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## Fundamental Equity Commentary

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# US Election and Equities

### Overview

On November 9, Donald J. Trump became the US President-Elect and the Republican Party has secured both houses of Congress.

Though many polls reflected a tight race, the result was a surprise for markets and the initial reaction has been volatile. Among the sharpest initial moves were a drop in the S&P futures index, and weakening in the Mexican peso versus the US dollar and rallies in assets that have traditionally performed well in periods of volatility, such as the Japanese yen, Swiss franc, US treasuries and gold.

### Market Outlook

We think the market reaction to the election is likely to be similar to the UK referendum scenario: 1) a volatile, risk-off response, followed by 2) a gradual reversal as investors recognize that changes under a Trump administration will take time to play out and the Federal Reserve is likely to remain in wait-and-see mode, and then 3) isolated bouts of volatility as the administration's policy priorities, and ability to execute them, become clearer. As a result, we expect volatility to remain elevated over the near- to medium term, and we believe we are well placed to leverage opportunities should they arise.

### Investment Implications by Asset Class

Similar to the Brexit result in June, we believe market participants have not been positioned for a Trump election victory, despite the narrow gap in the polls. As a result, we expect stock markets are likely to sell-off initially in a risk-off response. We have not explicitly positioned our strategies based on potential political outcomes. As such, we believe our strategies should perform in a relatively narrow range around their benchmarks.

Below we offer more specific comments regarding our positioning and expectations by asset class.

### US Growth

- We are generally neutral sectors that might experience more volatility based on the election outcome, such as Financials and Healthcare, as a result of our bottom-up stock selection. Within Financials we favor regional banks and exchanges over larger banks and insurance companies. Within Healthcare, we remain selective and are avoiding more highly valued areas.
- Regardless of political events, we remain focused on high quality growth companies, trading at attractive valuations, that have the potential to outpace the broader market over the long term.

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## US Value

- Over the course of 2016, we have taken steps to become more balanced across our strategies: we have been limiting binary risk and adding exposure to companies with resilient financial positions and management teams focused on increasing efficiencies in the absence of strong top-line growth. We will maintain this balanced approach with a bias to add to high-conviction names in the event of a market pullback.
- We believe that markets will likely experience a pullback of 5-10% immediately following a Trump victory. We expect our portfolios to fare well in this scenario given our quality orientation and more conservative positioning. If we were to see a period of exuberance akin to the days following the initial Brexit selloff, we expect to lag modestly.
- In the event of a sharp pullback, we believe we are well positioned to add alpha given our quality orientation and more conservative positioning.
- We believe a Trump victory would be conducive to pro-business legislation, putting upward pressure on rates in the medium- to long term. This would benefit our aggregate underweight positioning in the bond proxy sectors.
- De-regulation in areas such as Healthcare, Banks and Energy is likely to occur under a Trump administration. This would be helpful for our overweight positioning in Healthcare and Banks, though our strategies could be negatively impacted by another low-quality rally in Energy.
- Similar to Secretary Clinton, Trump has proposed upgrades to domestic infrastructure albeit with different funding mechanisms. The passing of such a bill would benefit select Materials and Industrials names in our strategies.

## US Broad-Market and Income-Oriented

- In more income-oriented strategies we are neutral or underweight sectors that might experience more volatility based on the election outcome, such as Financials and Healthcare, as a result of our bottom-up stock selection.
- In broad-market US equities we are currently overweight the Financials sector as we find the risk/reward compelling regardless of the election outcome. We are underweight the Healthcare sector.
- Generally within Financials we favor banks and consumer finance over financial services and insurance companies. Within Healthcare we favor pharmaceutical and healthcare equipment and supply companies over biotech and healthcare providers and service companies.

## Liquid Real Assets: US Energy Infrastructure, Global Real Estate and Global Infrastructure

- The US election outcome does not change our view that fundamentals (supply, demand and the financing environment) and valuations (relative to bonds, private real assets and history) will remain the primary drivers of long-term performance of liquid real assets. Fundamentals remain healthy and valuations attractive.
- We also believe that strong investor demand will provide a favorable technical backdrop. Liquid real assets feature a number of investment attributes that are even more compelling in the current low interest rate/low growth environment; under such circumstances they could potentially offer an attractive yield, predictable growth, lower volatility than equities, greater inflation and interest rate resiliency compared to bonds and diversification benefits.
- **US Energy Infrastructure:** While near-term volatility may increase due to general market uncertainty, we believe a Trump presidential victory will be a positive for the Energy sector, including energy infrastructure. Specifically, we anticipate a more favorable regulatory environment going forward as it relates to new pipeline construction.

Diversification does not protect an investor from market risk and does not ensure a profit.

- **Global Real Estate Investment Trusts (REITs):** Concerns around real estate will be heightened following the election given Trump's views on monetary policy and its impact on asset prices. However, we believe fundamentals remain compelling and valuations are attractive following the recent pullback. Significant private capital on the sidelines, recent legislation and tax changes are additional factors that should continue to be a positive for REITs longer-term.
- **Global Infrastructure:** Interest rate concerns following the election of Trump may have a negative impact on global infrastructure but we believe increased fiscal spending will be a positive. While we are still awaiting policy details, Trump has made a clear commitment to infrastructure spending. The outcome of the election has not changed our view that governments in the US and beyond are realizing the limits of monetary policy and will increasingly focus on fiscal spending to generate growth.

### Global Equity

- Based on fundamental views at the company level, the strategy is currently underweight US equities relative to the benchmark position, and underweight exposure to the US in terms of aggregate revenues of the companies held in the strategy.
- Any volatility in US markets in the period after the election is likely, in our opinion, to be balanced by overweight positions in Japan and Switzerland, whose currencies tend to be more stable in volatile markets.
- At the company level, US holdings are focused in the Consumer Discretionary and Technology sectors – and mainly in large, globally diversified companies. We do not anticipate that the election outcome is likely to affect our fundamental view of such companies relative to other global opportunities.
- We believe large cap, higher quality companies will prove to be more robust in the event of a sell-off.

### European Equity

- Many European companies have exposure to the US from their operations and sales. Reflecting the strong economic growth in the US, relative to many other developed markets, the aggregate US revenue exposure of companies held in the strategy is currently above that of the benchmark weighting.
- Volatility in the US market may impact the share prices of US-exposed companies in Europe, in either direction, but we would expect this to be short-lived as fundamental reassess themselves.
- We would expect the US election outcome to be relatively neutral for the portfolio, other than any influence from the short-term factors indicated above.

### Japan

- The US is the biggest trade partner for a large number of Japanese exporters. Hence, a change of pace in the growth in US economy could impact Japanese companies. Similarly, extreme changes to the JPY/USD exchange rate could impact the profitability of Japanese exporters.
- If a Trump victory leads to heightened volatility in global markets, risk-off sentiment amongst investors may cause the yen to strengthen over the short term, which could lead to a decline in equity markets, with export-oriented companies impacted more severely.
- We are neutral Consumer Discretionary, overweight Healthcare and Industrials, and underweight Information Technology. Within Consumer Discretionary we are underweight autos, which have the largest exposure to overseas markets. Within Industrials we are invested in companies which are market leaders in their businesses and believe the companies will be resilient if the election outcome leads to increased volatility and a down market.

**International**

- At the regional level, the strategy is underweight Asia, including Japan, and overweight Europe. At the sector level, an overweight position in Consumer Staples is balanced by underweight positions in Financials and Consumer Discretionary. Revenues earned in the US from companies at the aggregate level are in line with the benchmark exposure.
- Given the current positioning, we do not anticipate any particular sensitivity to the US election result, and this is borne out by our high level risk analysis.

**Emerging Markets**

- We believe the US election result will impact EM equity markets and currencies, especially in the near term, but it is likely to vary by country.
- We expect countries with stronger economic links to the US, such as Mexico, Korea and China, to be more vulnerable to negative sentiment given the uncertain impact of Trump's policies on trade and consumption. Countries with stronger current account positions, healthy foreign exchange reserves and stronger growth profiles are likely to be more resilient.
- We continue to believe that country-specific factors will remain the dominant driver of EM equity returns longer-term. For example, the performance of Brazil's Temer government, the progress of reforms in India and Poland's ties to the German economy are likely to drive equity returns in each of these countries.
- In our view, focusing on stock selection will lead to better long-term investment performance than market timing or making decisions based on macroeconomic variables. As such, we continue to believe our success will be driven by our stock selection, irrespective of the US election outcome.

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