The HOT SPOT

Markets React to Surprise U.S. Presidential Election Outcome (11/09/2016)

The initial reaction of world financial markets to the U.S. Presidential election results on Nov. 8, 2016, was extreme and severely negative, beginning well before final results were determined even as the chances of victory for former Secretary of State Hillary Clinton diminished. As victory by Donald Trump became more certain, U.S. stock futures, evidenced by the Standard & Poor's 500 Index, had dropped by 5% and several market circuit breakers were triggered. The negative reaction was generally attributed to uncertainty with now President-elect Trump, as opposed to the relative known quantity of former Secretary Clinton. This immediate reaction began reversing in early hours this morning, and most market levels had significantly recovered by the market open in the U.S. Not only are investors uncertain about how Trump's economic policy proposals (e.g. tax cuts and spending to stimulate growth and inflation) would impact the financial markets, but they are also concerned about proposals he made during his campaign that could cause major shifts in trade and immigration. In addition, investors are concerned about geopolitical implications. Asian equity markets closed overnight down 5%. European markets recovered (the Stoxx Europe 600 was up 0.7%) after opening with a steep drop. Government bond prices and oil prices showed similar volatility. Given concerns about trade issues, foreign exchange rates also reacted. A brief review of each of the major markets is as follows:

<u>Equity Markets</u>

Global stocks tumbled initially this morning but have rallied back into positive territory in Europe and the U.S. Late last night, the S&P 500 Index futures experienced a 5% decline as the very close presidential election brought about uncertainty. The S&P 500 Index opened this morning down only 0.5% as election uncertainty ended, and is currently up 1.3%. Since Sept. 30, the S&P 500 has dropped 0.1% as of today, but it is still up 6.0% year to date (YTD). The S&P 500 Index has been volatile in recent days as the fortunes of the election shifted back and forth. The Asian stock markets led the declines today with the Japanese Nikkei 225 stock index down 5.4% (futures indicate +4% recovery), the Hong Kong's Hang Seng Index down 2.2% and China's CSI 300 down slightly by 0.54%; YTD, the Nikkei 225 is down 14.6%, the CSI 300 is down 10.1%, but the Hang Seng is up 2.3%, all in local currency terms. In Europe, the London's FTSE 100 Index initially opened down 1.4%, but has since recovered to close up 1%, slightly break even since Sept. 30 but up 10.7% YTD in local currency terms. The German DAX Index is up 1.6%, and the French CAC 40 is also up 1.5%, although both are down YTD at -0.9% and -2%, respectively.

The hardest hit sectors today within the S&P 500 Index were the more interest rate sensitive utilities (-3.2%) and real estate (-2.4%), as well as the defensive consumer staples (-1.5%). Higher were financials (+3.2%) as they could benefit from a steepening yield curve, and healthcare (+2.8%) from perceptions that Trump would exert less pressure to lower drug prices – or let the free market set prices.

U.S. insurer investments in unaffiliated common stock totaled $305 billion in book/adjusted carrying value (BACV), or roughly 6.2% of unaffiliated invested assets at year-end 2015. The table below represents total invested assets as of year-end 2015.

Invested Assets as of 12/31/15 ('000,000) - Affiliated and Unaffiliated	Life	P/C	Health	Fraternal	Title	Total	Pct of Total
Bonds	2,745,532	970,398	90,374	98,515	4,987	3,909,806	72%
Preferred Stock	9,713	14,124	324	288	305	24,753	0%
Common Stock	147,728	491,100	29,773	3,655	1,746	674,003	12%
Mortgages	403,898	12,269	38	10,639	36	426,880	8%
Real Estate	23,685	11,626	5,340	294	179	41,123	1%
Other Long Term Assets	158,200	135,874	8,252	3,691	343	306,360	6%
Derivatives	53,830	594	6	26	-	54,457	1%
Securities Lending (Reinvested Collateral)	11,685	2,792	1,308	888	-	16,673	0%
Total	3,554,270	1,638,776	135,413	117,998	7,597	5,454,055	100%

Government Bond Yields

U.S. Treasury yields experienced significant volatility as the world awaited the U.S. presidential election results. Last night, 10-year U.S. Treasury yields plunged 14 basis points (bps) to 1.71% as global equity markets sold off with the uncertainty of the election outcome. However, yields rebounded (and prices dropped) as it became clear Trump would win the White House; 10-year yields rose 34 bps to 2.05% (or 20 bps higher than the previous close) on expectations that Trump's fiscal policies will lead to increased spending and debt. The differential between the 30-year and 12-month U.S. Treasury yields has steepened to 216 bps, from 173 bps on Oct. 1, on expectations that inflation will begin to accelerate. U.S. insurance companies, particularly life insurers, benefit from steeper yield curves given their long-dated liabilities. Although the yield curve is not as steep as it has been in past years (in the 300 to 400 bps range), it is beginning to move in the right direction. Offsetting the benefits of a yield curve steepening, however, is the expectation that interest rates might stay lower for longer than expected. Expectations for a rate hike in December are unclear with the recent market volatility and the uncertainty of a Trump administration; overnight, the Fed funds futures had indicated a less than 50% probability of an imminent rate hike but are now back to an 80% probability given inflation concerns and the pull back in Treasury yields.

Movement in global government bond yields was muted, with German and UK 10-year yields rising two bps to 0.20% and 1.25%, respectively and Japanese 10-year yields unchanged at -0.08%.

Credit Spreads

Investment grade credit default swap (CDS) spreads jumped from yesterday's close of 75.8 bps to 79.9 bps at today's open before rallying down to 75.7 bps by 1:00 pm. Over the past month, investment grade CDS spreads ranged from 73 bps on Oct. 24 to Friday's high of 81 bps. The high over the past year was 124.6 bps on Feb. 11.
High yield CDS followed a similar path jumping from 409 to 426 bps before rallying back to yesterday's 409 bps. Their one-month range was 394 to 436 with a one-year peak of 589, also on Feb. 11.

U.S. insurance industry bond exposures totaled $3.9 trillion BACV at year-end 2015, with $2.1 trillion BACV in corporate bonds. Overall, both exposures are heavily skewed to investment grade: 94% of total bonds and 91% of corporate bonds. Of the investment grade exposure 71% of total bonds and 48% of corporate bonds carry an NAIC-1 designation.

Stock Market Sector Reactions

Relative to the U.S. stock market's overall response, there has been considerable disparity between market sectors as investors sort out the likely ramifications of policy goals, specifically fiscal stimulus in the form of tax cuts and increased infrastructure and defense spending, restrictions on free trade and immigration, and a rollback of regulation on businesses. Overall, it appears initial fears that more restrictive trade policy would choke economic growth have been

offset by potential short-term benefits of increased government spending, although the longer-term effects of a tougher stance on trade and immigration would be inflationary.
Financials are the day's best performers thus far, rallying on the prospects that the regulatory burdens placed on banks and other institutions by Dodd-Frank and the Labor Department's fiduciary rule could be lifted and that higher deficit spending steepens the yield curve.
Healthcare stocks—mainly biotech and pharmaceuticals—are higher on prospects that that the new administration will refrain from controlling drug prices, and on the defeat of California's Proposition 61, which sought to limit what state agencies pay for prescription drugs to what the Department of Veterans Affairs pays. Probable headwinds if the Affordable Care Act is repealed or changed are weighing on managed care stocks, however. Industrials are higher on prospects for boosts in defense and infrastructure spending. Materials stocks are higher, most likely on prospects for a tougher U.S. stance on trade and perhaps increased demand down the road from infrastructure spending. Energy shares are up, but prospects for the sector are more nuanced; a roll-back of regulations and potential opening of federal land to drilling would be welcomed by exploration and production companies because of the potential to produce more barrels at lower cost, while pipeline companies would benefit from higher volumes. Still, the potential negative impact on global growth of protectionist policies could crimp oil demand, increasing the likelihood that the oil glut continues and depressing oil prices again, and the uncertain geopolitical ramifications of a Trump presidency could be a wild card for oil prices. Coal stocks are bouncing because of Trump's relaxed stance on climate change, although coal likely will struggle to compete with cheap natural gas under a fracking-friendly regime.

Currency Markets

Currency markets, as they often do in reaction to uncertainty, were also rattled. The U.S. dollar initially plunged on the news but not long after, it began to rebound. The WSJ Dollar Index, which measures the dollar against 16 other currencies, was down by as much as 0.8% overnight but had recovered much of that by morning. Emerging market currencies also fell as traders sold off riskier assets in favor of safer ones. The Mexican peso was the biggest loser, tumbling to its weakest level on record on fears that Trump would follow on his pledges to end the North American Free Trade Agreement (NAFTA) and deport millions of immigrants from the U.S. Nearly 80% of Mexico's exports go to the U.S. The Canadian dollar also tumbled to an 8-month low on investor concern that the end, or renegotiation, of NAFTA could reduce trade between Canada and the U.S. The U.S. is Canada's largest foreign market, and it is the biggest foreign investor in Canada. Trump's speech earlier today seems to have calmed market nerves, at least somewhat and for the time being, as he appeared to be more conciliatory in his first official address.