

Markets Shrug Off Election Outcomes

If there are any lessons to be learned from this year's market performance, one of them surely would read "Election-Related Volatility is Short-Lived." After several momentous elections this year, including Brexit and the U.S. presidential election, market participants seem to embrace this learning and are becoming pros at limiting their reaction to outcomes from the voting booths.

Over the weekend, Italian voters overwhelmingly nixed proposed changes to their constitution in a national referendum. Had the vote resulted in a "Yes," it would have decreased the powers of the country's parliament and limited the role of regional politics while centralizing decisions in Rome. This would have been seen as support for the current direction of the country. Instead, the result was a 59% vote against the changes, and this outcome ultimately led to the resignation of the country's prime minister¹. Italy has one of the weaker banking systems in the Eurozone, and instability in the country can be viewed as a detriment to the slow improvement in European financial conditions since Greece's financial troubles were resolved last summer. Although not explicitly on the ballot, a vote against the establishment also makes an Italian exit from the Eurozone appear more probable. Both developments are negative for the Euro as well as for European securities; however, the market did not panic on the news. After a quick sell-off period, reaching a 20-month low, the Euro reversed its losses and ended stronger on Monday. European equities also traded higher on the day and Italian bond yields stabilized around 2%, well below the highs from late November, offering support to the country's bonds. Higher yields suggest concern by investors.

With most major political events now behind us, market attention is now shifting toward fundamentals. Early indications suggest that European stocks ignored Italy's election results and instead reacted positively to signs of continuing economic growth across the Eurozone. Domestically, market attention is shifting toward inflation expectations and Federal Reserve rate policy. The prevailing attitude seems to be shifting toward a higher inflation and a higher interest rate regime. This may result in higher potential for economic growth, and may also lead to tighter monetary policy. It is almost a foregone conclusion that the Fed will raise interest rates next week.

As our portfolios were positioned for increased market volatility, we have not made major portfolio allocation changes in light of the U.S. election results. However, given the increasing opportunities that we have seen in foreign markets, we did make some slight portfolio adjustments at the beginning of the fourth quarter. We moved closer to our strategic weights for most portfolios, decreasing some of the underweight to emerging markets and slightly increasing international equity allocations.

In fixed income we continue to recommend duration shorter than the benchmark, balanced with exposure to investment-grade intermediate bonds in order to buffer equity volatility. We have maintained an overweight to credit-sensitive bonds in 2016 as we believe their additional yield can offset some of the principal losses from falling bond prices. We are comfortable with this credit overweight because improving growth prospects, which push up yields, are also likely to cause default rates to remain subdued and may narrow credit spreads. We strive to diversify all of our portfolios across risk factors such as duration, credit or sector in fixed income, as well as buy size, geography and industry in equities.

We also favor an allocation to alternatives to help smooth portfolio returns and take advantage of nontraditional sources of return. Most importantly, however, it is imperative to remain disciplined and remember that a portfolio should reflect an investor's investment objectives, goals and risk tolerances.

¹ Matteo Renzi, Italy's prime minister formally resigned on 12/05/16, but the country's president Sergio Mattarella has requested a delay until Italy's Senate passes its 2017 budget. The president will later have to either select a new prime minister or call early elections

About Tower Square Investment Management®

Tower Square Investment Management LLC is an SEC registered investment adviser owned by Cetera Financial Group®. It provides investment research, portfolio and model management, and investment advice to its affiliated broker-dealers, dually registered broker-dealers and registered investment advisers.

Disclosures

The material contained in this document was authored by and is the property of Tower Square Investment Management LLC. Tower Square Investment Management provides investment management and advisory services to a number of programs sponsored by affiliated and non-affiliated registered investment advisers. Your registered representative or investment adviser representative is not registered with Tower Square Investment Management and did not take part in the creation of this material. He or she may not be able to offer Tower Square Investment Management portfolio management services.

Nothing in this presentation should be construed as offering or disseminating specific investment, tax, or legal advice to any individual without the benefit of direct and specific consultation with an investment adviser representative authorized to offer Tower Square Investment Management services. Information contained herein shall not constitute an offer or a solicitation of any services. Past performance is not a guarantee of future results.

For more information about Tower Square Investment Management strategies and available advisory programs, please reference the Tower Square Investment Management LLC Form ADV disclosure brochure and the disclosure brochure for the registered investment adviser your adviser is registered with. Please consult with your adviser for his or her specific firm registrations and programs available.

No independent analysis has been performed and the material should not be construed as investment advice. Investment decisions should not be based on this material since the information contained here is a singular update, and prudent investment decisions require the analysis of a much broader collection of facts and context. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. The opinions expressed are as of the date published and may change without notice. Any forward-looking statements are based on assumptions, may not materialize, and are subject to revision.

All economic and performance information is historical and not indicative of future results. The market indices discussed are unmanaged. Investors cannot directly invest in unmanaged indices. Please consult your financial advisor for more information.

Additional risks are associated with international investing, such as currency fluctuations, political and economic instability, and differences in accounting standards.

While diversification may help reduce volatility and risk, it does not guarantee future performance.

Investors should consider the investment objectives, risks and charges, and expenses of the fund carefully before investing. The prospectus contains this and other important information about the fund. Contact your registered representative or the issuing company to obtain a prospectus, which should be read carefully before investing or sending money.