (ACA) and arguably one of the early architects of some of the law's basic concepts. Trump, on the other hand, has stated his interest in repealing it, a key pillar of the Republican platform. Both candidates have expressed support for the government (Medicare) to negotiate drug prices directly to help bring down prescription drug costs, though Clinton has more credibility on this issue than Trump.

What is the market saying? The ACA means more insured patients, so the healthcare facilities and managed care groups should have done well recently as Clinton's odds of winning have increased. But as shown in Figure 4, they really haven't, especially facilities (remember the relative performance lines are inverted). Some of this inconsistency, we believe, reflects the profitability challenges for certain healthcare institutions under the ACA. Pharmaceutical stock relative performance has only begun following its expected path (inverse correlation to Clinton's odds) over the past month. The weakness of this link, besides various company specific issues, may be due to the market's expectation that, even in a Democratic administration, it is unlikely that major drug reforms will get through Congress. **Alignment between market and polls: Mixed.**

Energy

The candidates have very different approaches to energy policy. Clinton wants to reduce American oil consumption by a third through cleaner fuels and more efficient cars, boilers, ships, and trucks. Trump, on the other hand, has talked about reducing regulations for drilling, approving the Keystone XL pipeline, and put one of the pioneers of the oil and gas shale revolution on his economic advisory council.

What is the market saying? Drawing comparisons between energy and policy is tricky because of the many macroeconomic factors that drive oil and the tight relationship between oil prices and oil stocks. Still, oil and gas exploration and production stocks did underperform from mid-May through the end of July as Clinton's odds improved [Figure 5]. The outperformance of energy stocks in August, despite Clinton's improving odds, has been driven more by anticipation of an OPEC production agreement next month than politics. **Alignment between market and polls: Fairly close until recently.**

What About Infrastructure?

Both candidates have supported infrastructure spending, such as fixing roads and bridges, to help stimulate the economy and increase employment. In what has been more of a Democratic position in recent years, Trump has proposed to spend double Clinton's $275 billion over the next five years. All things considered, the candidates have not differentiated themselves much on this issue (similar to international trade, which both would like to restrict to varying degrees). Not surprisingly, construction materials stocks did quite well early this summer as Trump's plans became clearer.

CONCLUSION

The broad market seems to be in alignment with the polls in suggesting a Clinton victory in November is likely, although anything can happen. The lack of market volatility in recent months may reflect the market's preference for less uncertainty under Clinton's leadership, while financials stocks, which would be expected to do better under Trump, have generally struggled as Clinton's odds of victory have risen. The messages from other politically sensitive groups including healthcare and energy are more mixed. We will continue to watch for signals from the market as to what may happen in November, as we can all agree, regardless of one's political leanings, that this election will have investment implications.

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The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Investing in stock includes numerous specific risks including: the fluctuation of dividend, loss of principal, and potential liquidity of the investment in a falling market.

Because of its narrow focus, sector investing will be subject to greater volatility than investing more broadly across many sectors and companies.

All investing involves risk including loss of principal.

INDEX DESCRIPTIONS

The Standard & Poor's 500 Index is a capitalization-weighted index of 500 stocks designed to measure performance of the broad domestic economy through changes in the aggregate market value of 500 stocks representing all major industries.

This research material has been prepared by LPL Financial LLC.

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Tracking #1-528429 (Exp. 08/17)

Weekly Economic Commentary | Week of August 22, 2016

Highlights

- Global policymakers initially countered the financial crisis with both monetary and fiscal policy; but monetary policy has been the tool of choice more recently. Fiscal policy tools are now being more actively considered.
- Fiscal policy has been contracting in the U.S. after the large initial fiscal stimulus in response to the financial crisis in 2008.
- Both presidential candidates have made fiscal stimulus, especially infrastructure spending, part of their campaign platforms.

Fiscal Policy--String Theory

Even many central bankers admit that monetary policy is exhausted, and that fiscal policy should increasingly be the focus of efforts to stimulate the economy. When monetary policy has reached the limits of its effectiveness, economists sometimes refer to continued monetary easing as "pushing on a string." Fiscal and monetary policies have both been employed globally to ameliorate the impact of the Great Recession. Most countries engaged in some form of fiscal stimulus in 2009-10. In the U.S., a combination of state budgetary restrictions and the federal budget sequestration led to fiscal contraction, which partially negated the impact of loose monetary policy. Both presidential candidates have made increased infrastructure spending and other forms of fiscal stimulus part of their economic plan.

TO PUSH OR TO PULL? THAT IS THE QUESTION

The debate over which government policies should be implemented to boost economic growth is often phrased in terms of a "string." When monetary policy seems to have reached the limits of its effectiveness, which certainly seems to be the current case globally, monetary policy is said to be "pushing on a string"--a metaphor for ineffective action. Increasingly, policymakers are looking to fiscal policy to fix what ails the global economy.

But what do these terms mean? Monetary policy refers to the management of the money supply and interest rates within a country, or in the case of the European Union, across a number of countries. Monetary policy is set by central banks, for example the Federal Reserve (Fed) in the U.S., the European Central Bank (ECB) in Europe, or the Bank of England in the United Kingdom. These central banks are generally considered independent of the government, though some countries, most notably China, do not have this separation. Monetary policy also includes setting some of the rules regarding the availability of credit, typically through banks. The Chinese authorities often use changes in lending rules, such as the amount required as a down payment on property purchases, as a policy tool.

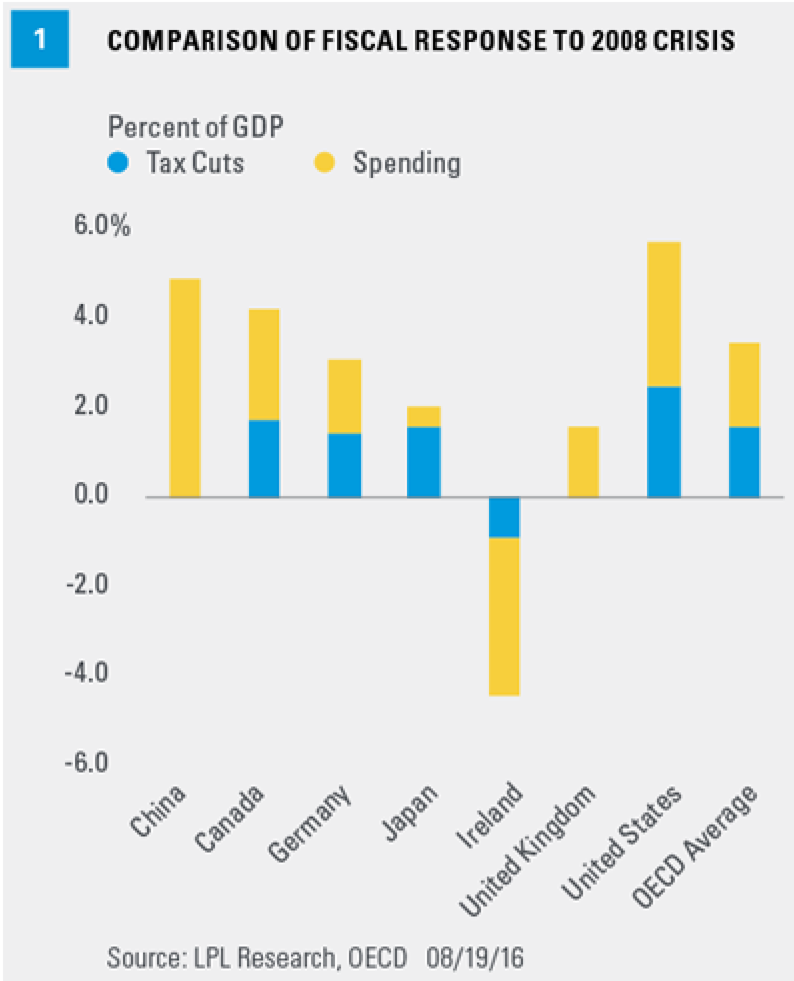
Fiscal policy refers to a nation's taxation and spending policy, and is a function of its government, not a central bank or other agency. In this regard, fiscal policy is more directly impacted by politics and elections, whereas monetary policy is generally considered above the fray. Because fiscal policy is a function of politics, discussions quickly get heated. It's important to remember that fiscal policy refers to both tax and spending policy, and tax cuts can be just as impactful as spending increases.

ACCOUNTING FOR GOVERNMENT SPENDING

When doing national income accounting (calculating things like GDP), government spending includes anything purchased by the government, from aircraft carriers to paper clips. It also includes salaries for government employees. But GDP does not include government spending in the form of *transfer payments*, that is, payments directly to individuals. This includes Social Security, Medicare, unemployment insurance, welfare programs, and similar types of spending.

FISCAL POLICY TIED IN A KNOT

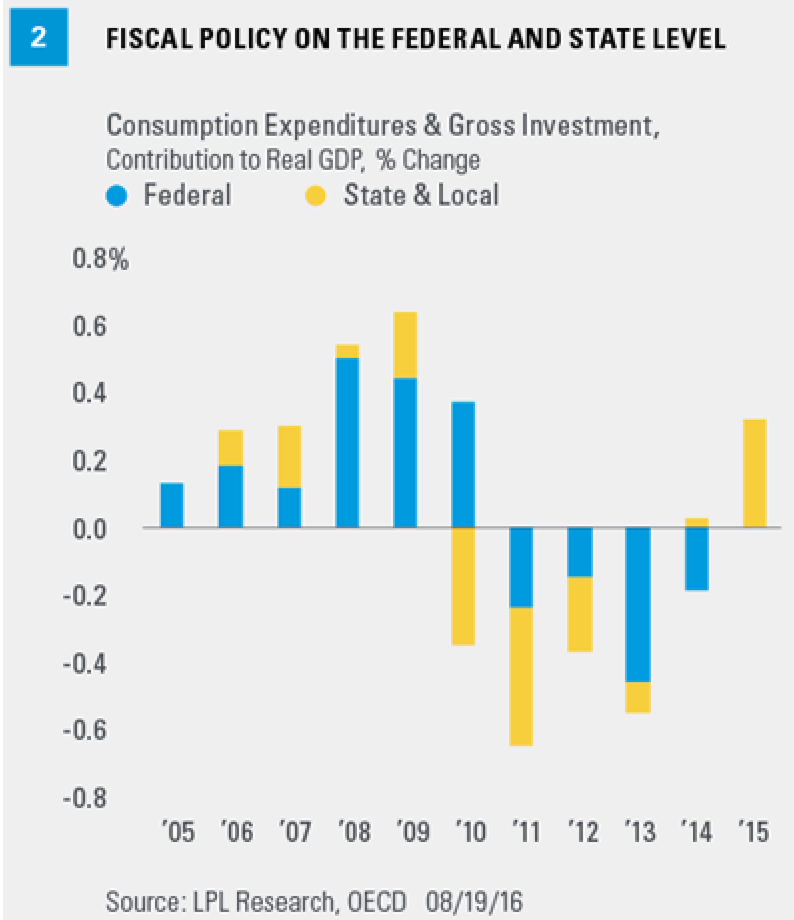
The initial response to the global financial crisis of 2008 consisted of coordinated monetary and fiscal policies. Interest rates globally were slashed, and in some countries, bank lending rules were eased. At the same time, most countries engaged in fiscal policy expansion. Figure 1 details some of these responses and the mixture of policy between tax cuts and spending. These policies were typically enacted over a period of years, with most of the impact felt in 2009-10, depending upon the country.



A few things stand out. Not all countries expanded fiscal policy; a few countries, like Ireland, engaged in austerity policies by raising taxes and cutting spending. China is also an outlier, as most of its policy response was done through the expansion of bank lending, which is technically part of monetary policy. In a country without an independent central bank and where the government is so entwined with the private sector, these sorts of distinctions become blurry at best.

Economists will debate for decades the effectiveness of these policies. But regardless of whether these policies were the most effective ways of preventing the kind of downward spiral seen in the 1930s, the global economy avoided the worst possible outcome from the financial crisis.

Fiscal and monetary policies did not stay aligned for long. Interest rates remained low, with most major central banks engaging in some form of quantitative easing (QE). Yet, fiscal policy tightened globally. This is especially true in the U.S. [Figure 2]. The U.S. is rare, globally, in that fiscal spending is done at both the state and federal level. Already by 2010, state and local spending were contracting. Most states have some legal provisions, either constitutionally or by statute, requiring a balanced budget. So whether there was a deliberate effort to cut spending, or there simply was a decline in revenue that necessitated a reduction in spending, fiscal policy on the state level began to counteract federal spending. If the intention of fiscal policy is to be "counter-cyclical"--to go against the trend in the economy--rigid rules like balanced budget laws defeat this purpose.

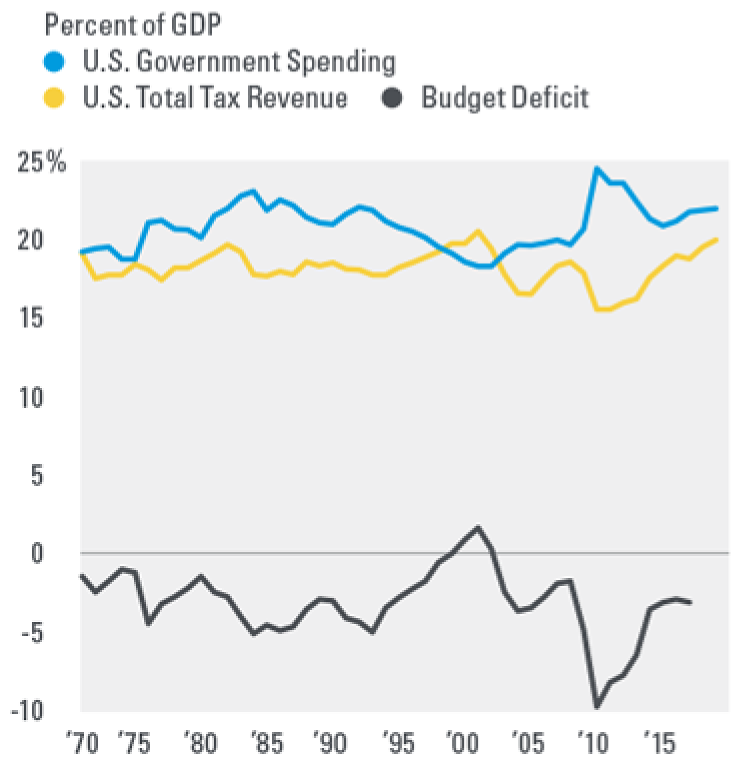


Fiscal spending on the federal level declined due to the budget sequestration section of the Budget Control Act of 2011, though the provisions did not become effectively until March 2013. More recently, states have begun to increase spending, partially because tax revenue has increased, but also because things like infrastructure maintenance and improvement can only be delayed for so long. Federally, sequestration is still in effect and creates some drag on U.S. gross domestic product (GDP).

WILL EITHER CANDIDATE PULL THE STRING?

Both presidential candidates have invoked fiscal policy as a way to improve the U.S. economy, with some predictable similarities and differences between them. As the election nears, we are likely to get more details, and more rhetoric, from the candidates with regard to their proposed fiscal policies. The federal budget deficit has been growing in absolute terms; relative to GDP, the deficit has been stable at 2.8% of GDP and is expected to remain at this level for the next few years based on current trends [Figure 3]. As the candidates have promised to expand fiscal policy, the budget deficit is likely to increase in the near term, regardless of who wins the election.

3 A HISTORY OF TAXING AND SPENDING



Source: LPL Research, Bloomberg 08/19/16

One common fiscal policy proposal from both the candidates is an increase in infrastructure spending. Hillary Clinton has proposed $250 billion in additional infrastructure spending over the course of the next four years; Donald Trump has countered with $500 billion. Though neither camp provided details as to how that money would be spent, they do differ on how this spending would be funded. Trump has proposed borrowing these funds. Clinton has proposed creating a national infrastructure bank, funded from changes to the corporate tax code, likely from closing loopholes and changing the structure of the tax code, rather than raising rates. Though these numbers sound big, assuming the spending would occur during the course of a four-year presidential term, Clinton's plan would amount to 0.25% of GDP, Trump's to 0.5%, nowhere near the big numbers seen in the immediate response to the crisis.

Another likely change in fiscal policy will be tax reform, particularly for corporate taxes and some provision to encourage the repatriation of the over $2 *trillion* U.S. companies are holding overseas to avoid taxes. There is broad agreement in both parties that the tax code needs to be reformed, with lower rates and fewer exceptions and loopholes. The details of these reforms will be determined as much by the makeup of Congress as the identity of the next President. Either way, we would expect tax reform to be a source of fiscal stimulus after the election.

CONCLUSION

There is broad consensus, globally and in the U.S., that fiscal policy is going to be revamped to boost the global economy. Monetary policy has done all it can. Concerns about the budget deficit and state balanced budget mandates have been two major factors preventing the expansion of fiscal policy in the U.S. Rightly or wrongly, these issues have been put on the back burner by the presidential candidates, who have promised changes on the both taxation and spending policy to improve the U.S. economy.

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Gross domestic product (GDP) is the monetary value of all the finished goods and services produced within a country's borders in a specific time period, though GDP is usually calculated on an annual basis. It includes all of private and public consumption, government outlays, investments, and exports less imports that occur within a defined territory.

Quantitative easing (QE) is a government monetary policy occasionally used to increase the money supply by buying government securities or other securities from the market. Quantitative easing increases the money supply by flooding financial institutions with capital in an effort to promote increased lending and liquidity.

The Organization of Economic Cooperation and Development (OECD) brings together the governments of countries committed to democracy and the market economy from around the world to support sustainable economic growth, boost employment, raise living standards, maintain financial stability, assist other countries' economic development, and contribute to growth in world trade.

RES 5617 0816 | Tracking #1-528482 (Exp. 08/17)

Federal law requires the three major nationwide consumer reporting companies -- Equifax, Experian, and TransUnion -- to each provide you with a free copy of your credit report, at your request, once every 12 months.

Your Credit Report: Can You Afford to Ignore It?

When was the last time you obtained a copy of your credit report? If your answer is "never" you are not alone. A recent survey found that one in four Americans have never checked their credit report. The simple reason? They don't think it is important.[1]

Credit reports ARE important to every consumer. They typically are a major factor in determining if you will be approved for a loan, be able to rent an apartment, or even get hired at a new job. They qualify your creditworthiness and are one of the first places to detect whether you have become the victim of identity fraud.

If all of those reasons are not enough to convince you that monitoring your credit report is a good idea, the no-brainer fact you can't deny is: It's free and has been for more than a decade!

The Fair Credit Reporting Act (FCRA) requires the three major nationwide consumer reporting companies -- Equifax, Experian, and TransUnion -- to each provide you with a free copy of your credit report, at your request, once every 12 months. These three companies sponsor an official website -- annualcreditreport.com-- that allows you to request credit information from all three agencies in one place.

Once you receive your report(s), be sure to review all of the following for accuracy:

- Your name (including any variations or nicknames)
- Your Social Security number
- Date of birth
- Current and previous addresses
- Employment data
- Credit accounts and history
- Public records (e.g., liens, bankruptcies, etc.)

If you find errors in the report, you'll need to contact the credit bureau and provide documentation to correct the error.

Confusion Compounded

Even among those who have checked their credit reports fairly recently, confusion persists about what is included in the report and why it matters to them. For example, a survey of more than 4,300 adults conducted in early 2015 by Credit.com found that:[1]

- 27% of those surveyed were surprised by some of the information included in the report.
- One in five found (21%) incorrect or outdated information.
- One in 10 (10%) found a collection account they didn't know existed.
- 15% were unsure of the relevance of each section of the report.

Further, the study showed that many consumers only saw their credit reports in conjunction with an application for housing or a loan and were left with little or no time to respond to any problems or mistakes that may have surfaced.

Don't be blindsided by errors in your credit report that could cost you a job or disqualify you from a loan application. Credit experts generally encourage individuals to check their credit report at least annually to ensure that the information it contains is accurate and up-to-date.

[1]*Credit.com, "Are Credit Reports Important? Many Americans Say No," March 3, 2015.*

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Investors: Don't Let Fear Keep You on the Sidelines

One of the key determinants to investment success over the long term is having a disciplined approach to balancing short-term risk (stock price volatility) with long-term risk (loss of purchasing power).

While the U.S. stock market, as represented by the S&P 500 Index, has risen a stunning 205.66% as of March 31, 2015, since its low on March 9, 2009, some investors are still reluctant to participate after the near market collapse that accompanied the 2007-2008 financial crisis.[1]

Fleeing the market certainly may have felt like the right thing to do at the height of the financial crisis. But history shows that making investment decisions based on emotion has never proven successful. For instance, greed may have led an investor to own too many technology stocks when the bubble burst on that industry in 2000. Alternatively, fear may have caused investors to cash out of stocks following the crash of 1987 and miss some or all of the subsequent rebound.

Fast forward to 2015, and the reality is that investors who missed the extraordinary rally that has occurred since March 2009 may have helped to put their long-term accumulation goals at risk. This is especially true for investors with shorter time horizons, such as those approaching retirement. Consider this: From 2010 through 2014, U.S. stocks recorded an average annualized return of 15.5%, compared to 0.1% for money market securities.[2] The nearly nonexistent returns associated with cash-like investments could have a powerful impact on investors' purchasing power over time.

Maintain Balance to Manage Risk

One of the key determinants to investment success over the long term is having a disciplined approach to balancing short-term risk (stock price volatility) with long-term risk (loss of purchasing power). Finding a "middle ground" in your investment philosophy -- and portfolio makeup -- may go far toward helping investors manage overall risk and realize their investment goals.

For instance, history supports the case of stocks, as they have tended to outperform other asset classes as well as inflation over long periods of time.[3] But investors who are too focused on the long term may over-allocate their portfolios to stocks -- and over-expose themselves to short-term volatility risk. Alternatively, investors who are extremely averse to short-term risk may do the opposite and face heightened long-term risk.

Easy Does It

How might this balanced approach to risk be used to get investors back in the market? One of the best ways to take emotion out of investing is to create a plan and stick with it. And one of the best ways to do that is through a systematic investment plan called dollar cost averaging (DCA).[3] Dollar cost averaging is a process that allows investors to slowly feed set amounts of money into the market at regular intervals.

Although DCA does not assure a profit or protect against a loss in declining markets, it can help achieve some important objectives. First, it gives investors a measure of control while eliminating much of the guesswork -- and emotion -- associated with investing. Second, DCA can help investors take advantage of the market's short-term price fluctuations in a systematic way -- by automatically buying more shares when prices drop and fewer when prices rise.

It is important to remember that periods of falling prices are a natural part of investing in the stock market. But by maintaining a long-term focus and following a balanced approach to managing investment risk, you may better position yourself to meet your financial goals. A qualified financial professional can help you identify which strategies may be best for your situation.

[1]*Wealth Management Systems Inc. Stocks are represented by the daily closing price of Standard & Poor's Composite Index of 500 Stocks (the S&P 500), an unmanaged index that is generally considered representative of the U.S. stock market. The percentage increase represents the gain through March 31, 2015. It is not possible to invest directly in an index. Past performance is not a guarantee of future results.*

[2]*Wealth Management Systems Inc. For the five years ended December 31, 2014. U.S. stocks are represented by the S&P 500 Index. Money market securities are represented by Barclay's 3-Month Treasury Bill rate. Example does not include commissions or taxes. Past performance is no guarantee of future results.*

[3]*Dollar cost averaging involves regular, periodic investments in securities regardless of price levels. You should consider your financial ability to continue purchasing shares through periods of high and low prices. This plan does not assure a profit and does not protect against loss in any markets.*

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