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TRUMP AND MARKETS

Last night's firing of the acting Attorney General was just the latest in a series of almost daily political shocks coming from the new Trump Administration. How can we expect these events to affect markets?

The VIX volatility index rose +12% yesterday, its strongest daily spike since November 3rd, just before the election. It's important to realize, however, that its close on Friday, 10.58, was the lowest since July 2014, and notably lower than the latest peak (22.51) reached on Nov. 4, or many of the recent peaks seen during episodes of global market jitters over the last two years, which were prompted by China or U.S. slowdown fears.

How do markets respond to political scandal or infighting in the U.S.? Not very noticeably, for the most part. While the S&P 500 index fell −29% from the time the Watergate scandal burst on the scene, in February 1973, to Nixon's resignation, in August 1974, one has to keep in mind that there were many other things going on at the time, including mounting inflation, and the Yom Kippur War and subsequent Arab oil embargo in October 1973, which pushed the U.S. into recession for over a year. The big downturn in the market came with the oil shock, and gathered momentum. It would not be far-fetched to imagine that the deteriorating economy impacted the President's political fate more than the other way around.

In contrast, the market sailed through the Iran Contra scandal in the mid-1980s with little apparent impact. During the Clinton-Lewinsky scandal, the S&P 500 rose +28% from when the story first came to light in January 1998 to the president's trial and acquittal by the Senate a year later. There was a sharp −19% correction in mid-1998, which coincided with the president's grand jury testimony and public confession. But the market's downturn was mainly driven by the Russian ruble crisis, which triggered the near-collapse of a large U.S. hedge fund (LTCM), and stocks rebounded once the financial (as opposed to political) crisis had passed.

In the more recent past, markets have been remarkably blasé about budget confrontations between President Obama and Congress, reacting negatively only in the last few days before a deadline on raising the debt limit (and avoiding a potential Treasury default).

The lesson we draw from all of this is that the economy's performance, and explicitly economic or financial shocks, matter a great deal more to the market than purely political turmoil. It is true, however, that some of the controversies surrounding the Trump Administration—particularly its more combative approach to trade—have a more direct economic edge, and a potential economic (and market) impact. But despite mounting rhetoric, we are in early days

yet, in terms of seeing what those policies actually turn out to be, and the market continues to be more optimistic about the prospective impact of other proposed policies, such as tax cuts, deregulation, and greater infrastructure and defense spending. So far, we have seen some concerns over U.S. trade policy rattle overseas markets, in Asia and Europe, but nothing that has left a lasting mark on their performance.

With all this in mind, we should continue to focus on the economic and earnings data, and the prospective impact of specific policies on both, in shaping our market outlook.

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Patrick Chovanec
Managing Director, Chief Strategist

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