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Storm Clouds & Turkeys

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Happy Thanksgiving! In this world of trade tariff tantrums and political polarization, we take a high level view of last year's tumultuous stock market, how things may be different this time and settle in with a lighter note.

We are just over the half-way mark for the fourth quarter of 2019 and many still remember the dramatic drop in the domestic equity markets during the fourth quarter of last year and specifically the month of December. Are the storm clouds that existed then passing through again? Are there new storm clouds on the horizon?

Investors are now cautiously watching the impeachment process. We believe it is instructive to review what caused the market down draft last year and how this year may or may not be the same. We will also take a look at past impeachments and how the markets played out.

In my quest to look at the bigger picture and read between the lines, let's take a closer look.

STORM CLOUDS?

Just How Bad Was the Fourth Quarter of 2018?

The fourth quarter of 2018 was remarkable. Consider the following:

> **Worst December Since the Great Depression (1931)** – The S&P 500 hit a low on Christmas Eve day, nearly hitting an official correction level – down 19.78% from its peak on September 20, 2018.

> **Worst Quarter Since the Great Recession (2008)** – The S&P 500 was down 13.97% for the fourth quarter – the worst since 2008 when the domestic stock market declined 22.56%.

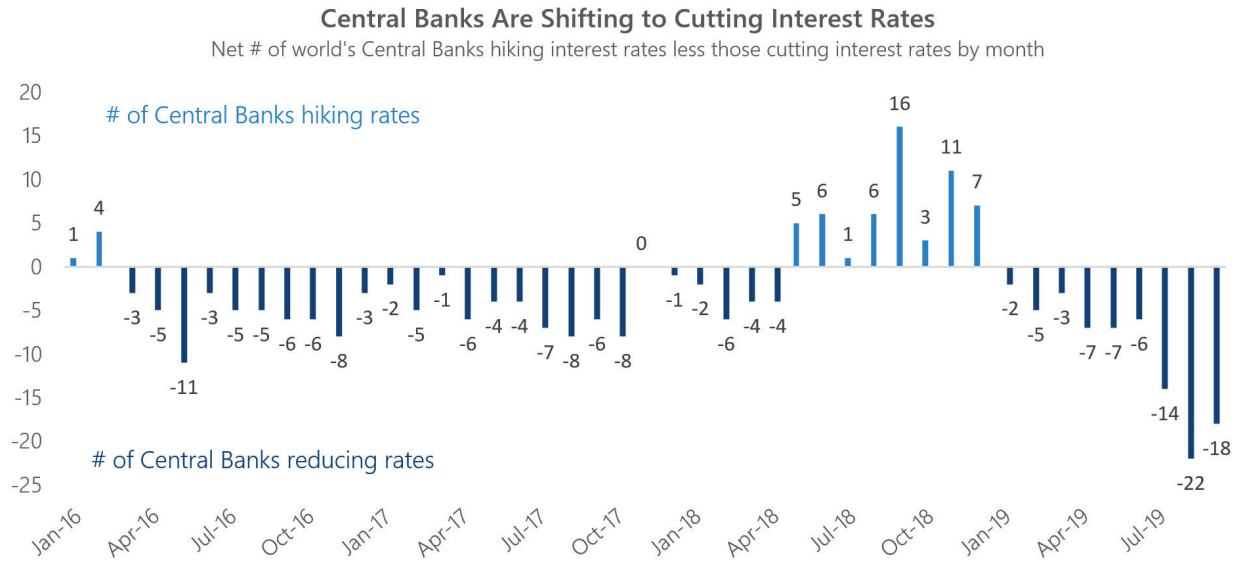
The reasons for the market's drop were many but may be primarily attributed to the following;

> **Trade Policy (Tariffs)** – Markets do not like uncertainty and the tariff drama at that time was ever present. Tariffs tend to create winners and losers and can reduce economic growth. To that point, the International Monetary Fund (IMF) had reduced global growth rates based primarily on tariffs. The volatility during the quarter was fed by comments from President Trump coming out of the G20 meeting with China's Prime Minister, Xi Jinping. Trump suggested great progress but in reality the markets reversed and dropped significantly on the reality that progress had not (or not enough) been made.

> **Monetary Policy (Fed Rate Hikes)** – Markets did not like that the U.S. Federal Reserve hiked 25 bps in December. They dropped their estimate for hikes for 2019 at that time from three to two. But this good news was swiftly diminished by their comments that the economy has a more balanced set of risks (i.e., softer economy).

We would be remiss to not mention that there were other concerns driving uncertainty in the markets during 2018, including, but not limited to, concerns for a global economic slowdown and the threats of a government shut-down.

EXHIBIT 1: GLOBAL CENTRAL BANKS HAVE PIVOTED TO A MORE DOVISH STANCE



Source: Schwab

So, as we are amidst the mid-point of Q4 2019, what has changed? The most obvious answer is a shift in Fed Policy to a more dovish stance in both rate movement and outlook, which has been confirmed by international central banks (Exhibit 1). Heading into Q4 2018, the U.S. Fed raised interest rates eight times, which was then capped off with the contentious December rate increase making nine straight hikes. In 2019, the U.S. Fed has reduced rates three times and credit markets are suggesting risk is well below December 2018 levels.

In addition, there appears to be much more progress on the trade war front with Canada, Mexico, European countries and China. China represents the largest issue in this camp. Despite the fact that the drama continues and is now more complicated with the unrest in Hong Kong, there has been much more progress and more clarity than in late 2018.

A Look at Historical Impeachments

Markets generally adapt to changing political environments. Nonetheless, there is certainly a lot of attention being paid to the current impeachment proceedings. A look at historical impeachments provide some context.

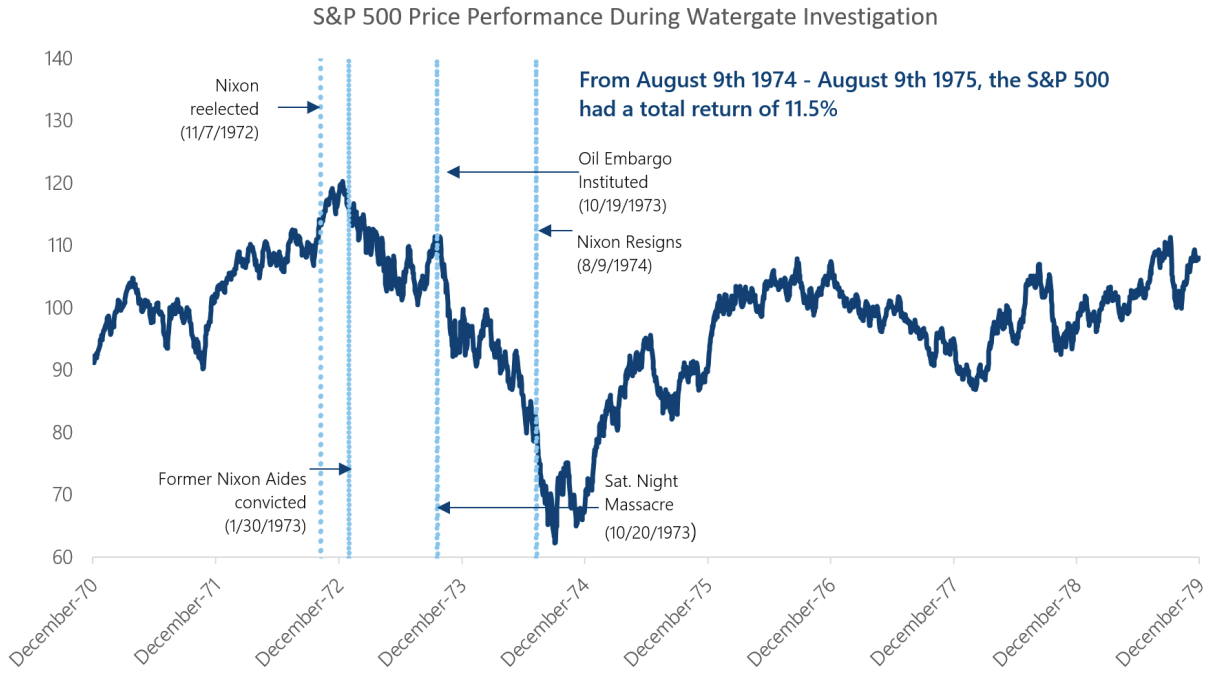
Impeachment proceedings are uncommon in the U.S. --- Andrew Johnson (17th President) was impeached on March 2-3, 1868, but the two more recent occurrences were President Nixon and President Clinton. Nixon resigned before the formal process concluded and President Clinton was impeached in the House, but it wasn't confirmed by the Senate.

Using market performance under the Nixon and Clinton impeachment proceedings, we can extrapolate that while risk in Washington is notable, it's historically more transitory than a structural change (Exhibit 3 & 4) and those periods may have been more impacted by other events.

EXHIBIT 2: STORM CLOUDS

Storm Clouds	4th Quarter 2018	4th Quarter 2019
Trade War & Tariffs	Reversal in expectations for progress.	More progress made. Generally better shape with relatively more clarity.
Monetary Policy	U.S. and other central banks were increasing interest rates.	U.S. and other central banks are decreasing interest rates.
Global Growth	Concerns for global growth slowdown juxtaposed by tariff concerns and tightening monetary policy (i.e., central banks increasing rates).	Softening economic data, but U.S. being powered by its consumer. Possibility of global economies bottoming from their soft patch.
Presidential Impeachment Process	While concerns were circling the President and the Mueller investigation was occurring, no formal impeachment process had started.	Formal impeachment process under way.

EXHIBIT 3: IMPEACHMENT PROCEEDING RISK DURING WATERGATE PROVED TRANSITORY



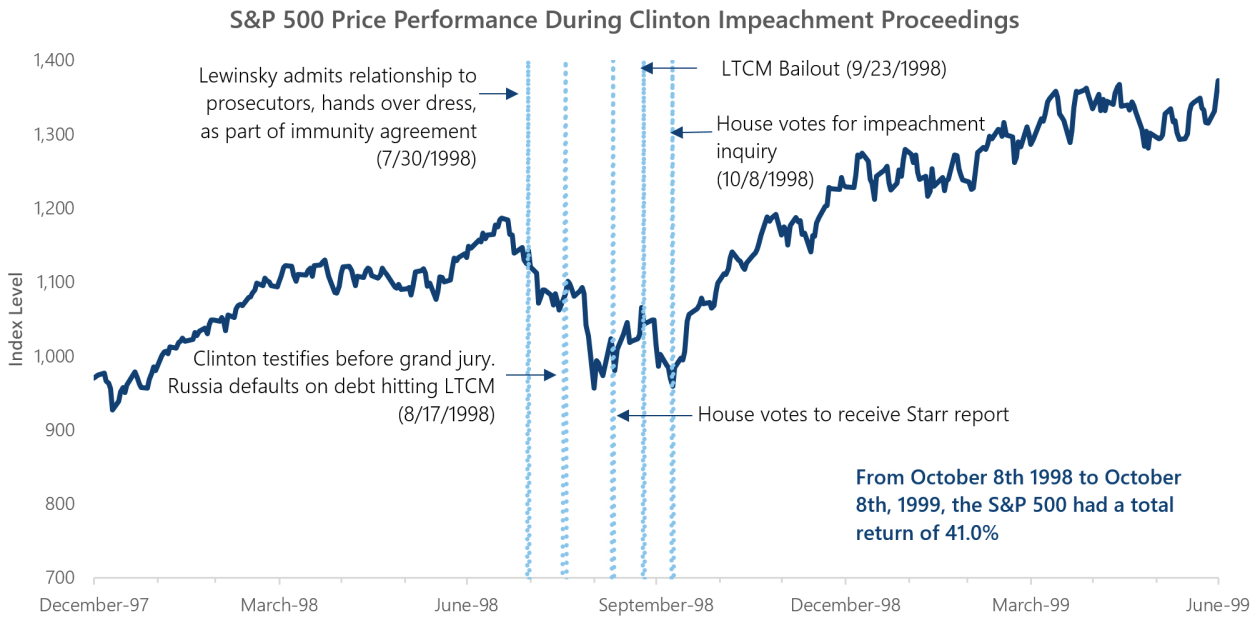
Source: Bloomberg. ***Past performance is no guarantee of future results.***

> **Nixon: Watergate/Impeachment -** During the Nixon Watergate Investigation, we note that the real drama started in January of 1973 as former Nixon aides were convicted. While the market modestly traded lower prior to running up in the Fall, two major events then occurred in October within a day of each other. First the Oil embargo was instituted on Friday, October 19th. It was on Saturday, October 20th, that the infamous Saturday Night Massacre occurred. As you can see in Exhibit 3, the domestic stock market really started to turn down during this period. Nixon eventually resigned on August 9th of 1974. The market appears to have bottomed shortly after this period and was up 11.5% over the next 12 months.

> **Clinton: Impeachment –** Exhibit 4 on the following page shows that the market seemed much less impacted by the days surrounding the Clinton impeachment saga. The domestic stock market was increasing up through the summer of 1998, before Monica Lewinsky admits to a relationship with President Clinton. However, during this same period the markets were digesting major concerns regarding the Asian Financial Crisis in 1997. The firm, Long Term Capital Management (LTCM), which was founded by legendary investors lost $4.6 billion in 1998 in just a few months. This triggered a crisis, which was finally stemmed off on September 23rd with a bailout by 14 financial institutions including the Federal Reserve. This was followed weeks later by a House vote on impeachment near the bottom of the market trough. Clinton went on to be cleared by the Senate. The stock market climbed from the fall of 1998 and was up 41.0% one year later.

Using market performance under the Nixon and Clinton impeachment proceedings, we can extrapolate that while risk in Washington is notable.

EXHIBIT 4: IMPEACHMENT PROCEEDING RISK DURING THE LATE 90'S PROVED TRANSITORY



Source: Bloomberg. ***Past performance is no guarantee of future results.***

While we cannot forecast what may be the final outcome of the current Trump impeachment process, we do believe that markets will settle in on longer-term economic issues. If the market's performance over the past several years are an indication, it has climbed higher despite a constant dose of tempestuous tweets and political chaos. Perhaps the market has become immune to such events and will be more interested in tariff resolutions and economic data.

In the meantime, it is important to remember that trying to time market movements based on external news events is futile. Exhibit 5 shows that missing just the best 10 days dropped your annualized return from 5.6% to 2.0%. Missing the best 50 days provided a swing of nearly 11.5% annualized (5.6% to -5.9%).

However, realizing that diversification is important for long-term success, we can help manage shocks by employing strategies that either potentially protect in down drafts or provide asymmetrical risk and return opportunities. Those strategies may include, but aren't limited to, market neutral, convertibles, global infrastructure and fixed income.

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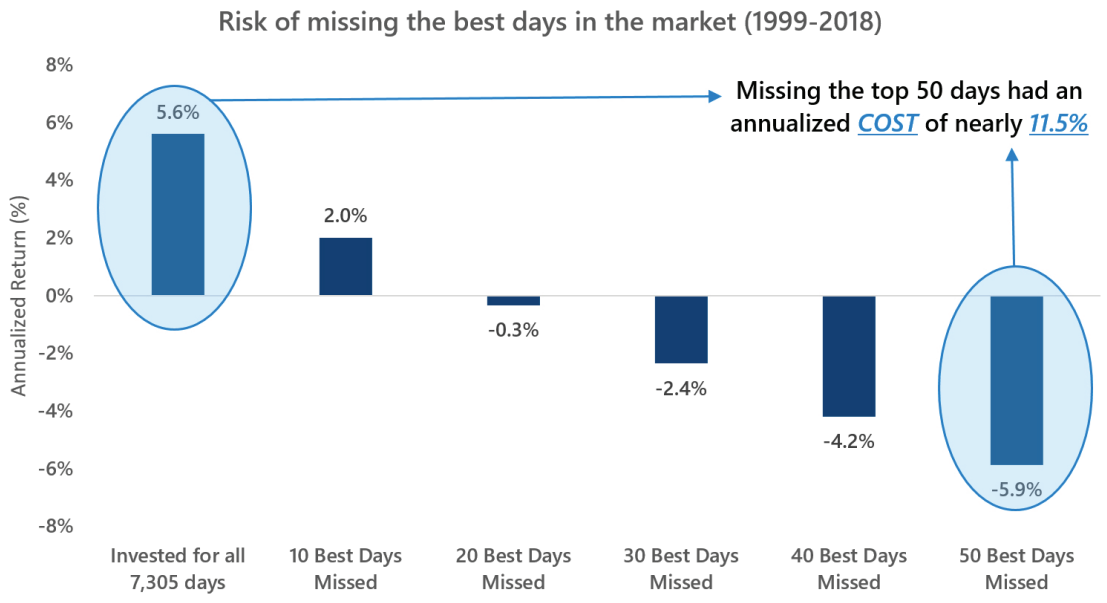
EXHIBIT 5: MARKET TIMING DOESN'T WORK



Source: Bloomberg. ***Past performance is no guarantee of future results.***

TURKEYS

On a lighter note, we bring everyone a reminder that we are amidst the Thanksgiving season. It is helpful to give thanks to one another, particularly during these turbulent times.

We do know that the biggest losers during this holiday will be turkeys. Did you know?

> **Presidential Pardons –** George H.W. Bush was the first president to officially pardon a turkey in the year 1989. Today, two turkeys are sent to the White House — one that gets a pardon and one that is the runner up. So close, but yet so far.

> **How Much Do We Eat on Thanksgiving?** According to Wallethub, the average person consumes anywhere between 3,000 and 4,500 calories on Thanksgiving. In total, Americans consume 8.1 billion calories during the holiday. Let's not get in to how long it takes to burn a calorie.

> **Thanksgiving Travel -** As 96% of Americans say they will celebrate Thanksgiving, over 54 million will travel (most since 2005), according to WalletHub. One in four Thanksgiving hosts wish they had more help preparing the feast, but most agree that a fridge full of leftovers is a nice consolation.

> **Can Turkeys Fly?** That question is best answered by viewing classic sitcom, *WKRP in Cincinnati's hilarious 1978 episode, Turkeys Away* and heeding the sorrow in character Gordon Jump's closing salvo, "As god as my witness, I thought turkeys could fly." In actuality, domesticated turkeys cannot fly, but wild turkeys can for short distances and up to 55 miles per hour. They can also run up to 20 miles per hour.

About the Author

Reed Murphy serves as Chief Investment Officer of Calamos Wealth Management where he oversees all aspects of the firm's investment platform with over 25 years of industry experience. Reed has held a variety of executive level roles in the industry and is a speaker on topics pertaining to personal and institutional investing.

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