

On May 17th, the S&P 500[®] Index dropped 1.79% on concern that controversy around President Trump and investigations into his campaign staff's ties to Russian officials could derail his administration's legislative agenda. This was just the second time since the election that the S&P 500[®] Index had a one-day decline of more than 1% and it was the largest one-day decline since September 2016. Do the investigations of the Trump Administration present increased risks for investors? One could argue that investing is inherently risky irrespective of politics, and the current political climate doesn't heighten investment risk. Typically, only events that directly change the ability of companies to operate and generate profits have a significant and sustained impact on the market.

Historically, certain political events, including investigations into presidential activities, haven't had a significant impact on the market. In examining equity market returns during investigations of allegations concerning the Nixon¹, Reagan² and Clinton³ administrations, we find that market returns were consistent with the economic environment of the times with little evidence of politics driving market outcomes.

Event	Start and End Dates	S&P 500 [®] Index Return	Max Drawdown	Recession?
Watergate	6/17/1972 to 8/9/1974	-19.67%	-30.97%	Yes
Iran-Contra	11/3/1986 to 2/26/1987	15.12%	-4.39%	No
Clinton-Lewinsky	1/16/1998 to 2/12/1999	27.64%	-19.19%	No

Source: Bloomberg, L.P.

¹ From the time the Watergate perpetrators were arrested on June 17th, 1972 until President Nixon resigned on August 9th, 1974, the S&P 500[®] Index returned -19.67% with a maximum drawdown of 30.97% from January 1973 to August 1974. The bear market was primarily driven by an environment that included a recession with high inflation, high unemployment and shocks, such as the OPEC oil embargo. The equity market continued to decline after Nixon was pardoned by President Gerald Ford on September 8th, 1974 and reached its ultimate trough on October 3rd after a decline of 44.80% from its peak.

² From the time of the first public reporting of the weapons-for-hostages deal known as the Iran-Contra affair on November 3rd, 1986 until the release of the Tower Commission report on February 26th, 1987, the S&P 500[®] Index returned 15.12% with a maximum drawdown of 4.39% occurring in December of 1986.

³ From the time the Monica Lewinsky story broke on January 17th, 1998 until the conclusion of Senate acquittal of President Clinton on February 12th, 1999, the S&P 500[®] Index returned 27.64% with a maximum drawdown of 19.19% that occurred in July and August of 1998. The drawdown was primarily driven by economic factors including Russia defaulting on its sovereign debt and the meltdown of Long-Term Capital Management, a highly leveraged quantitative hedge fund.

Scandals and investigations aside, the policies that presidents and other political leaders propose and enact through the political process can have an impact on the market. And, as frequent references to the “Trump Trade” in the financial press indicate, the policy proposals of the Trump Administration have had an impact on financial markets. Shortly after the election, the sharp increases in equity market returns, bond yields and the value of the US Dollar were market responses to anticipated policy changes that had the potential to produce economic growth and inflation. Within the equity market, sectors and companies perceived to benefit from deregulation, tax cuts and infrastructure spending were favored by investors based on policies espoused by Trump during the campaign and shortly after the election.

As the political process has played out with the current administration, company and sector returns have been influenced by investors assessing the likelihood of policy changes and which companies are expected to benefit. This influence is evident in sector returns. With 10 out of 11 S&P 500® Index sectors showing positive total returns since the Trump election, there has been more divergence in the path each sector has followed to its return than differential in their respective outcomes. While all sectors except energy have had positive returns since the election, each sector has had a drawdown that exceeds the maximum drawdown of the S&P 500® Index as a whole. Double digit declines include both energy and telecommunications services companies, followed by financials, with a drawdown of nearly nine percent. The fact that these sector drawdowns have occurred, for the most part, independently rather than simultaneously, has helped mask this layer of volatility in a market that appears calm at the surface. This has all unfolded with a positive fundamental backdrop, which has also helped keep a damper on volatility. Specifically, corporate earnings growth was strong in both Q4 2016 and Q1 2017 with a high percentage of companies beating expectations, global economic growth forecasts have been upgraded and confidence in central bank policies has been high.

Sector Returns and Max Drawdowns Since the 2016 Election

Sector	Return	Max	Drawdown	
	11/8/16 - 5/31/17	Drawdown	Start Date	End Date
Energy	-4.60%	-14.81%	12/13/2016	5/31/2017
Telecom Services	3.81%	-12.88%	1/3/2017	5/17/2017
Financials	17.25%	-8.81%	3/1/2017	4/13/2017
Utilities	11.53%	-6.51%	11/8/2016	11/14/2016
Health Care	12.31%	-5.12%	11/10/2016	12/7/2016
Consumable Staples	9.23%	-4.86%	11/8/2016	12/1/2016
Real Estate	6.49%	-4.76%	2/27/2017	3/10/2017
Industrials	16.07%	-3.80%	3/1/2017	4/13/2017
Information Technology	21.96%	-3.46%	11/22/2016	12/1/2016
Materials	13.51%	-3.37%	3/1/2017	4/13/2017
Consumable Discretionary	16.66%	-2.95%	12/13/2016	12/30/2016
S&P 500®	14.07%	-2.58%	3/1/2017	4/13/2017

Source: Bloomberg, L.P.

Volatility is a cyclical phenomenon and the current low phase of the cycle will come to an end at some point. A return to persistently elevated volatility is more likely to be driven by a perceived or actual deterioration in the ability of companies to meet or exceed the level of profit growth priced into the market, or another fundamental factor that broadly impacts the market, rather than a political scandal or adverse outcome of an investigation into the recent activities of the Trump administration. As always, Gateway will avoid incorporating forecasts into its investment approach, nor will it attempt to anticipate how events will unfold. Gateway will continue to apply the market agnostic, risk-first approach that has served its investors well for nearly 40 years.