YOSEMITE CAPITAL MANAGEMENT

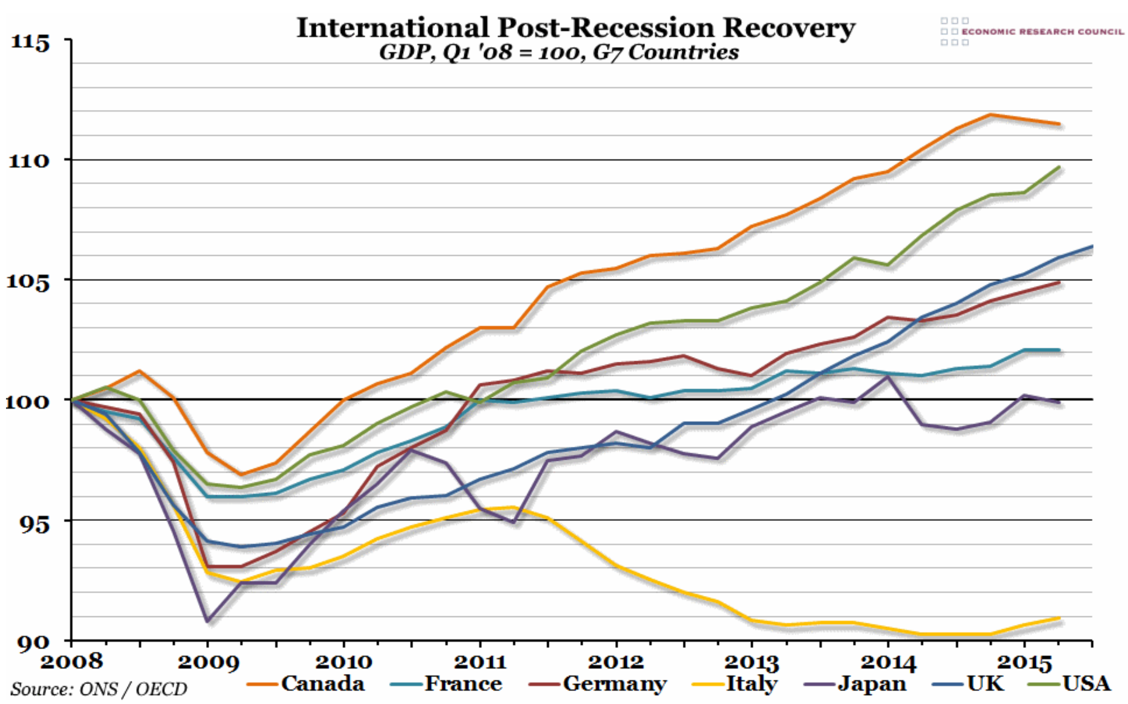
Third Quarter 2016 – COMMENTARY

"I am an optimist. It does not seem too much use being anything else." – Winston Churchill

The economy of the United States has grown slowly since the trough of the Great Recession in June 2009. Many lament the slow pace of growth, but this should not have been a surprise to anyone who knows anything about how the economy actually works, especially after a credit bust, as we pointed out in our Commentaries of 2009Q3 and 2010Q1 (http://www.YosemiteCapital.com/news-commentary). But the facts are that growth has been positive, not flat or negative, and, perhaps much more noteworthy, among the highest in the developed world (Exhibit 1).

Exhibit 1, International Post-Recession Recovery

The growth of the United States has been among the highest in the developed world



Source: Economic Research Council

As we detailed earlier this year, the weight of the evidence suggests this trend of slow growth is likely to continue with the caveat that this kind of environment is vulnerable to shocks such as those caused by geopolitical events.

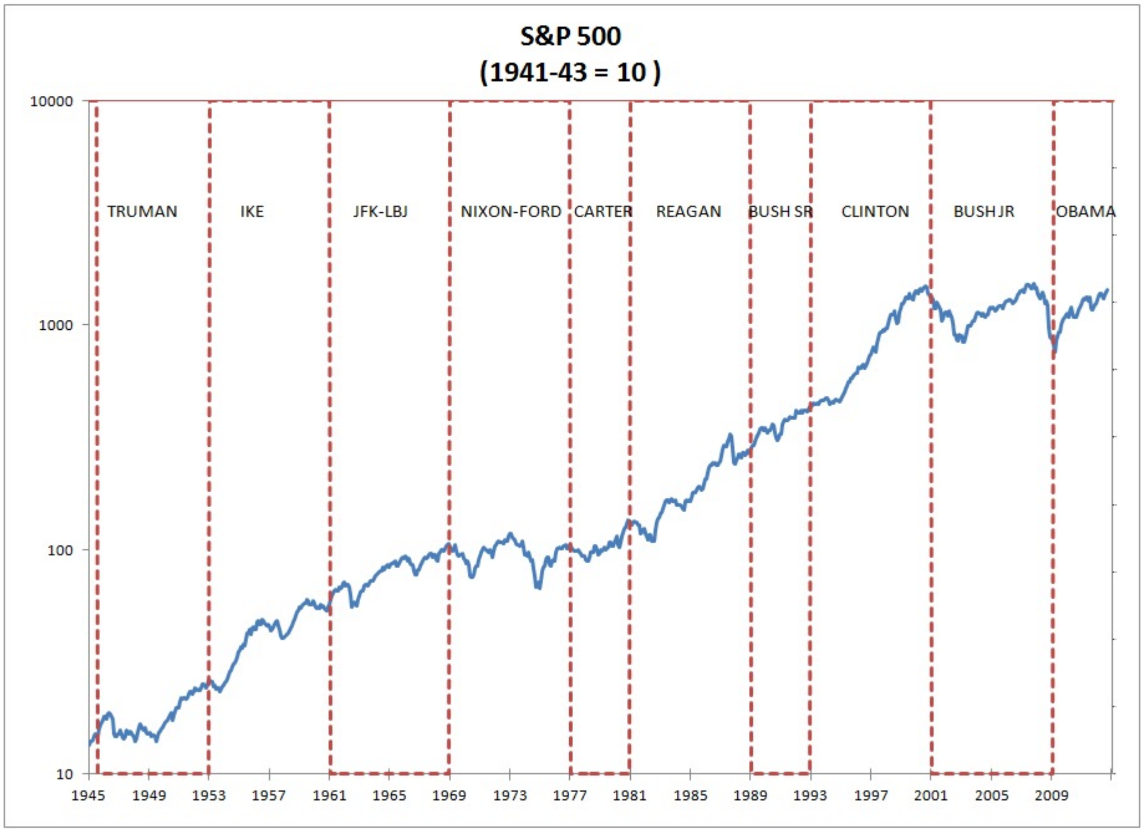
The domestic economy is naturally a subject of discussion in any presidential election year, with the party of a current president touting the positive aspects and the opposition pounding on the negative aspects. Many are concerned about how the election results in this certainly strange political year will affect the economy and the stock market.

The most important thing about the relationship between the election and the economy is that ***the economy largely determines the outcome of the election, not the other way around***. The middle third to half of Americans (i.e., those not blindly tethered to a particular political party) generally vote for a president according to their wallets, perhaps personified via the unemployment rate. This means they choose to keep the same political party in office if the economy is growing (and presumably the unemployment rate is falling) and will vote to change parties if the opposite is true.

As far as the relationship between the election of the president and the stock market, we are not aware of any ***causation*** between the party in the White House and the stock market, although in the post-World War II era there is a ***correlation*** of higher stock market returns under a Democrat president compared to a Republican president. But ***correlation is not the same as causation***. This is important to keep in mind because there are so many factors that contribute to how the stock market behaves, including earnings growth, interest rates, inflation, valuation, money flows, sentiment, global growth, etc. The person in the Oval Office does not remotely come close to controlling any one of these, let alone all of them. Suffice it to say that the chart of the S&P 500 generally moves upward over time regardless of, and often in spite of, which party or person is in charge of the executive branch of the government of the United States (Exhibit 2).

Exhibit 2, The S&P 500 and Presidential Administrations Since 1945

The S&P 500 has grown over time regardless of, and often in spite of, which party or person controls the offices at 1600 Pennsylvania Avenue



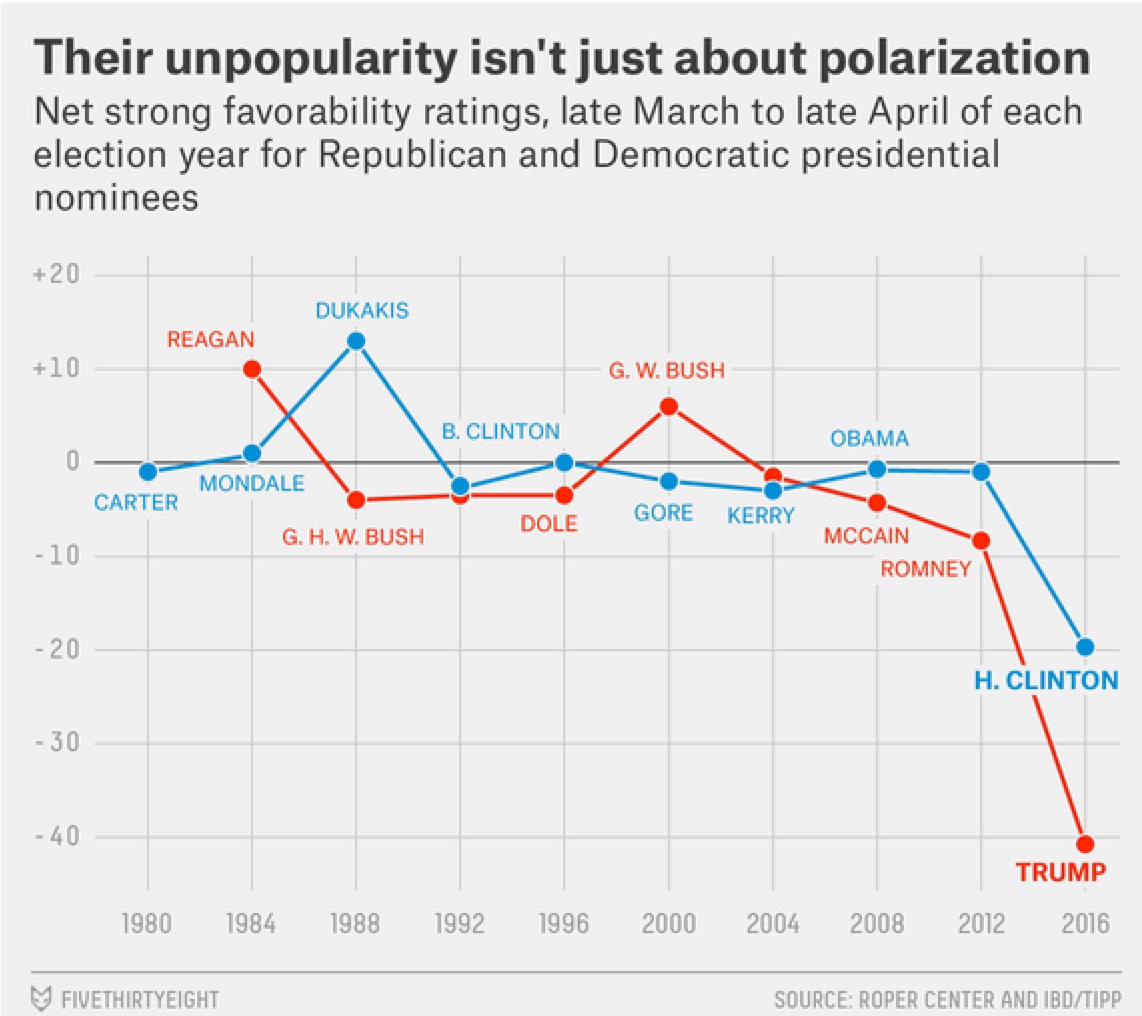
<< The S&P 500 recently closed at 2175

Source: Angry Bear

The people of the United States have a severe distaste for the presidential nominees of both major political parties (Exhibit 3).

Exhibit 3, Americans Dislike Clinton and Trump at Historic Levels

"No major party nominee before Clinton or Trump had a double-digit net negative "strong favorability" rating. Clinton's would be the lowest ever, except for Trump."



Source: FiveThirtyEight.com

These are two of the most odious candidates in American history, or at least in our lifetimes. Both are about power and ego. Neither one has a grand plan or vision for the country, as they speak only in sound bites and shallow platitudes. Like the vast majority of presidential candidates, both are ignorant about how the economy really works; their so-called "plans" are piecemeal steps intended for political points instead of a better economy and at best treat symptoms instead of addressing the root causes of problems. Both have significant segments of their own parties who do not support them. Poll results demonstrate that many Americans believe each of them in their own way is loathsome and despicable.

And one of them is going to be our next president.

While this may seem like bad news, we are still very much of the opinion that the future is positive. Yes, we will likely have, to one degree or another, a bad president devoid of effective political leadership. But that is nothing new. Besides, there are checks and balances built into the structure of our system that are intentionally designed to limit what any single person in the White House can and cannot do. And perhaps much more importantly, the United States of America is a strong country that is so very far beyond depending on its “leader” to achieve success. The people run the USA, not its political class and certainly not individual politicians no matter what their position.

Commerce will still take place, millions of people will still go to work every day to make their lives and the world a better place, and profits will still be made to advance the economy and society. And though a better political establishment would make this easier to attain, long-term success is still the most likely outcome and, in our view, the only way to live life. The economy can still grow, the financial markets can still advance, and new technologies and ways of enjoying life can continue to develop.

We look forward to what the future has to offer!

John Kleponis, CFA
Chief Investment Officer

Paul Heckler
Managing Director

Past performance is not indicative of future results. The information contained herein is based on internal research derived from various sources and does not purport to be statements of all material facts relating to the issues mentioned. This information contained herein, while not guaranteed as to accuracy or completeness, has been obtained from sources we believe to be reliable. Opinions expressed herein are subject to change without notice.

The S&P500 Index is designed and maintained by Standard & Poor’s (a division of The McGraw-Hill Companies), is a free-float market capitalization weighted index that includes 500 leading companies in leading industries of the U.S. economy, and is intended to be an ideal proxy for the total market. This index is calculated on a total return basis with dividends reinvested and is not available for direct investment.

The Barclays US Aggregate Bond Index is a broad-based flagship benchmark that measures the investment grade, US dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS and CMBS (agency and non-agency). This index is calculated on a total return basis with interest reinvested and is not available for direct investment.