Odds appear to favor a Clinton victory but voter behavior is inherently difficult to predict, leaving us open to surprise.

All else being equal, markets should perform better near term with a Clinton victory due to the perceived uncertainty of a Trump presidency.

A Democratic sweep of Congress could lead to market volatility but may nonetheless yield fairly similar economic policies as a split Congress.

Despite the outcome and hype surrounding the election, gridlock will likely persist and most near-term market reactions should reverse longer term.

**Election Odds and Predictability**

As of this writing, the odds still favor Secretary Clinton to win the Presidency, despite the renewed investigation into her private email server. In our view, the best election predictor is the data-intensive model put forward by Nate Silver on his website FiveThirtyEight.com (Exhibit 1). The model aggregates state-level polls, adjusted for demographics, to provide a more accurate prediction than national polls. These adjusted state-level polls are then used within the model to assign electoral votes by state and estimate the range of outcomes using the error/mismeasurement rates of each state poll. According to this model, Secretary Clinton currently has a greater-than-80 percent chance of winning. It is important to note, these models do not fully reflect voter sentiment concerning developing news cycles. Given the proximity of the election, it’s unlikely the models will factor such sentiment in advance of November 8th.

**EXHIBIT 1: Election Probability Based on State Polls**

Forecast model by Nate Silver/FiveThirtyEight.com based on state-by-state poll results aggregated from HuffPost Pollster, RealClearPolitics, polling firms and news reports. Data as of October 27, 2016, 10:10AM Est.
A surprise outcome will likely depend on turnout. If large segments of the Obama/Clinton coalition fail to vote, including African Americans, Hispanics and younger voters, and there was an extraordinary turnout among Mr. Trump’s base, an upset could be possible.

Is Clinton the Financial Market’s Favorite?
Right now, Clinton is the markets’ preferred candidate. Common reasoning applies: While Mr. Trump has been a more consistent advocate for free-market policies, he has also been a critic of trade and immigration. Combined with his non-traditional campaign persona, Clinton represents a more known and welcomed outcome.

The best illustration of the market’s favoritism can be seen in S&P 500 futures overnight trading on the evenings when there has been a presidential debate. Free from economic and company-specific news, these actions reflect the isolated influence of the election probabilities. David Rothschild, of the online prediction market and analysis firm PredictWise, highlighted the markets’ positive response to Clinton’s rising election probabilities during one of the debates (Exhibit 2).

EXHIBIT 2: Link Between Stock Market and Clinton’s Election Probabilities

Source: Betfair, provided by David Rothschild (prediction markets). Debate on 9/26/2016
So what about Congress?

As the odds of a victory for Secretary Clinton increase, the next question to consider is whether the Democratic Party will win the Presidency and both houses of Congress, as they did in 2008. The odds are now tilted toward a Democratic takeover of the Senate with a 78 percent chance of occurrence according to FiveThirtyEight.com. The possibility of a Democratic victory in the House is much lower. According to Real Clear Politics (Exhibit 3), the GOP will lose seats in the House but, given the size of their existing edge and the stickiness of incumbency, should hold onto a majority.

However, a Democratic sweep is not impossible—and the odds have been placed as high as 30 percent by one respected non-partisan Washington strategist.

EXHIBIT 3: House Likely to Remain Under Republican Control

Source: Real Clear Politics.com, dated 10/27/2016
Expected Economic Policy Outcomes

As with all Presidential candidates, both Clinton and Trump have articulated fairly detailed economic platforms and promises. On the surface, these plans would take the country in divergent directions. Mr. Trump has staked out strongly worded positions on trade and immigration, which he could effectuate through executive action.

Secretary Clinton has outlined a set of goals and promises that are significantly more progressive than even President Obama. This is due in part to shifting Democratic voter attitudes and a more heated than expected race with Senator Sanders. These promises include a $15-hour minimum wage, significantly higher income taxes on the wealthy, a Medicare option for working-age individuals, a significant rise in the estate tax and increases to social security benefits.

With a Trump victory increasingly unlikely, there are two other scenarios to consider. First, Clinton wins and the Republicans retain one side of Congress. Second, Clinton wins and the Democrats sweep. While the latter outcome may be celebrated by Democrats, the end result may not be too dissimilar in terms of economic policy outcomes. Winning a majority in both houses may put the Democrats in the driver’s seat but their ability to enact controversial policies may be limited, as legislation in the Senate needs to pass by sixty votes. Even if Democrats win the House, they will do so by electing representatives in moderate swing districts. The last time Democratic moderates comprised a majority that passed significant legislation (2009-2010), they were swept out in the subsequent election. Passing groundbreaking legislation may be the goal of party leadership, but for moderates in either party from swing districts, staying in office generally ends up the priority. Hence, if there is a Democratic sweep, we will likely see headlines about a new wave of progressive legislation, which could unsettle the markets over the short term. How much progressive legislation actually gets passed will be another question.

Gridlock is Good

While gridlock may not sound good, it may ironically be the best outcome. A historical study of markets and U.S. government leadership shows that markets perform weakest when the executive and legislative branches are aligned, with strong control in either the Senate or House of Representatives. Interestingly, the best outcome seems to occur in periods where the President has alignment but weak Congressional majorities. Such a situation creates expectations for successful policy-making but also a need to compromise in order for legislation to succeed. However, the middle result, where the new President meets substantial opposition in Congress, is likely where we will end up. While this will be a difficult environment in which to push legislation, the legislation that results will likely be balanced and well-reasoned through countless hours of negotiation across party lines.
Under any election scenario there may be middle ground for both parties on meaningful issues. For example, both candidates suggest the U.S. pursue a round of investing in cities, bridges, railroads and other infrastructure initiatives. Another middle ground is corporate tax reform with carried interest and repatriation of foreign profits discussed quite heavily. A “tax cut” for corporate America would probably require some form of offsetting by progressive legislation.

**Perceived Winners and Losers**

Another game market participants often play is to identify the companies that may win or lose as a result of the election outcome. The below table shows presumed winners and losers in the case of a Clinton victory.

**EXHIBIT 5: Winners and Losers By President-Elect**

<table>
<thead>
<tr>
<th><strong>CLINTON WINNERS (TRUMP LOSERS)</strong></th>
<th><strong>CLINTON LOSERS (TRUMP WINNERS)</strong></th>
</tr>
</thead>
<tbody>
<tr>
<td>Industrials (Infrastructure)</td>
<td>Healthcare/Biotech</td>
</tr>
<tr>
<td>Clean Energy</td>
<td>US-based manufacturing</td>
</tr>
<tr>
<td>Mexico (equities, peso)</td>
<td>Energy</td>
</tr>
<tr>
<td></td>
<td>Real Estate</td>
</tr>
</tbody>
</table>

Segments of the table correlate to typical party biases, such as energy and clean energy. Others reflect particular stances of the candidates.

1 Presumed winners and losers are select groups of companies that have been highlighted in various analyses regarding the U.S. election and its effects on equities.
For example, Secretary Clinton has criticized drug pricing following the EpiPen price-gouging episode. Trump, on the other hand, has been quite oppositional to Mexico and its government—the Mexican peso has traded in line with the U.S. presidential election probabilities as a result. U.S.-based manufacturing also may feel a lift from Trump’s protectionism. Many of these, like the peso, have shown some sensitivity to the election’s outcome. However, while investors should expect these relationships to continue through the election, we suspect such price deviations may reflect over-confidence in any President-elect’s ability to deliver on their promises and campaign rhetoric in the face of gridlock.

At the end of the day, the economy, earnings and valuations rule

Where does this leave us? We believe investors should keep an eye on the election and the likely policy implications. However, we should recognize there are far more factors to consider, such as the ongoing slow-growth expansion that will likely continue despite the election’s outcome. Investors should also recognize that most assets are now either fairly or over-valued, placing the substantial upside years behind us. We continue to believe investors should maintain a healthy weight toward equities, despite their concerns, but protect themselves from unwanted deviations in value through defensive equity strategies, value-oriented international strategies, and esoteric strategies such as options and absolute return. Reasonable returns likely remain in our future but bumps, whether created by political uncertainty or other unforeseen event, should be expected.

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