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Independent Investment Strategy

U.S. Election: Assessing Sector Impacts

Campaign Rhetoric Vs. Political Realities

Investment Implications Of The Upcoming U.S. Presidential Election

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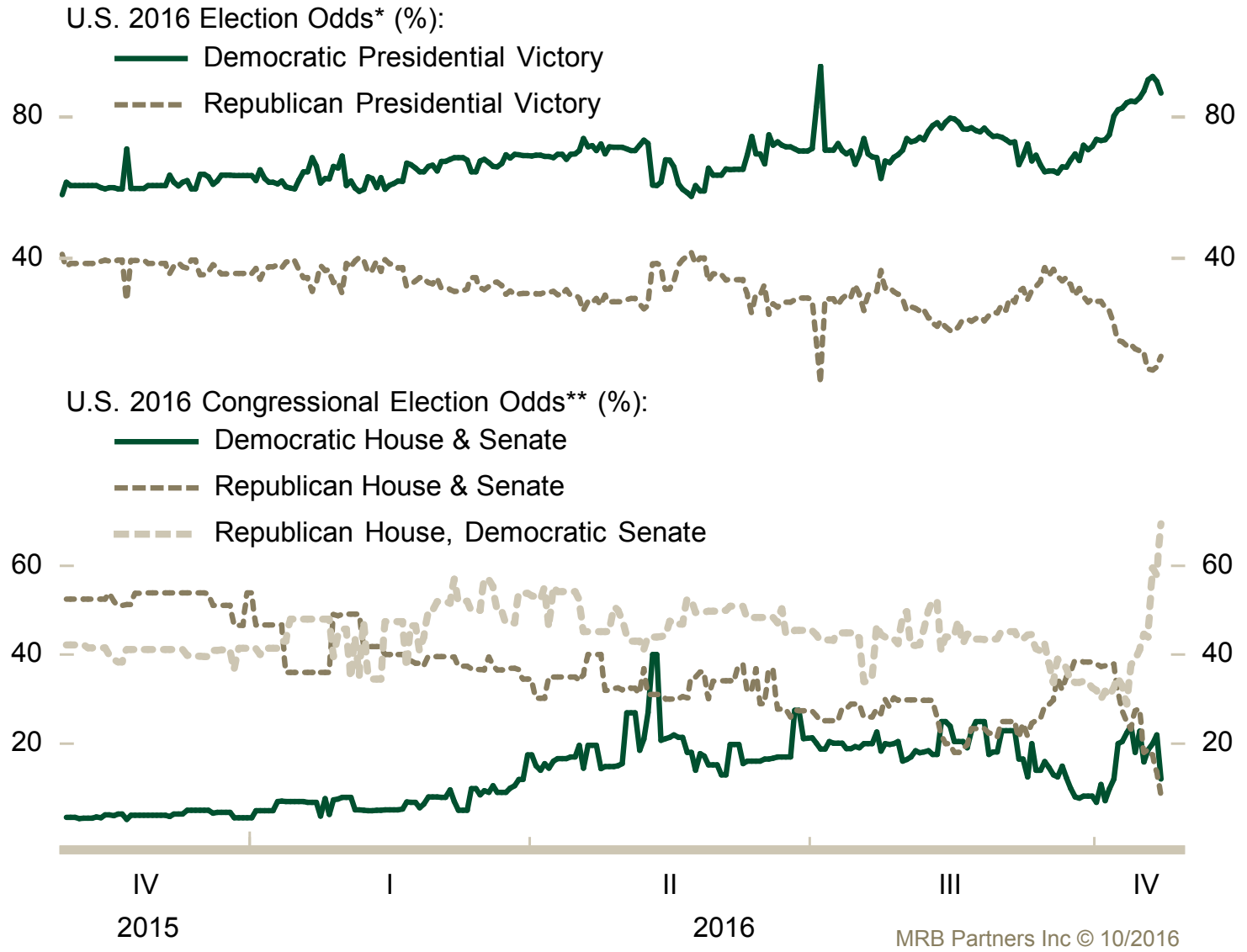
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Sectors/Issues Impacted By The U.S. Election

- Health Care
- Energy
- Financials
- Industrials/Infrastructure
- Defense

Odds Favor A Clinton Presidency And Split Congress



* Winner take all; source: Iowa Electronic Markets
 ** Source: Iowa Electronic Markets

Health Care: Policy Platform Highlights

Clinton

- Defend and improve the Affordable Care Act (ACA).
- Make premiums more affordable and lower out-of-pocket expenses.
- Extend coverage in the 19 states that have not yet expanded Medicaid.
- Let the government take a more active role in lowering drug costs.

Trump

- Repeal the ACA in favor of self-funding private alternatives.
- Eliminate the individual mandate; allow contributions to Health Savings Accounts.
- Block-grant Medicaid to the states.
- Allow health insurers to sell coverage across state lines.

Health Care: Investment Conclusions

- Political realities and other constraints will limit the ability of the two candidates to meaningfully effect change to the economics of the industry.
- Health care stocks usually outperform in the 12 months following the election vote.
- The sector has significantly de-rated in the past year, implying a lot of bad news has been discounted.
- Health care stocks offer above-average earnings and revenue growth in a mushy economic environment.
- The bigger risk to the sector over the next 6-12 months is if significant positive economic growth surprises lead to a full on rotation into cyclical sectors.

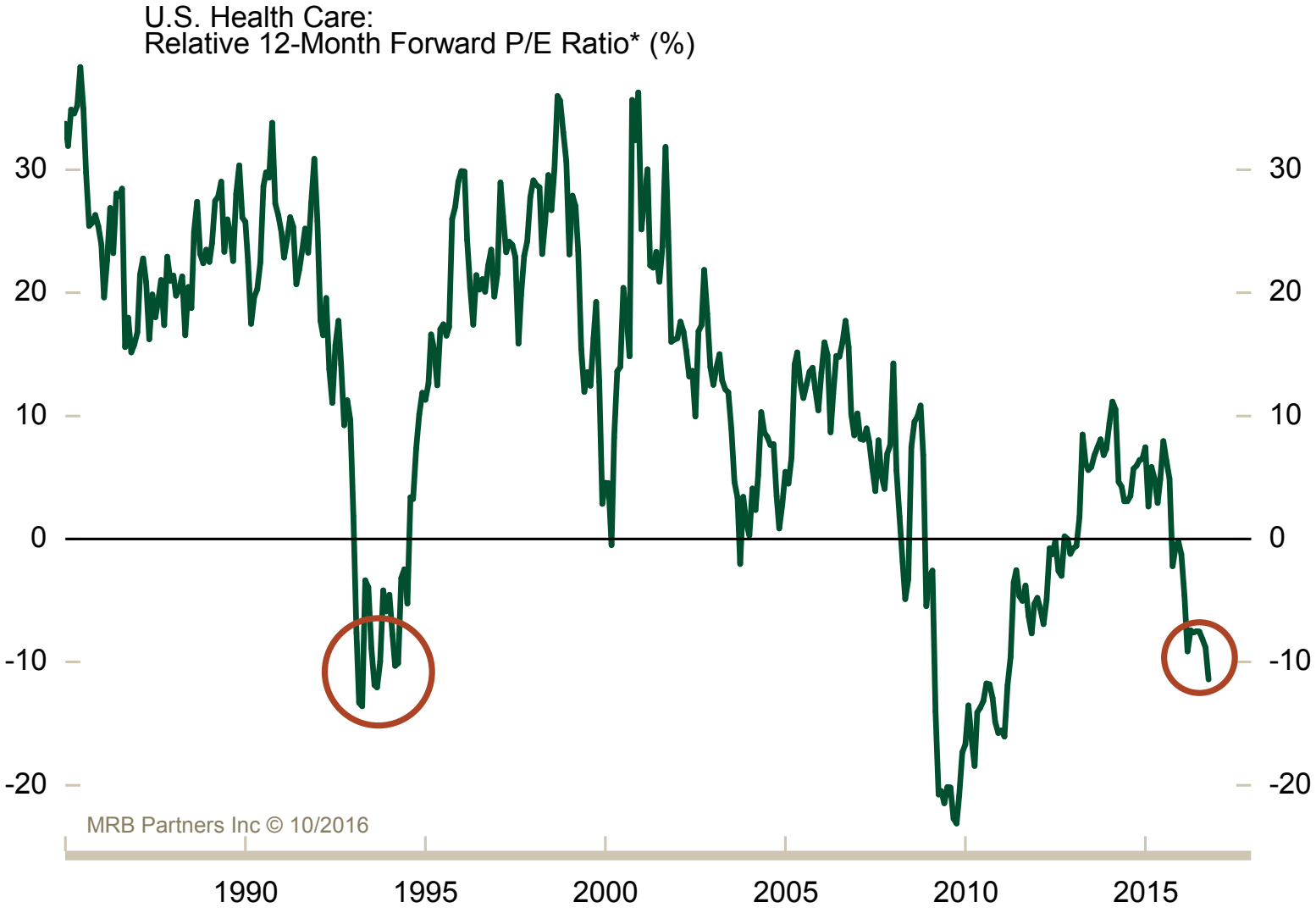
Health Care Stocks Typically Outperform Post Election Day

Total Return 12 Months After Election Day (%)			
Year	Health Care	S&P 500	Margin Of Outperformance (%)
1976	-10.5	-10.9	0.4
1980	16.3	-5.9	22.2
1984	28.3	13.9	14.4
1988	43.2	23.1	20.1
1992	-6.9	9.7	-16.6
1996	33.6	32.0	1.6
2000	-4.9	-21.9	17.0
2004	13.6	6.7	6.9
2008	13.9	11.9	2.0
2012	35.5	25.3	10.2

Sources: Datastream and Standard & Poor's

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Relative Valuation Approaching The 1993 Low



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* % Premium (+), discount (-) to U.S. equity benchmark; source: Datastream

Energy: Policy Platform Highlights

Clinton

- Defend the Clean Power Plan (CPP), the centerpiece of the Obama administration's climate change agenda.
- Create the Clean Energy Challenge, a US\$6obn initiative that provides grants to incentivize states to accelerate clean-energy deployment.
- Opposes the completion of Keystone XL Pipeline and expansion of offshore drilling, but conditionally supports fracking.

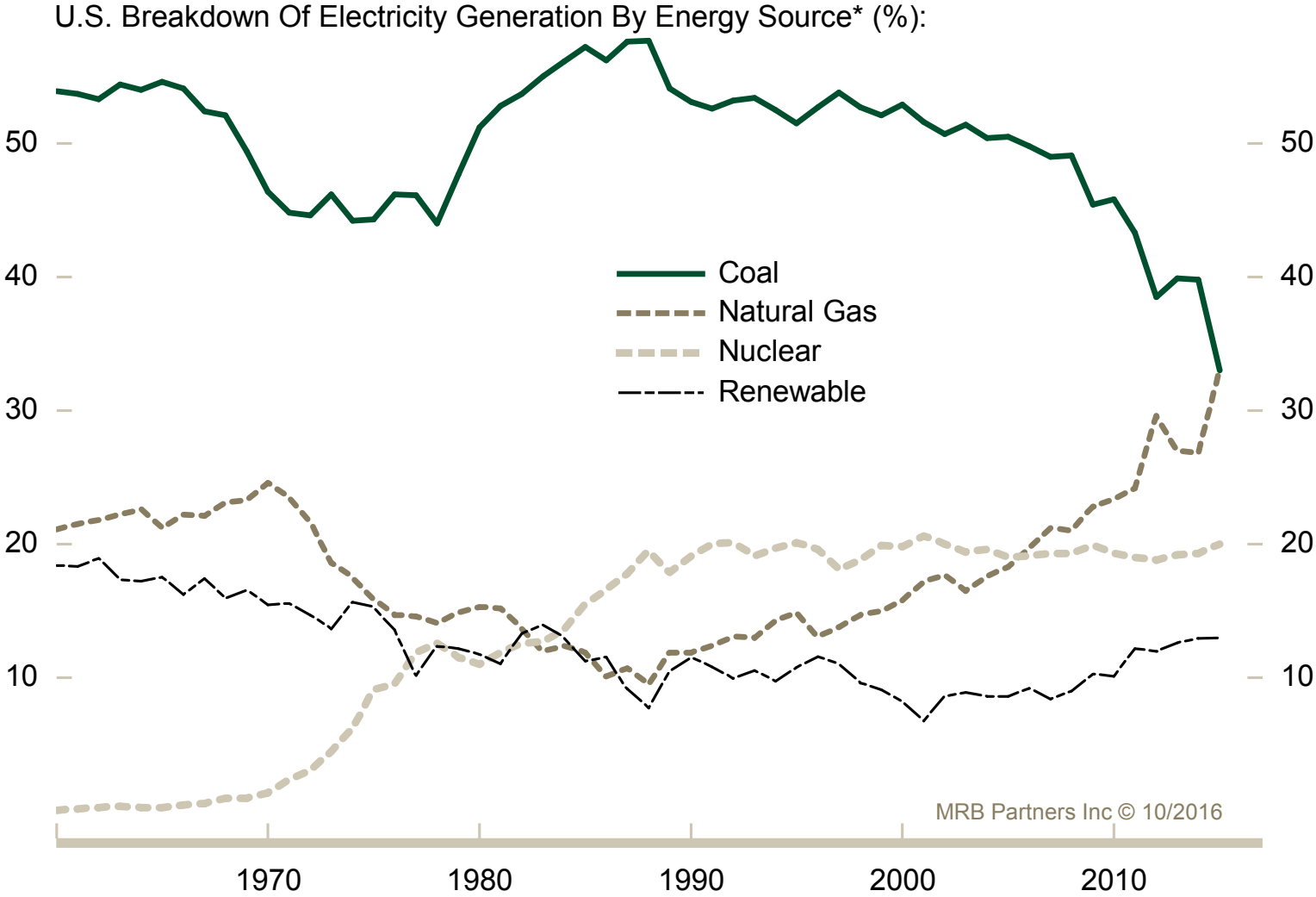
Trump

- Rescind energy regulations enacted by the Obama administration, including the CPP and the moratorium on new leases for coal mined on federal lands.
- Favors expanding offshore drilling and fracking.
- Supports the completion of the Keystone XL Pipeline.
- Withdraw the U.S. from the Paris Climate Accord.

Energy: Investment Conclusions

- Outcome of November election will have long-term implications for how the U.S. approaches climate control in the coming years.
- However, the impact of policy on the performance of the energy and utility sectors over the next 6-12 months will be limited.
- Oil prices and bond yields will remain the dominant drivers of energy and utility stocks, respectively.
- A Trump win could reinforce the recent rally in coal mining stocks, but structural forces will weigh on the group's longer-term prospects.
- A Clinton victory should improve sentiment towards alternative energy stocks, provided these companies can improve their earnings performance.

Coal Has Been Losing Market Share For The Past 25 Years



* Source: U.S. Energy Information Administration

Financials: Policy Platform Highlights

Clinton

- Extend the reach of Dodd-Frank to more lightly regulated areas of finance such as the shadow-banking industry and large insurance companies.
- Levy a “risk fee” every year on banks with more than US\$50bn in assets.
- Tax high-frequency trading.
- Close the Volker Rule’s loophole that allows banks to invest in hedge funds.

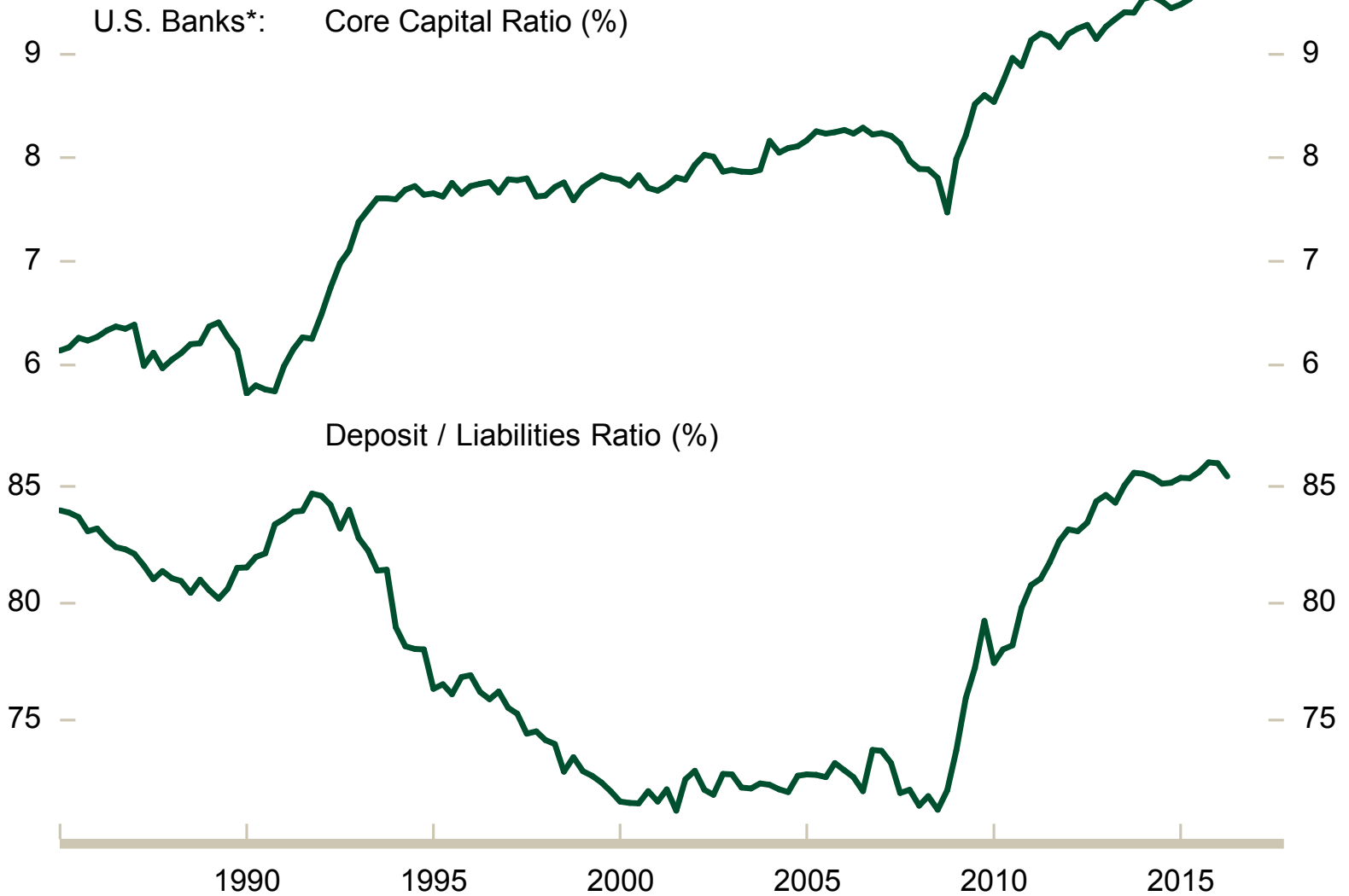
Trump

- Move to scale back or eliminate Dodd-Frank, as well as the Consumer Finance Protection Bureau.
- Tax carried interest as ordinary income.

Financials: Investment Conclusions

- Neither candidate wants to break up the large banks.
- A Republican House would not allow the reinstatement of Glass-Steagall.
- A Trump victory would be better for large banks, insurers, and investment banks.
- Under Clinton, large financial institutions would face additional costs, but in most cases her proposals are modest. More onerous measures such as the “risk fee” would likely be blocked by Congress.
- The relative performance of the financial sector will continue to be primarily dictated by prospects for economic growth and changes in slope of the yield curve.

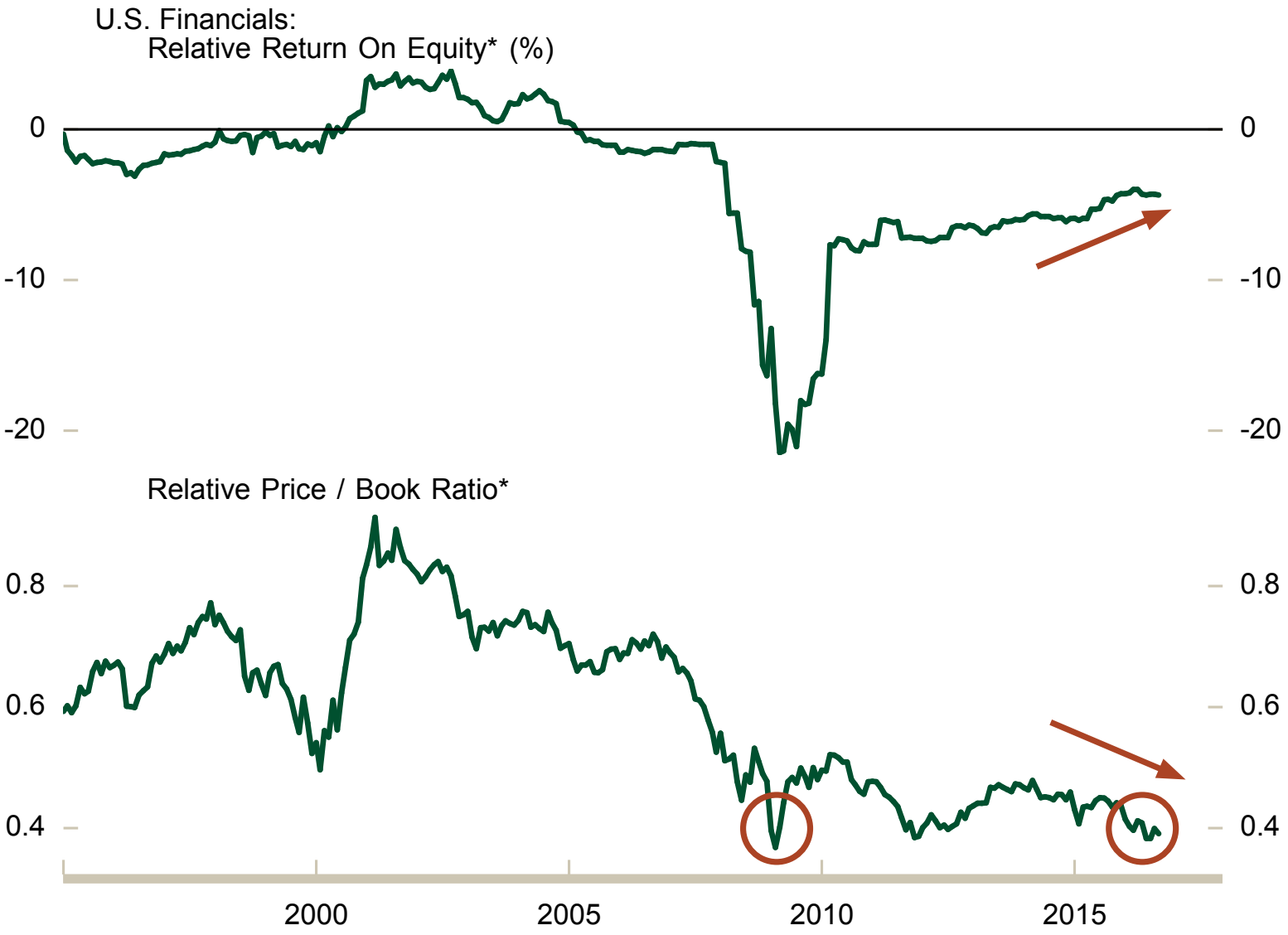
The U.S. Banking System Has Been Recapitalized And Is In Solid Shape



* FDIC-insured corporations; source: U.S. Federal Deposit Insurance Corporation

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Financial Stocks Are Priced To Generate Poor Relative Earnings For An Extended Period Of Time



* Relative to U.S. equity benchmark; source: MSCI MRB Partners Inc © 10/2016

Infrastructure: Policy Platform Highlights

Clinton

- Proposes a US\$275bn plan over a 5-year period comprised of:
 - US\$250bn supporting direct public investment in highways, public transit, ports, railways, clean-energy projects, airports, and broadband.
 - US\$25bn to seed an infrastructure bank, which could generate an additional US\$225bn in spending by leveraging private capital.
- Wants to fund her plan through tax reforms, but has offered few details.

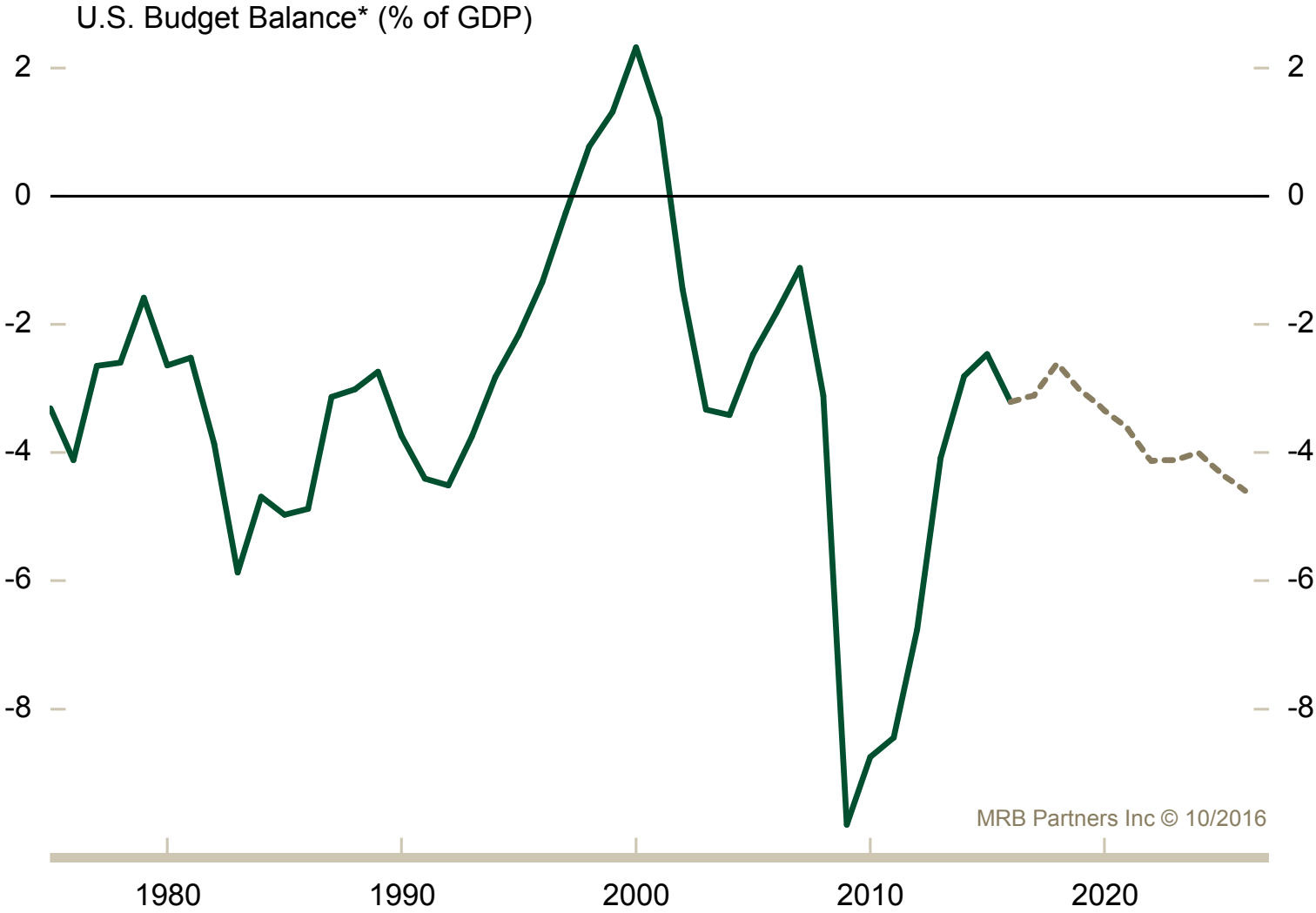
Trump

- Proposes to spend US\$1tr on infrastructure over an unspecified period.
- Intends to pay for his plan by creating a fund that would issue infrastructure bonds.

Infrastructure: Investment Conclusions

- While there is bipartisan support for spending on infrastructure, the parties disagree on how to pay for it or how it should be allocated.
- The next president will face the specter of a widening budget deficit, which will provide less latitude to increase spending.
- Infrastructure projects take time to implement, and will have a slow impact on the earnings of capital goods companies.
- Infrastructure theme is difficult to play.
 - Construction machinery and engineering stocks also sell into commodity end-markets, which are weighing on the relative earnings of these companies.
 - Construction material stocks are a purer play, and hence are better positioned to benefit from an increase in infrastructure spending.

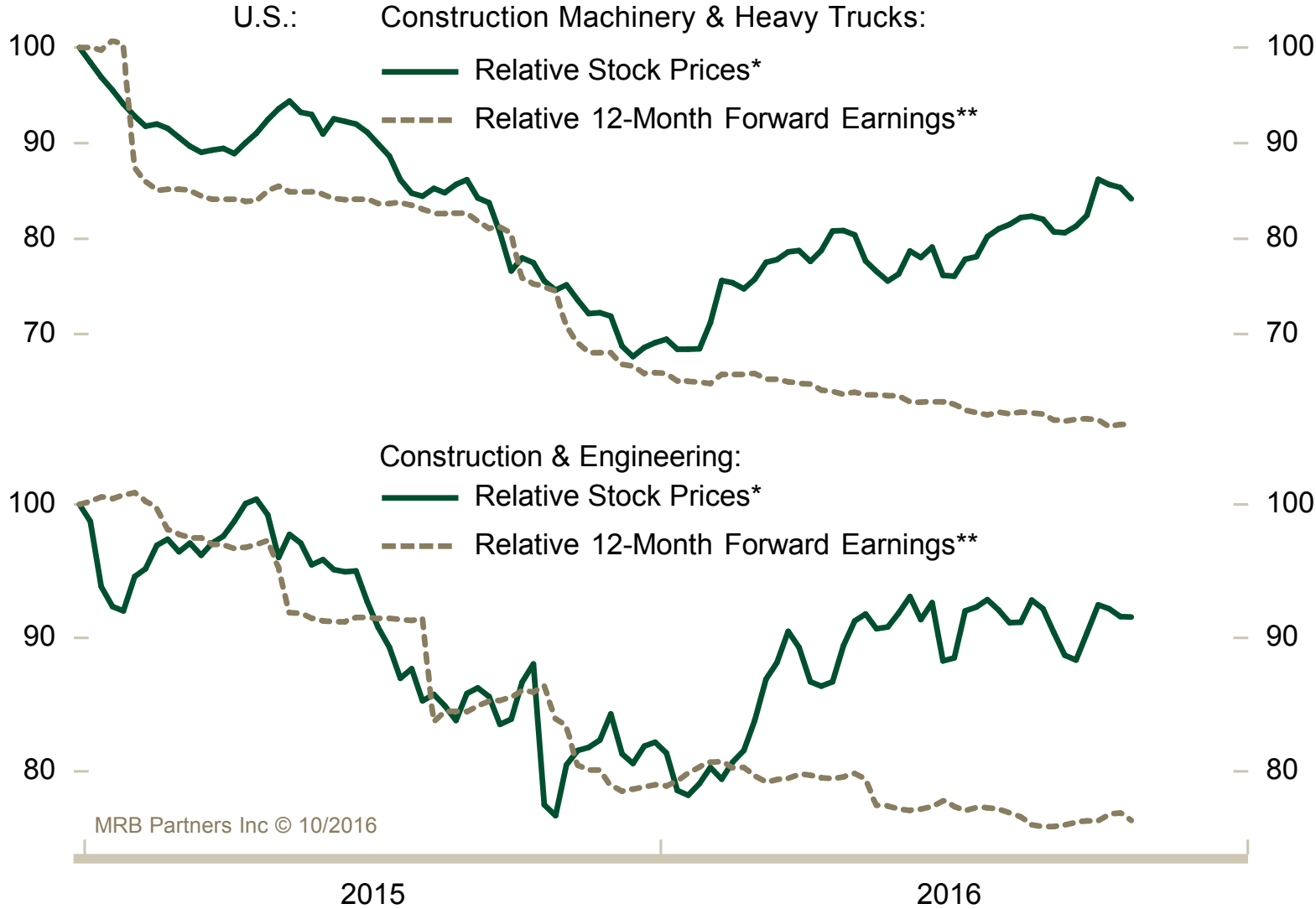
U.S. Budget Deficit Set To Widen



* - - - forecast from 2016 - 2026; source: Congressional Budget Office

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Construction Machinery and Engineering Stocks Are Anticipating Better Earnings



* Rebased; relative to U.S. equity benchmark; source: Standard & Poor's
 ** Rebased; smoothed; relative to U.S. equity benchmark; source: Thomson Financial / IBES

Defense: Policy Platform Highlights

Clinton

- Repeal the defense sequester spending caps.
- Has not provided specific proposals about a defense program or taken a position on the size of the defense budget.
- Reputation as a defense hawk.

Trump

- Also favors eliminating the defense sequester.
- Plans a large military buildup by:
 - Adding at least 100 more fighter aircraft to the U.S Air Force.
 - Increasing the size of the U.S. Army to 540k active duty soldiers from 480k.
 - Building a Navy towards a goal of 350 ships and submarines, up from 276.
 - Growing the Marine Corps to 36 battalions from 23.
 - Modernizing missile defense and cybersecurity.

Defense: Investment Conclusions

- Defense spending is poised to increase under either candidate.
- However, defense stocks would probably do better under a Trump presidency.
 - Trump and a Republican-controlled Congress would be expected to agree on a larger defense budget than what Clinton could produce in a scenario where the House remained in Republican hands.
- A major caveat is that the stock prices of defense contractors have already significantly outperformed in anticipation of increased military spending (not just in the U.S., but also globally), and are not historically cheap.

Defense Stocks Have Already Significantly Re-Rated



* Rebased; relative to U.S. equity benchmark; source: Datastream
 ** % Premium (+), discount (-) to U.S. equity benchmark; source: Datastream

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Potential Winners & Losers Under Each Candidate

Sector/Issue	Clinton Victory		Trump Victory	
	Positive For	Negative For	Positive For	Negative For
Health Care	Managed care companies and hospitals	Pharma, biotech, specialty pharma companies , and PBMs	Pharma, biotech, specialty pharma companies , and PBMs	Managed care companies and hospitals
Energy	Renewable energy companies (wind & solar)	Conventional E&P companies, coal miners, and utilities with large coal-fired assets	Conventional E&P companies, coal miners, oil services , pipelines, and utilities with large coal-fired assets	Renewable energy companies (wind & solar)
Financials		Large banks, large insurers, large investment banks	Large banks, large insurers, large investment banks, consumer finance	
Infrastructure	Construction materials, machinery, and engineering companies			
Defense			Defense contractors	

Bolded sub-groups denote the stocks most likely to be impacted by the various election outcomes

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Q & A