Summer 2016

360 Insights

Quarterly Investing and Financial Perspectives

U.S. Presidential Elections and Financial Markets

by **Jim Healey**, Director of Reporting & Analytics, Loring Ward

For those of us who have experienced more than one or two presidential election cycles, the 2016 campaign seems to be more heated and contentious than usual. The stakes are high for the economy and financial markets, as new political leaders will need to address a wide range of pressing issues.

While political decisions can and do have long-term impact on measures of U.S. economic performance, we need to remember what University of Chicago Professor and former chair of the President's Council of Economic Advisors Austan Goolsbee said:

"I think the world vests too much power, certainly in the president, probably in Washington in general for its influence on the economy, because most all of the economy has nothing to do with the government."[1]

While government may have some impact, the majority of companies will adapt and advance regardless of which political party controls the Oval Office.

But what about returns during election years?

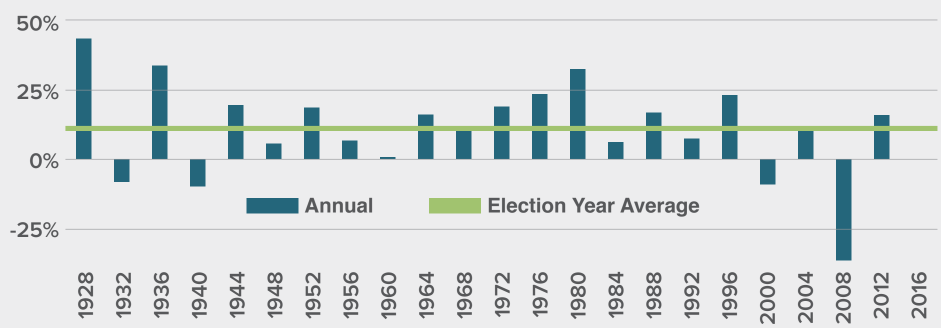
Since 1928 only four presidential election years saw negative returns. But before you attach any significance to that, realize that the average return on the S&P 500 during only the election years was slightly lower than the average return in all the years from 1928 to 2012.[2]

In our winter issue of *360 Insights* we looked at whether stock returns were higher with a Democratic president or with a Republican president…it turns out (at least from a stock market perspective) that the party affiliation of the next president doesn't have much of an impact one way or the other on returns.

So before you make changes in your portfolio, keep in mind that historically, the stock market has not been particularly influenced by whether Republicans or Democrats have won the White House. And your long-term goals should never depend on which party or candidate wins an election.

[1]Freakonomics Podcast 3/29/2012: "The Power of the President — and the Thumb: Full Transcript"
[2]United States Elections Project; Data Source: DFA Returns 2.0

Election Year S&P 500 Performance
1928 – 2016



The S&P data are provided by MorningstarDirect, June, 2016. The S&P 500(Standard & Poor's 500 Index) is a broad-based U.S. equity index. The S&P 500 Index is an unmanaged market value-weighted index of 500 stocks that are traded on the NYSE, AMEX and NASDAQ. The weightings make each company's influence on the index performance directly proportional to that company's market value. Indexes are unmanaged baskets of securities that are not available for direct investment by investors. Their performance does not reflect the expenses associated with the management of actual portfolios including, but not limited to tax deductions and management fees. Past performance is no guarantee of future results, and values fluctuate. All investments involve risk, including the loss of principal.

What's Inside

4 Ways to Help Manage Risks

by **Payel Farasat, M.Sc.**
Chief Investment Officer, Loring Ward

This is the third article of a four-part series to help you understand our investment approach — and why it matters to you.

Look up the word RISK in a thesaurus and you see words like *danger* and *hazard*, but also *opportunity* and *fortune*.

For investors, this double meaning of risk sits at the very heart of your portfolio. Risk is the price of admission you pay to invest in the potential of the stock market. The possibility of losing money is precisely where the potential to grow your portfolio comes from. Simply put, you can't get return without risk. "Nothing ventured, nothing gained" as the old saying goes.

The more "smart" risks you take in your portfolio, the greater your potential returns. The opposite is also true: When you don't take enough risks, or, take unnecessary risks in your portfolio, your potential returns are lower.

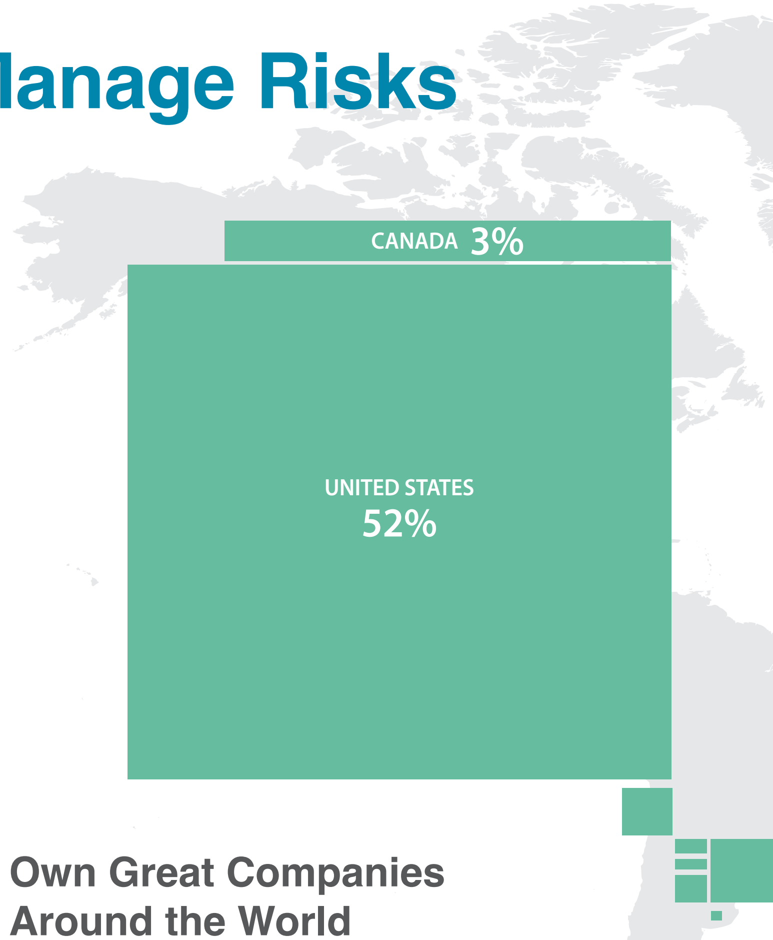
We seek to manage risk through our prudent Asset Class Investing approach. Here's how:

1. **Diversify globally. Almost half of the world stock market value is outside of the U.S.**

   We think of the U.S. as a world leader, but over the past several decades, America's stock returns haven't ranked even in the top 10 in terms of annualized performance of countries around the world. The average U.S. investor has a portfolio made up of about 75% U.S. stocks.[1] While that may seem like the patriotic thing to do, it can also mean missing out on a world of opportunity.

2. **Invest in thousands of securities to help reduce concentration/company-specific risk**

   If you own a lot of companies in a variety of industries in countries around the world, the impact on your portfolio is less significant if any one company or sector experiences losses.



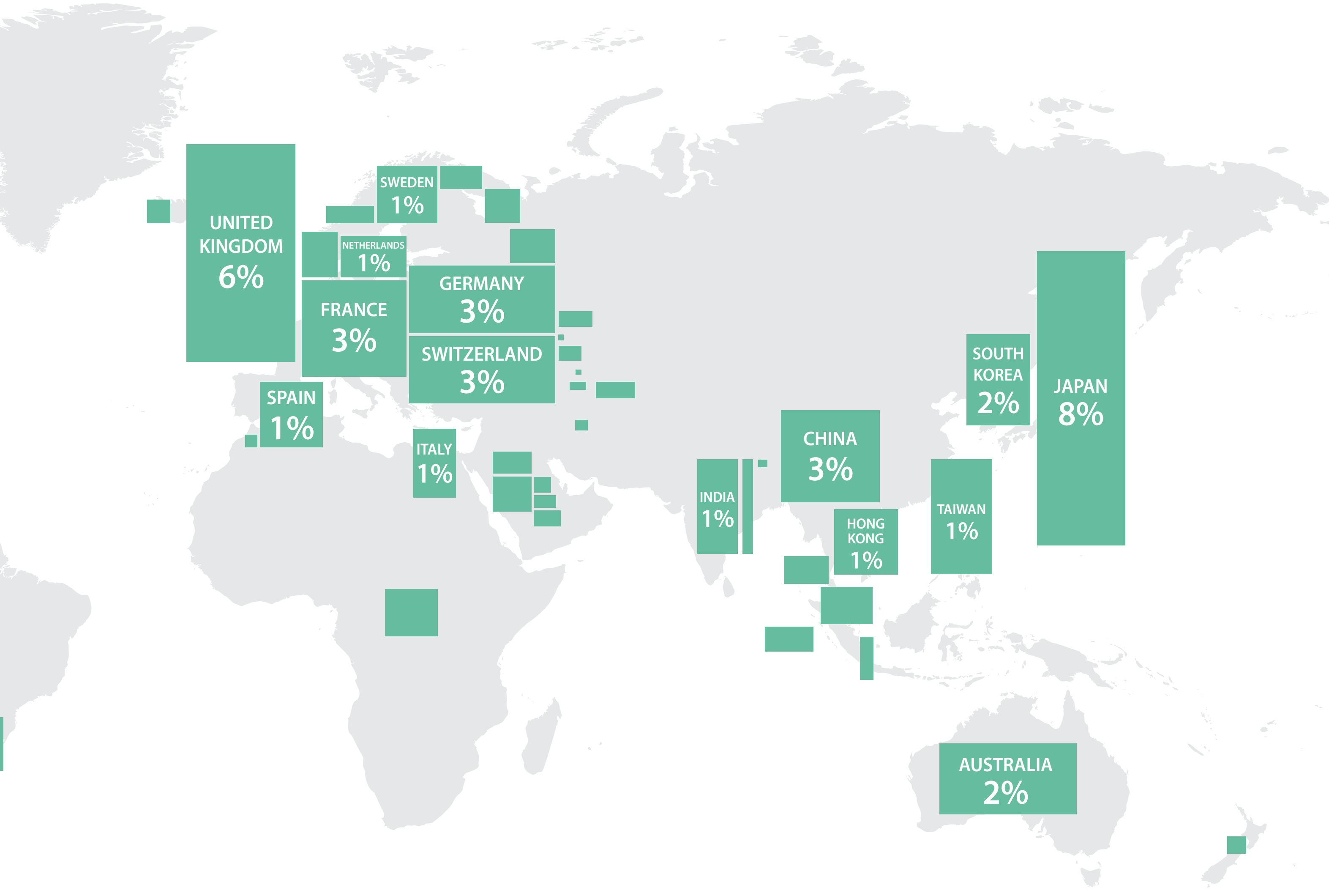
Own Great Companies Around the World

World Market Capitalization as of December 31, 2015

Source: Dimensional. In U.S. dollars. Market cap data is free-float adjusted from Bloomberg securities data. Many small nations not displayed. Totals may not equal 100% due to rounding. Past Performance is not indicative of future results. All investments involve risk. Foreign securities involve additional risks including foreign currency changes, taxes and different accounting and financial

3. **Combine Asset Classes that respond differently to various market conditions.**

   While small company stocks tend to outperform large company stocks over time, there can be periods when large companies outperform. The same is true of bonds versus stocks and growth versus value stocks. Sometimes, international market returns beat the U.S. markets; other times, the U.S. is ahead. Trying to predict which sector or country or asset class will outperform or underperform is something very few money managers can do consistently. And, the costs of their mistakes can have a real impact on your portfolio in the form



reporting methods. Countries represented by their respective MSCI IMI(net div.). Indexes are unmanaged baskets of securities in which investors cannot directly invest; they do not reflect the payment of advisory fees or other expenses associated with specific investments or the management of an actual portfolio.

of higher transaction costs, higher taxes and poorly-guessed market moves. Instead of trying to outguess the market, we prefer to let the long-term growth potential of global markets work for you with portfolios that include 9 asset classes representing up to 10,000 securities in 45 countries and 35 currencies.

4. **Invest in high-quality, short-term bonds in an effort to help smooth out dramatic ups and downs in your portfolio and to provide you income in certain interest rate environments.**

   Higher yields are available by investing in bonds with longer maturity and lower credit quality, but at the cost of increased portfolio volatility. This is why we believe that most investors are better compensated by allocating their risk budget towards stocks and staying more conservative with their bond allocations. We believe that a lower risk profile in bonds allows investors to take slightly more risk with their stock portfolio while maintaining liquidity.

Over time, stock markets (representing the great companies around the world) have tended to reward patient, strategic investors. However, the price for these long-term gains can involve living through periods of decline. In partnership with your financial advisor, we focus on managing risk in your portfolio to help improve your overall experience as an investor through both up and down markets.

[1]"Global equities: Balancing home bias and diversification," Vanguard, Feb. 2014

Diversification neither assures a profit nor guarantees against loss in a declining market. All investing involves risk. Principal loss is possible.

Is the Potential for Tax-Exempt Yield Really Worth the Risk?

by **Matthew Carvalho**, CFA, CFP®, Director of Investment Research, Loring Ward

In a recent period of low stock market returns, low interest rates and low economic growth, investors have faced the temptation of trying to find the elusive outperforming investment. Who wouldn't want to speed into the investment performance fast lane while others are stuck in traffic? Recently, promised outperformance has come from hedge funds, limited partnerships and high-yield bonds. Yet, as history proves again and again, great expected returns also mean taking on great risk. This year, the latest exemplar of this was the municipal bond market.

Would you buy a bond backed simply by the good faith of an entity that was drowning in debt and had poor growth prospects? What if the debt to GDP ratio rose above 70% as revenue dried up and borrowing cost rose?[1] And what if this entity did not have the option of defaulting on its debt? Yes, the investment we're discussing is Puerto Rico Municipal Bonds.

Why would anyone want these? Three words: triple tax exemption. The interest on these bonds is exempt from U.S. federal, state and local taxes! Many investors found the large tax-equivalent yields too great to pass up.

We initially discussed this topic in our quarterly review last summer following what Puerto Rico Governor Alejandro Garcia Padilla described as a "death spiral."[2] But the topic has come up once again with recent references on *This Week Tonight* with Jon Oliver and American Public Media's *Marketplace*.

This debt crisis has been brewing for some time, yet seemingly investors believed the risks were not substantial. As recently as 2005, the rating agency Standard and Poor's rated Puerto Rico debt as A-; however, by 2007 it was BBB-, the lowest possible grade within the Investment Grade universe.[3] In 2014 it fell to BB, going to High Yield or Junk Bond status for the first time. As of late 2015, their current rating was CC with a negative outlook.

It came as a big surprise to many investors to find that their otherwise innocuous sounding fixed income investments were actually holding significant portions of Puerto Rico debt. The declines seen over the last year have been noteworthy, especially for many conservative investors who did not look into what risk exposure they were actually getting.

For investors who want higher-credit-quality bonds, Puerto Rico has not been an option for some time now, due to the cratering of its credit rating.

Investors trying to stretch for that extra bit of yield should be aware of the risks they're taking to do so. In the case of Puerto Rico debt, the gleam of triple tax exemption may have blinded many to the real risks they were taking on.

As always, if something sounds too good to be true, it probably is not a good investment.

All investments involve risk, including the loss of principal and cannot be guaranteed against loss by a bank, custodian, or any other financial institution. Fixed income investments are subject to interest rate and credit risk. Emerging markets involve additional risks, including, but not limited to, currency fluctuation, political instability, foreign taxes, and different methods of accounting and financial reporting. Real estate securities funds are subject to changes in economic conditions, credit risk and interest rate fluctuations.

[1] "Puerto Rico's Debt Crisis Is About to Get Worse," Amilcar Antonio Barreto, *Fortune*, May 10, 2016

[2] 2015 Q2 QIR: https://www.youtube.com/watch?v=Gk6qLgasRmE&list=PLvIzCGfnTtn6yqJgr_mUe4FZoR6A_drYF&index=3

[3] Commonwealth of Puerto Rico, Standard & Poor's Historical Ratings, Sept. 2015 | "Puerto Rico's 'death spiral' can be traced back to one mistake," Linette Lopez, *Business Insider*, Aug. 7, 2015 | "Puerto Rico's Governor Says Island's Debts Are 'Not Payable,'" Michael Corkery and Mary Williams Walsh, *The New York Times*, June 28, 2015