October 26, 2016

Dear Client:

This will be a relatively short letter for a change, as 1) we have already stated our basic views on the presidential election, 2) we believe the outcome of the election is so critical to the outlook for the stock market that we don't want to go too deeply into other topics we might otherwise wish to discuss, and 3) virtually nothing has changed in the last quarter regarding the underlying global and domestic economic environment or the stock market.

An important disclaimer: As a general rule, as we've said before, we typically assiduously avoid injecting our personal political views into our letters. But this is not a typical election, and Trump is not an ordinary candidate. As professional investors, we have a responsibility to consider the potential impact of the election on the stock market, just as we would with any significant event or phenomenon.

In our judgment, a victory for Donald Trump would pose risks for the market that are unprecedented in a modern U.S. presidential election. Trump's behavior throughout the campaign has caused us, like many others, to doubt his judgment, self-control, and general temperament – indispensable traits in any leader, let alone one in charge of the U.S. nuclear arsenal. We fear that foreign leaders would view Trump as easily manipulated and goaded into misadventure and folly, as evidenced by Vladimir Putin's alleged efforts to influence the election in Trump's favor. On the point of Russia and NATO, Trump appears not to understand the basic purpose of America's alliance network or to appreciate the stability and hence prosperity it has lent the post–Second World War international order. Trump's policies on international trade, such as they are, risk sparking widespread protectionism and trade wars, which would be disastrous for the world economy and financial markets. Moreover, even if the more ominous scenarios one can imagine never come to pass, a Trump presidency would likely be attended by a constant state of volatility and uncertainty that would be toxic for confidence.

As for Hillary Clinton, markets see her, for all intents and purposes, as a typical presidential candidate. We believe the stock market would view a Clinton victory favorably – or, at least, not as a cause for panic. Fortunately for the market, polls moved sharply in her favor following the first presidential debate and have held steady since, with the most highly regarded polling averages showing her with a 5 to 6 percentage point lead as of this writing. Nate Silver's prediction models at FiveThirtyEight, which we put a good deal of stock in and have been following closely all the way along, currently give Trump about a 15% chance of winning – non-negligible and higher than in most other models, but not a cause for reducing our exposure to the stock market any further. At the other extreme, there is a small but nonzero chance that Trump's support could collapse, with disastrous consequences for Republicans down-ticket. Were that to happen, not only would the Democrats capture the Senate, already a likelihood according to FiveThirtyEight, but the House could be in play as well. Full democratic control of Congress would be of concern to us, as investors, because it might allow Clinton to pursue elements of her platform that could hurt equity valuations (e.g., higher corporate and personal income taxes). Mercifully, the campaign will be over, one way or the other, in less than two weeks.

A brief word on two other matters, on which we've written extensively in prior letters, that have been pushed to the background but will likely retake center stage for the market soon after Election Day: Brexit and the Fed. Regarding the former, while it is now clear that the short-term impact on the U.S. stock market of Britain's decision to leave the EU has been minimal, the intermediate- and long-term effects remain to be seen. As crucial elections approach in France, Germany, and elsewhere across the Continent, the questions Brexit has amplified concerning the European Union's stagnation, dysfunction, and instability will only grow louder in the months to come. Just this past week, the seeming ability of the tiny Wallonia region of Belgium to block a landmark trade agreement between the EU and Canada has again laid bare the EU's debilitating lack of cohesion. We will continue to monitor Brexit and the issues it both symbolizes and has exacerbated.

With respect to the Fed, Janet Yellen and company have effectively signaled a quarter-percent December rate hike barring unexpectedly negative economic developments between now and their December meeting. (For reasons that go without saying, the FOMC is not about to increase interest rates a week before Election Day at its November meeting.) As we have discussed in the past and may explore further in upcoming letters, we do not share the Fed's apparent eagerness to raise rates, which we are afraid poses greater risks than would leaving them lower for longer. Be that as it may, however, the Fed's signaling almost certainly means that a December rate increase is already largely if not entirely priced into the market. And while the effect of the Fed's stance may be to keep a lid on growth, the basic economic regime that has prevailed for the last number of years – slow to moderate growth combined with interest rates that, while a tick higher, look to stay very low for the foreseeable future – should hold more or less intact. And, as we've said countless times before, such an environment is favorable for equities. Looking past the election – assuming Clinton prevails but the Republicans hold onto the House – we remain reasonably bullish regarding the intermediate- to long-term outlook for the stock market.

If there have been any changes in your investment objectives or in your personal or financial circumstances, or if you have any questions or comments, please give us a call.

Sincerely,

Michael G. Hofkin

Benjamin J. Hofkin

(A copy of our disclosure brochure is available upon request.)