Clinton vs. Trump vs. the Markets: How to Play It!

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From now until November 8, Election Day, the media will go non-stop about the US elections –the endorsements, the polls, the debates. The candidates will do their best to convince you that they are the best choice – and for most Americans that comes down to how it affects their pocketbooks.

The media loves to speculate on what candidate and party will be best for stocks. All sorts of statistics will be trotted out to show that one party or the other will spur the Dow - or result in investors' worst fears. So, every investor must ask, how do you play election 2016?

Best Approach

Don't disturb your portfolio based on the elections. Speculation on who might win should not supersede decisions based on personal circumstances and goals, including tax objectives, liquidity needs, and risk tolerances. Continue to choose your investments based on such factors as valuations and fundamentals.

Predictions based on the political pundits, the parties' stated goals, or personal election preferences are too risky. History shows many exceptions to what many in the media consider reliable indicators.

Don't underestimate any candidate's inability or unwillingness to follow through on her or his initiatives. If you invest based on the consensus wisdom, you risk loss by having paid too much if a thesis doesn't materialize.

One exception is if very attractive valuations develop based on the public's belief that a particular sector will or will not fare well by virtue of particular candidate position. Profits can be made by betting against that likelihood. If the popular forecast is reflected in prices the downside may be less if it proves true than the potential upside should the fear not transpire.

Don't Rush to Cash if the Republicans Won't Be Elected

A frequent shibboleth is that a Democratic victory will spell doom for stocks. After all, aren't the Republicans the party of business? However, a careful review of the record doesn't support that stocks do better under the Republicans.

In recent years, there's been very strong market performance under Democratic Presidents Clinton and Obama, while the market tanked under George W. Bush. While you might say Obama inherited such a low stock market that it could only rise, your opportunity to profit came more on focusing on cheap fundamentals than who was in the White House.

Possible Gridlock's No Excuse to Put Risk On

Many believe that what makes our American system of government so economically friendly is the three branch system. Laws don't pass unless there's a concurrence of both Houses of Congress plus the President.

Some investors believe that if different parties control Congress and the Presidency, concurrence on changes is less likely, gridlock will prevail and the markets do well. Don't allow those beliefs to cause you to throw caution to the wind.

Not infrequently markets have disappointed even when different parties control the Presidency and Congress. Markets have done well even when controlled by the same party.

It's simply too risky to abandon sensible diversification and asset allocation based on some belief that having separate parties control the branches of Government will cause markets to perform far better than fundamentals otherwise warrant.

Don't Run to Cash Due to Election Uncertainty

The talking heads love to spout that the markets abhor uncertainty. Since the election is uncertain, hide in cash until there's clarity.

That's a big mistake. Uncertainty always pervades markets. After all, who has tomorrow's newspaper today?

Perceived greater uncertainty may provide opportunity because it can keep prices low. Cheap valuations reduce investment risk and can give rise to superior returns. It's when the investment crowd is convinced that uncertainty has cleared up that you want to be cautious. As Warren Buffett is wont to say, you pay a high price for a cheery outlook.

The current uncertainty may also provide opportunity because it may keep other policymakers from making decisions potentially adverse to investors' interest. For example, most market watchers believe that the upcoming elections give the Federal Reserve an additional reason to keep from raising interest rates and taking the punch bowl away.

The Investment Implications of Party Planks Can Be Difficult to Analyze

Be cautious about extrapolating the investment implications of any candidate's oft stated positions.

For example, investors would be excused from having thought gun and ammunition makers would be obvious investments to sell, both during the Obama presidency and in the event of a Hillary administration. But that was the wrong move during the Obama's reign and may well be wrong as to Hillary.

Both **Smith & Wesson (SWHC)** and **Sturm Ruger (RGR)**, leading weapons makers, are up tenfold since Obama's inauguration, despite the President's passionate support of stricter gun control. The President's lobbying on the issue has spurred their businesses, as the public rushed to arm up before the window shut.

Election Year Opportunity: Healthcare

Healthcare is a traditional election year punching bag. While everyone needs it, few can afford it, so it's an inevitable political issue. Yet, due to the insatiable thirst for improved medical services and powerful lobbying interests, healthcare stocks seem to always come out on top after periods of underperformance due to politics.

For example, after Bill Clinton's election in November, 1992, wife Hillary was tasked with developing universal healthcare. The market panicked, with healthcare stocks plunging as much as 40%. But, 18 months later Senator McConnell declared the proposal dead, and healthcare stocks soared 80%.

Similarly, Obamacare was feared to result in a single payer policy, eliminating the need for health insurance outfits. But, following the law's passage in March of 2010, investors realized that not only were private insurers not going way, but that lots of new customers would be available. Such large players as **United Health Group (UNH)**, **Aetna (AET)** and **Cigna (CI)** rose 80% the following year, nearly doubling the performance of the overall market.

Today, we have a similar situation, with election uncertainty pummeling healthcare stocks. A biotech focused ETF, the **iShares Nasdaq Biotechnology ETF (IBB)**, is down 31% over the past year versus a 4% gain on the S&P 500, amid Hillary's September 2015 tweet: "Price gouging…..in the specialty drug market is outrageous." That tweet alone is said to have cost that ETF $160 billion in just a week.

Here's the investment case to buy healthcare now: If Clinton is elected and a plan challenging the industry is implemented, much of the downside may already be reflected in the stocks' cheaper prices. But, she might not be elected, a plan could be thwarted by a divided Congress, or the plan may not be as onerous as feared. The upside then could outweigh the potential downside if healthcare adverse legislation is enacted.

A component of that ETF we find interesting is **Gilead (GILD).** Trading at just 7 times earnings, GILD owns the largest HIV drug franchises, and now, through an acquisition, controls one of the largest HEP-C drugs on the market.

Another component is **Mylan Labs (MYL)**. MYL is the maker of Epipen and a major player in the generic drug market. The current valuation is very cheap at 10.4x 2016 earnings.

Financials, Traditional Election Year Bad Boys, Present Opportunities

Wall Street and big corporations are frequent populist politician targets going back to the early days of the Republic, but this election season is notable because candidates on both sides of the aisle are throwing punches. Lefty Bernie Sanders said "fraud is the business model of Wall Street," but even Republicans have denounced the banks, arguing that they need an "ethics lesson," should not be "bragging" that they are too big to fail, and that we need not bail out "rich Wall Street banks."

In the last year an ETF of financials, the **Financial Select SPDR Fund (XLF)**, has trailed the broader market by 8%. When the elections wind down the rhetoric will undoubtedly cool, helping this sector.

Both **JP Morgan (JPM)** and **Bank of America (BAC)** are top holdings in the XLF, trade at low valuations, and have world class franchises. The downside should onerous new legislation actually pass may be much less than the upside should it become business as usual when the next President takes office.

Defense Stocks: Over Loved on Hillary Prospects?

While most Republicans would have you believe that a vote for Hillary is simply a vote for a continuation of Obama's policies, most agree that Mrs. Clinton, the former Secretary of State, strikes a more hawkish tone on the use of America's military might. The knee jerk reaction is to bid up aerospace and defense stocks.

You might want to resist that urge. Defense stocks have soared in the last year; an index of such stocks is up 24% versus just 4% on the broad market.

You could surmise that the upside in those stocks is already priced in if Hillary is elected and arms us up, but the downside could be significant if she strikes a more conciliatory tone, is blocked from carrying out her plans by a deficit weary Congress, or Trump takes the election. While such companies as **Lockheed Martin (LMT)** and **Northrup Grumman (NOC)** are extremely well run, be cautious at buying them at current prices.

In sum, your best bet is not to let the elections upset your long term investment plans. Focus on investment fundamentals. Take advantage of others' fixation on the current political winds.