FineMark
National Bank & Trust®

Fine Points

The Quarterly Trust and Investment Publication of FineMark National Bank & Trust

Quarter 2, 2016 | Volume 1 | Issue 2

MARKET PERFORMANCE & AN ELECTION YEAR

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Following the scary sell-off the stock market experienced in January and early February, the market has rebounded and seems to have settled into a trading range. Differing views from market experts, conflicting economic data and the memory of recent painful bumps on the road to recovery have left investors and the market without a clear path forward or conviction on what to believe. Earnings season was "OK," but we continue to see companies and analysts lower the bar for future earnings expectations. The market rallied off the February 11 lows, not because we suddenly believe the economic growth story, but because a stabilization of oil prices, narrow credit spreads, and a reduced fear of bankruptcies, have lessened concerns of another recession. Many of the questions that existed at the beginning of the year are still with us and we expect volatility to remain high through November and in the months following the election.

The relationship between a presidential election and the stock market has been a hot button topic for years and we are frequently asked how the election will impact the equity markets. While the primary season has certainly been long on rhetoric, we really have had little discussion on the policies the candidates would like to implement.

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Accordingly, it is difficult to identify potential winners and losers in the market, and equally difficult to identify sectors that would be beneficiaries of the election outcome. What we can do, however, is look back at history to see if we can get any clues for the market performance in election years.

The Presidential Election Theory, developed by Yale Hirsch, provides that the markets are strongest in the third year of a presidency. On the other hand, volatility tends to develop in the first year following an election as the market digests change.

Over the past 100 years, experts have found that the stock market has performed better under a Democratic president. With a Democrat holding the highest office in the land, the Dow Jones Industrial Average has generated an average annualized return of 7% versus 3% under a Republican president*. History further shows that the returns of the S&P 500 do tend to be weaker in presidential election years. Going back to 1948, the fourth year of the presidential cycle has shown an average gain of 6.1% versus a rise of 8.8% in all years. The S&P has gained in 76% of presidential election years versus 71% of all years. Looking a bit deeper, we find that going back to 1928, in those election years in which a new president must be elected, we have seen the S&P lose 4% on average. This is the situation we face this year with President Obama completing his second term in office.

Finally, you can often determine who will win a presidential election based on three month returns of the S&P 500. A rise in the index between July and October of an election year has historically indicated the reelection of the incumbent candidate or party, while the reverse has pointed to a replacement.

We should note that these statistics fail to take into account the economic backdrop in which the elections were held. As one might guess, the stronger the economy, the more likely the market returns would be good, and the better chance the incumbent or incumbent party would be elected into office. This stands to reason, as the electorate would favor continuing the policies that contribute to a growing economy.

Regardless of how interesting the correlation between election cycles might be, it should not dictate one's investment decisions. Instead, one should continue to look to the basics of making sound investment choices such as acknowledging investment goals, understanding risk tolerance and diversification.

*Nath, Trevir. "How Presidential Elections Affect the Stock Markets." nasdaq.com. Nasdaq, Inc., 01 March 2016. Web. 25 May 2016. *Udland, Myles. "The stock market loves Democratic presidents more than Republicans." businessinsider.com. Business Insider, Inc., 20 December 2015. Web. 25 May 2016.

THE BUTTONWOOD AGREEMENT

Before the ticker tape and the bell, the earliest stock traders in New York chose a nice shady spot under a buttonwood tree outside what is now 68 Wall Street for their exchanging activities.

As time went on (more than 100 years), the brokers decided to set down some basic rules. On May 17, 1792, twenty-four of them wrote and signed America's first trading regulations. The *Buttonwood Agreement* was only two sentences long. The brokers agreed that:

1. **They were only allowed to trade with each other, and**
2. **The commissions on trades would henceforth be 0.25%.**

Wall Street was Wall Street before New York was New York. The now world-famous street was once a lowly pathway that ran alongside a wall, which was built to keep the Native Americans out. Now, *Wall Street* is more than a location on a street map, it's an adjective, an ideal, and the mecca of the finance industry.

CURRENCY VALUES

By Tim Nguyen
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Movement in currency values can significantly affect U.S. companies that derive a large percentage of revenues overseas. It is estimated that a third of the decline in U.S. company earnings from 2014 to 2015 was attributed to an overly strong dollar, which makes the cost of U.S. goods and services more expensive to foreign buyers. This is why there is a high level of public attention garnered at each Fed meeting. Investors clamor over every word spoken by Fed Chair, Janet Yellen, because movements in the value of the U.S. dollar, vis-à-vis other currencies, are affected by the level of U.S. interest rates relative to the rates in other countries.

Europe and Japan are continuing their quantitative easing programs and experimenting with negative interest rates, while in the United States, short term interest rates are higher. With global capital in abundance, money will flow to where investors can get the highest returns on the highest quality short term sovereign debt, in this case, the United States. More capital flowing into a country can cause its currency to strengthen.

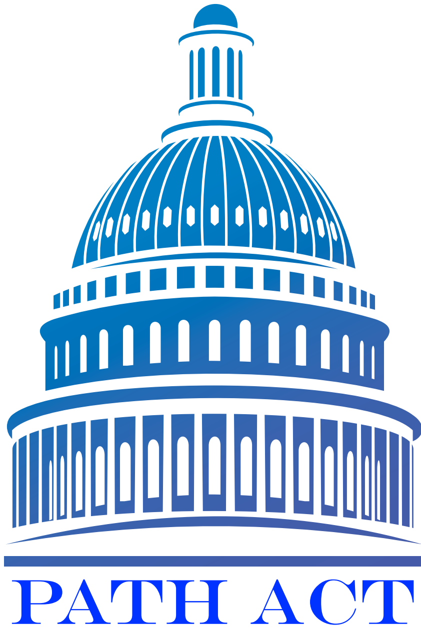
As mentioned, a negative interest rate policy is a tool used by key central banks. But, what really happens when deposit rates turn negative? As a short primer, when deposit rates turn negative, banks' excess reserves held at their central bank are charged a rate of interest. Depositors don't actually pay to have their money held at the bank; instead, banks absorb this charge. To prevent bank profitability from suffering due to negative interest rates, banks are incentivized to lend out all or a portion of their excess reserves to help stimulate the economy. Since these policy deposit rates provide a benchmark for other short term rates across an economy, interest rates on short term bonds will typically decline in tandem. The Bank of Japan has recently joined the ranks with others in Europe (European Central Bank, the Danish National Bank, the Swedish Riksbank, and the Swiss National Bank) to experiment with negative interest rates. A country may also pursue a policy of negative interest rates to devalue its currency for the purpose of igniting exports.

While a strong currency engenders confidence, an overly strong currency can hurt a country's exports (as we saw in 2015). On the flip side, a very weak currency is not desirable either, as it may indicate a high level of inflation or a loss of confidence in economic policy. Brazil and Argentina are currently dealing with this dilemma. In their case, higher short term interest rates may be desirable to bring down inflation and make investing more attractive.

Monetary policy affects capital flows, capital flows affect currency movement, and currency movement affects earnings of U.S. multinational companies. Interest rate policy, through its effect on currency values, is inextricably linked to the earnings of U.S. multinationals. This is why investors hype up meetings of the biggest central banks, which have to balance domestic economic interests with the external effects of currency fluctuations.

The terms *weak dollar* and *strong dollar* are generalizations used in the foreign exchange market to describe the relative value and strength of the U.S. dollar against other currencies.

THE PATH ACT OF 2015



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As part of the Protecting Americans from Tax Hikes Act of 2015 (PATH Act), Congress voted to permanently allow a tax exemption for contributions from Individual Retirement Accounts (IRAs) to public charities. Anyone over 70 1/2 may donate up to $100,000 per year from their IRA directly to the charity or charities of their choice and the entirety of the contribution will be excluded from their income. While people have been able to make such direct contributions since 2006, Congress would usually vote to allow the exemption so late in the year that most people did not know if their contribution would be tax exempt until it was too late.

Now that the exemption is permanent, it is another planning tool for those who must take required minimum distributions from their IRAs. If, for example, you do not need the money you are required to take for living expenses, this option allows you to make a charitable contribution while also avoiding having to include the donated amount as part of your income. To effectuate this strategy, instead of taking the distribution, you must contribute the amount (up to $100,000) directly to a charity. Since everyone's tax situation is unique, please talk to your advisor to determine whether this option is best for you. Additionally, only public charities qualify for the exemption. Contributing to a private foundation, supporting organization or a donor-advised fund will not qualify for the exemption.

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