Monthly Commentary

November 15, 2016

"Good investors gather information, put that information into current and historical context, then make sound decisions."

Equity markets could hardly wait for the election to be over, so they didn't. The last five trading days of October and the first four trading days of November the S&P 500 Index declined for nine straight days, with a total decline of a little over three percent. That turned around the Monday before Election Day as a very sharp rally ensued for four days that would more than recover the nine-day straight decline. While some would say that equity markets were celebrating the election outcome, the reality is that the party had started two days before the electoral votes were all counted. The financial press absolutely loves to brand equity market rallies and declines with current events titles. Ergo this recent move has been titled The Trump Rally.

That being said, during the evening of Election Tuesday futures markets foretold a potential horror show. As early returns came in it became evident that this was not going to be a Clinton runaway but in fact a very tight race. Overnight DJIA futures markets started swinging wildly, and at one point were down almost 900 points. Once it became clear that Trump was still moving toward the magic number of 270 electoral votes while Clinton was stuck on 215, futures markets started to recover. By Wednesday, the surprise and the shock was replaced with the prospects for economic growth unburdened by huge government. And the race was on!

This brief but powerful rally has positively impacted several market sectors. Most notably, SmallCap and MidCap equities had been particularly weak in the course of those nine days preceding Election Week. They have both now reversed their corrections and rallied for six days straight. Instead of threatening to break below a trading range, they are now breaking above their respective trading ranges. Large cap equities have also demonstrated renewed strength. The DJIA has moved to new all-time highs. The broader S&P 500 Index, which has been more restrained the past couple of days, is within 1.5% of its all-time highs. More importantly, it has recaptured important moving averages. We believe that seasonality deserves far more credit than the election, but a rally is a rally and positive momentum is the market's best friend. While sharp advances may invite profit-taking, tis the season to be invested in equities.

International equities, on the other hand, have been having quite different experiences since the election. European equity markets have been quick to fade following the election. Emerging markets equities have also demonstrated specific price weakness. Some of this weakness may be hinged to the pullback in oil prices since mid-October. Light crude oil prices were trading just above $52/barrel at that time. Remember that oil prices were as low as $26.05/barrel in February before rallying back to settle in a wide trading range between $39 and $52. Interestingly, gasoline prices remain relatively low, in spite of the price increases of oil. Gold, has also been very weak since the election and has now fallen over - 6% over six consecutive days.

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Bond markets have also been struggling over the past six sessions with most bond indexes breaking below trading ranges that have contained prices since July. The common explanation is that bonds are being sold sharply to fund the sharp rise in equities, as institutional investors scrambled to get on board with the new agenda. However, bond prices were declining throughout the month of October in lockstep with equities. A broader perception is that bond markets in general had been enjoying an unrealistic rise in prices throughout the year, and were ripe for profit-taking. Season that concept with December's impending bump in short-term interest rates by the Federal Reserve, and a pullback in bonds at this juncture appears to be reasonable.

Last but not least, I am compelled to revisit two sectors discussed in the October Monthly Commentary. The financial equities and the transportation sector were both presenting compelling technical and fundamental pictures. Since the election, both of these sectors have broken out of trading ranges and advanced by more than +10%. These moves have been accompanied by very impressive volume as institutional investors worked to push their way into the room. The bottom line is that even in this business, every once in a while you get to take a favorable selfie.

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Sources: Bloomberg, Marketwatch.com, StockCharts.com