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Guide to the 2016 Elections

Our Most Likely Outcomes and What They May Mean for Investors

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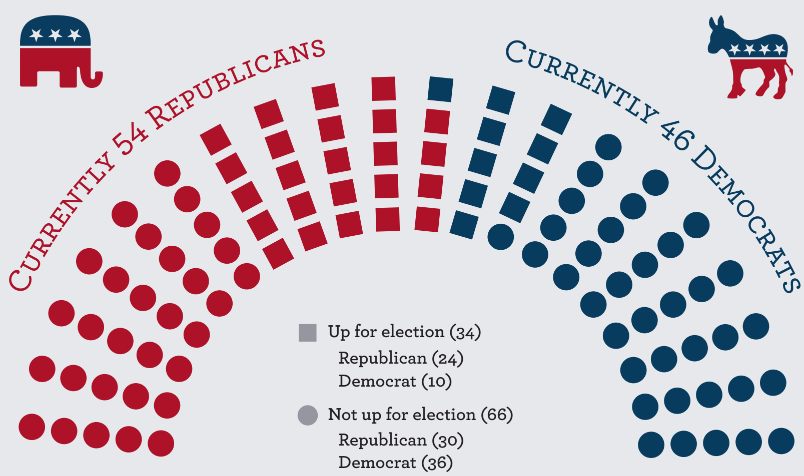
Keep Your Perspective

The elections are likely to have economic and investment implications, but we advise investors to ride out the waves of campaign rhetoric. The private sector is dynamic and has developed innovative strategies for dealing with high and low tax rates and large and small deficits for decades, even during the current recovery. We foresee continued U.S. and international economic growth improvement long after November is behind us. Although the elections are important, they don't affect our strongest recommendation: Have a long-term plan and stick with it. Here are a few reasons why:

1. **Campaign promises increasingly are unreliable.**
   Research over presidents from Woodrow Wilson to Jimmy Carter found that an average of 75 percent of campaign promises were kept during a president's first term. Yet, the average fell to 47 percent since 2001.[1]
2. **National elections have been politically volatile.**
   Voters twice have removed the majority party in each chamber of Congress since 2006.
3. **A handful of races may determine Senate control.**
   The House seems safely in Republican hands, but the Senate may come down to a handful of races, as shown below. The polls do not suggest a clear consensus, and we suspect that the presidential election could influence the final split of seats in the Senate.

What's at Stake in the Senate



Ultimately, political volatility and disagreement between Congress and the president—not to mention the uncertainty about the next Supreme Court justice—should make it difficult to plan large portfolio changes around possible election outcomes.

This report addresses two broad questions about the elections and investment decisions:

- What issues may determine which party will prevail in the White House and Senate races?
- How do investors maintain perspective between potential election-related opportunities and a long-term investment plan?

[1] "A PolitiFact Special Report: Obama's First-Term Campaign Promises," politifact.com/truth-o-meter/article/2013/jan/17/politifact-obamas-first-term-campaign-promises/.

Government Spending and Taxes

Presidential Candidates Want Wider Deficits

Both presidential candidates oppose cutting entitlements (e.g., Social Security and Medicare) and favor additional spending on infrastructure (roads, bridges, etc.). Both want corporate tax reform, but a deal is unlikely without a compromise on individual taxes. However, bipartisan consensus on individual tax rates could be difficult and time consuming because many Republicans favor broad tax cuts while Democrats would likely target cuts to low-income taxpayers.

Trade

Eventual Policies May Be Less Extreme Than Rhetoric Suggests

Donald Trump opposes the proposed Trans-Pacific Partnership (TPP), threatens to renegotiate the North American Free Trade Agreement (NAFTA), and endorses trade sanctions against China. Hillary Clinton argues instead to renegotiate trade deals to make conditions more favorable for U.S. exporters, but we see her position as generally more favorable to trade than Mr. Trump's. She could take a view similar to President Obama's; he spoke cautiously of NAFTA as a candidate but turned more positive as president.

Economic Policy and Regulation

Candidates Agree on Added Spending but Little Else

Both candidates are in favor of raising the federal minimum wage, and Mrs. Clinton proposes a variety of rural and urban development programs as well. However, there also are important differences. Mrs. Clinton favors clean energy, limits on fossil fuel emissions, and generally more regulation. Mr. Trump opposes these positions and particularly favors fossil fuels.

Immigration

Fundamental Differences Separate the Candidates

Mr. Trump wants enforcement of immigration laws, favors vetting and possibly deporting at least some immigrants, and would like additional barriers on the U.S.-Mexican border. Mrs. Clinton opposes these limits on immigration and favors a path to citizenship. Democrats also could try to limit corporate decisions to move jobs overseas (i.e., outsourcing of jobs).

Health Care

The Parties Split Over the Affordable Care Act

Republicans appear committed to repealing the Affordable Care Act (ACA), also known as Obamacare. However, Republicans may have difficulty passing an alternative law. Democrats favor keeping the ACA. Both parties would likely limit prescription drug price inflation, though Republicans favor negotiation while Democrats prefer regulations to cap prices.

❶ How will the candidates' unpopularity affect turnout?

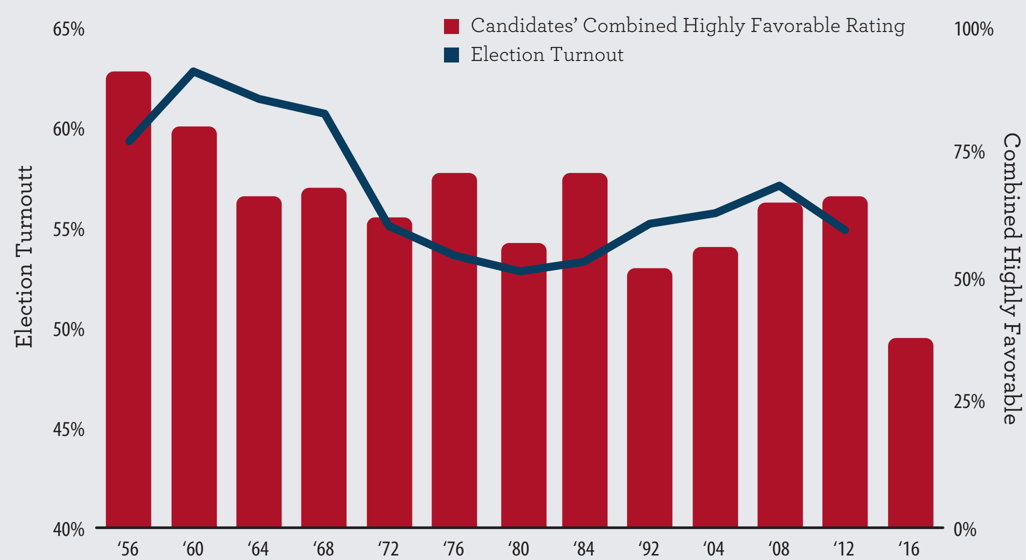
Voters who feel strongly negative about one or both candidates may do one of the following:

- Register a protest vote in favor of the other
- Feel impelled to vote for their "less unfavorable" choice
- Decline to vote

It is difficult to know what combination of these options may prevail, but the chart below suggests that turnout historically moves up and down with favorability. If turnout is difficult to predict, polls may not be reliable election predictors.

Turnout Tends to Fluctuate With Candidates' Favorability

When presidential candidates have high favorability ratings, turnout tends to rise



Sources: The American Presidency Project at the University of California, Santa Barbara, Gallup, and Wells Fargo Investment Institute, 8/17/2016.

Percentage of poll respondents who rated the two candidates as highly favorable, as of the final week before each election. The 2016 poll data were the latest available as of July 22, 2016. Poll data were unavailable for the elections of 1988, 1996, and 2000.

❷ How well does each candidate appeal to independent voters?

The debates are likely the last major public forum the candidates will have to reach a national audience. A candidate who focuses on constructive solutions should gain among independent voters. But the more a candidate uses personal attacks, the greater the chances that the candidate could drive turnout in favor of the other candidate.

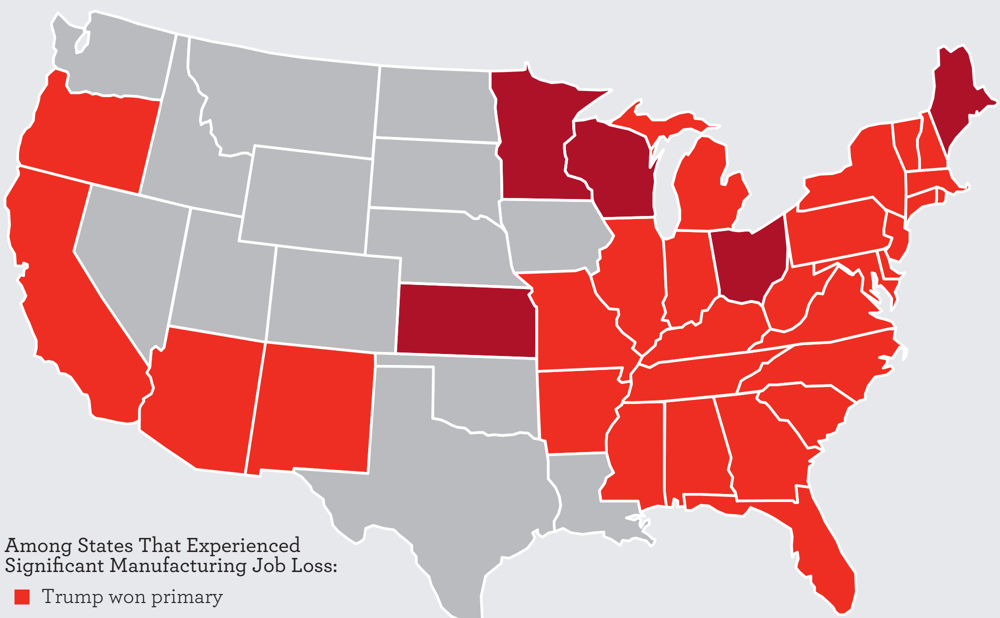
❸ Will populist sentiment or desire for predictability matter more?

Loosely defined, populism is a philosophy that prefers decisions appealing to the common person vs. those adhering to traditional ideologies. In some cases, populism prefers perceived national over international goals, such as globalization, or may seek to limit immigration. For example, Mr. Trump earned his party's nomination by proposing to limit immigration and global trade. He did especially well in the Republican primaries in the states most hurt by the loss of manufacturing jobs during the past 15 years, as shown in the graphic below. By contrast, Mrs. Clinton was part of the Obama administration and follows her party's past positions on many issues. She seems less populist and more predictable.

Thus, one way to forecast the winner may be to ask whether populist sentiment or predictability matters more for voters. As a complicating factor, populism may alter previous voting patterns. Younger and traditionally Democratic voters may reject Mrs. Clinton if they believe she hews too closely to her party's incumbent leaders and large corporations. Traditional conservative voters likewise may struggle to support Mr. Trump's positions on trade, immigration, and social issues.

Mr. Trump's Support Seems Tied to Manufacturing Job Loss

In the Republican primaries, he did best in states hit hard by manufacturing job losses



Sources: Bureau of Labor Statistics and Wells Fargo Investment Institute, 8/17/16.

Note: The map shows Republican primary results and does not depict actual or projected general election results.

Significant manufacturing job loss is defined as a decline of more than 10% in a state's manufacturing payrolls between January 2001 and June 2016. Gray states did not experience significant manufacturing job loss.

Our Most Likely Outcomes and Market Implications During the Next Four Years

We don't see a significant probability for an outcome that includes the Democrats taking control of the House of Representatives. Thus, we expect the elections to result in one of the four outcomes summarized below. Considering the probabilities and the expected market outcomes shown, our outlook is roughly neutral. In our view, the strong prospect of more divided government implies that extreme market outcomes are possible but unlikely. The following pages consider the potential implications for financial markets broadly and for particular equity sectors.

	President	Congress	Expected Market Impact[1]	Probability of Occurring
1	Democratic	Divided	Neutral	40 percent
2	Republican	Divided	Slightly Negative	30 percent
3	Democratic	Republican	Slightly Positive	10 percent
4	Republican	Republican	Negative	20 percent

Source: Wells Fargo Investment Institute, 8/17/16.

[1]Represents our outlooks for large-capitalization equity prices, the 10-year Treasury note price, and U.S. dollar exchange value during the next four years.

DEMOCRATIC President

Expected Market Impact

★ ★ ★ ★

Neutral

DIVIDED Congress

How Might it Happen?

The Democratic president's victory is commanding enough to sweep Democrats to a Senate majority.

Summary Outlook

- The new president's promised initiatives in taxes, spending, and regulation are negative for financial markets, but congressional compromises may blunt the impact somewhat. When combined with a more positive trade policy, the net overall market impact may be neutral.
- Some potential compromises have unclear sector impacts. Health Care sector and regulatory reforms may evoke divergent political positions, and compromises could emerge slowly. Such uncertainty seems negative for the Health Care and Financials sectors and fossil fuels, where we believe existing regulation is already a negative factor.
- Immigration policy compromises may create more visas for skilled workers but limit outsourcing. This mix does not clearly support the Information Technology sector, but the extra low-skilled labor should support the hospitality and leisure industries.

Issues With the Potential to Have the Greatest Financial Market Impact

Analysis	Market Implications
Government Spending and Taxes Republicans in Congress will likely try to limit spending programs but probably will have to compromise to advance any legislative plans of their own. A compromise to moderate tax hikes and new borrowing is likely. A bipartisan consensus should discourage tax inversions, but probably only if the compromise includes reforming the tax treatment of overseas earnings, a process that may take a year to negotiate.	*A compromise on spending will probably include infrastructure and defense spending, which favors the Industrials and Materials sectors. A tax deal that promotes earnings repatriation should benefit the Information Technology and Financial sectors and multinational Consumer Staples and Pharmaceuticals firms.*
Trade We expect Congress will eventually ratify the TPP with changes that do not materially limit trade. Existing trade deals will probably remain essentially intact.	*We expect a net positive impact on the dollar and financial asset prices. The Industrials, Agriculture, Financials, and Consumer Staples sectors and large Pharmaceuticals should benefit the most.*

REPUBLICAN President

Expected Market Impact

★ ★ ★ ★

Slightly Negative

DIVIDED Congress

How Might it Happen?

The Republican president's victory is not commanding enough to prevent Democratic challengers from taking Senate seats from Republican incumbents.

Summary Outlook

- The new president's promised initiatives in taxes, spending, immigration, and trade are generally negative for markets, in our opinion, but congressional opposition should blunt or dilute his proposals, producing only slightly negative overall financial market impacts.
- On some issues, the chances of a compromise seem particularly murky. Health care and energy policies evoke strong political positions, and reforms could take years to work out.
- Financial regulation could be changed, but Democrats in the Senate may fight hard to maintain current rules.

Issues With the Potential to Have the Greatest Financial Market Impact

Analysis	Market Implications
Government Spending and Taxes A compromise to moderate tax cuts and new borrowing is likely. There is bipartisan consensus to discourage tax inversions, but probably only if the compromise includes reforming the tax treatment of overseas earnings, a process that may take a year to negotiate.	*A compromise on spending will probably include infrastructure and defense spending, which would favor Industrials and Materials. A new tax deal that encourages overseas revenue repatriation should strongly benefit the Information Technology and Financials sectors and multinational Consumer Staples and pharmaceuticals companies.*
Trade The renegotiation of trade deals and new tariffs on Mexico and China are presidential priorities in this scenario. Republicans and Democrats in Congress probably will allow trade pact renegotiation but probably will decline to start a battle of rising tariffs around the world.	*Delayed or abandoned trade agreements should be negative for multinationals in the Industrials, Financials, Consumer Staples, and Agriculture sectors, which account for a majority of U.S. exports.*

DEMOCRATIC
President

Expected Market Impact
★ ★ ★ ★
Slightly Positive

REPUBLICAN
Congress

How Might it Happen?

The Democratic president's victory is not commanding enough to flip Senate leadership to the Democrats nor do the Republicans reach a veto-proof 67-seat majority.

Summary Outlook

- The new president's promised initiatives in taxes, spending, and regulation are negative for financial markets, but congressional compromises may blunt the impact significantly. When combined with a more positive trade policy, the net overall market impact may be positive.
- Some potential compromises have unclear sector impacts. Health Care sector and regulatory reforms may evoke divergent political positions, and compromises could emerge slowly. Such uncertainty seems negative for the Health Care and Financials sectors and fossil fuels, where we believe existing regulation is already a negative factor.
- Immigration policy compromises may create more visas for skilled workers but limit outsourcing. This mix does not clearly support the Information Technology sector, but the extra low-skilled labor should support the hospitality and leisure industries.

Issues With the Potential to Have the Greatest Financial Market Impact

Analysis	Market Implications
GOVERNMENT SPENDING AND TAXES New infrastructure spending is likely. An eventual, broad compromise would fund new infrastructure and defense spending out of revenues from lowering corporate taxes, especially on repatriated income.	*A compromise on spending will probably include infrastructure and defense spending, which would favor the Industrials and Materials sectors. A tax deal that promotes earnings repatriation should benefit the Information Technology and Financial sectors and multinational Consumer Staples and pharmaceuticals firms.*
TRADE We expect Congress will eventually ratify the TPP with changes that do not materially limit trade. Existing trade deals will probably remain essentially intact.	*We expect a net positive impact on the dollar and financial asset prices. The Industrials, Agriculture, Financials, and Consumer Staples sectors and large pharmaceuticals should benefit the most.*

REPUBLICAN President

Expected Market Impact

★ ★ ★ ★

Negative

REPUBLICAN Congress

How Might it Happen?

The Republican president's victory is commanding enough for Republican Senate incumbents to keep their seats.

Summary Outlook

- A unified government leadership may spark a variety of significant changes, including tax cuts and new borrowing, renegotiation of trade deals and new tariffs, increased immigration restrictions, repeal of the Affordable Care Act (ACA), and decreased regulations. We believe that all but the decrease in regulation are overall negative for the broad equity market, bond prices, and the dollar.
- Inversely, a decrease in regulation should benefit the Financial and Energy sectors especially.
- Democrats in the Senate may fight hard to maintain current regulations, implying uncertainty over whether deregulation may extend to the Financial sector.

Issues With the Potential to Have the Greatest Financial Market Impact

Analysis	Market Implications
GOVERNMENT SPENDING AND TAXES Broad tax cuts and new borrowing are likely. There is bipartisan consensus to discourage tax inversions, and a deal could lower the tax rate on repatriated overseas earnings. The Republican congressional leadership likely will limit new spending and borrowing.	*A tax deal that promotes earnings repatriation should benefit the Information Technology and Financials sectors and multinational Consumer Staples and Pharmaceuticals firms. New spending should support the Industrials and Materials sectors.*
TRADE The renegotiation of trade deals and new tariffs on Mexico and China are presidential priorities, and Congress may lack the political consensus to limit the negative consequences for trade in this scenario. A battle of rising tariffs around the world is possible.	*Abandoned trade agreements and tariff retaliation by other countries should be mostly negative for multinational Industrials, Financials, Consumer Staples, and Agriculture, which account for a majority of U.S. exports.*
HEALTH CARE A Republican-led Congress is likely to repeal the ACA, but uncertainty may cloud private business decisions while Congress devises an alternative plan. Congress probably will negotiate prescription drug price inflation caps.	*We expect health care regulation to remain an important source of uncertainty for companies, a net negative for equity prices.*

What it May Mean for You

- **Some key risks seem clear:** Higher budget deficits and trade restrictions are prominent risks in our scenarios. Limiting trade, widening deficits, and raising the public debt should be negative for the dollar and U.S. financial asset prices during the next four years.

  What it may mean for investors: We believe that the worst risks to the financial markets, discussed on pages 6-10, have the lowest probabilities of occurring and advise investors not to allow the candidates' broad unpopularity to drive fear of worse financial market impacts than are likely. In our view, investors should avoid large portfolio changes based on election fears or speculation.

- **Divided government obscures some potential opportunities but clarifies others:** The strong cross-party ideological divide complicates the task of spotting investment opportunities from immigration, health care, trade, and regulation policies. Yet, sector opportunities seem clearer from prescription drug price caps and, especially, fiscal policy, including tax reform and new infrastructure and defense outlays.

  What it may mean for investors: The previous pages identify some potential investment opportunities, but clues about policy direction may emerge only slowly until January 2017 and possibly not until mid-2017. As the eventual policy priorities become more discernible to financial markets, investors might use this guide to identify the issues and the potential investment implications.

- **Stay close to your investment professional:** If tax and spending policies change, or if we view trade restrictions as likely to burden the economy, your investment professional can help you keep your investment plan on track. In the meantime, we believe it's more important to have an investment plan and stick with it.

About the Authors

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Mr. Christopher focuses on the global economic outlook and currency trends, and guides the investment strategy process. He is frequently quoted in the national media, including *The Wall Street Journal, The New York Times, Forbes, Time, Investor's Business Daily, USA Today,* Bloomberg News, ABC News, NBC News, and CNBC.

Prior to joining Wells Fargo, he developed economic strategies to trade in global financial and commodity futures markets for Eclipse Capital Management. In previous positions, Mr. Christopher supplied international economic perspectives for Wells Fargo predecessor A.G. Edwards, and advised institutional clients of Istanbul-based Global Securities on the oil-based economies of the Caucasus and Central Asia. He has consulted with the governments of Hong Kong, Egypt, Russia, Kazakhstan, and the Kyrgyz Republic on monetary policy issues. He is based in St. Louis, Missouri.

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