NUVEEN ASSET MANAGEMENT

Election 2012: Implications for the Economy and Financial Markets

The economic and financial market implications of the election center around three elements: fiscal policy, monetary policy and regulatory policy.

FISCAL POLICY: APPROACHING THE CLIFF

On one hand, this election preserved the status quo, with the same parties retaining control of the Executive Branch, Senate and House of Representatives. However, it was a close, polarizing election with no public mandate regarding policy direction. We expect the parties' positions to be somewhat hardened, based on comments from Mitch McConnell and John Boehner, as well as an emboldened President Obama.

The end of the year brings a big adjustment on the fiscal cliff issues of spending cuts and tax increases to avoid a material drag on gross domestic product (GDP) in 2013. We believe an agreement will be reached, but the election results put that outcome at higher risk. There was hope that this process would result in a grand bargain to implement more comprehensive reform of the tax code and entitlement programs, putting the long-term budget situation on a more sustainable path. That's also less likely now. Without a path toward budget sustainability, we'll continue accumulating federal debt. This will ultimately result in further deterioration of the country's credit profile and ultimately lead to credit rating issues.

MONETARY POLICY: RATIFYING CURRENT MEASURES

Monetary policy has become much more politicized, given the unorthodox and somewhat experimental nature of recent Fed measures. Mitt Romney stated that, if elected, he would not reappoint Federal Reserve (Fed) Chairman Ben Bernanke.

NOVEMBER 2012

Keith Hembre, CFA
Chief Economist and Investment Strategist, and Head of Quantitative Strategies

Nuveen Asset Management, LLC

The re-election of President Obama is essentially a ratification of Bernanke's monetary policy. Bernanke does not want to serve beyond his term expiring in 2014, but Obama will no doubt appoint someone with a similar dovish approach.

Looking at the financial markets, gold was nearly the only area that rose the day after the election. That was somewhat predictable given an Obama win. Interestingly, the Fed's quantitative easing 3 (QE3) program has not had a sustained effect so far on the financial markets. Commodities are down pretty sharply since the Fed announced QE3. Equities and bond yields are also down. That is the opposite of what we've seen in prior quantitative easing episodes. We'll see if that trend continues.

REGULATORY POLICY: STRENGTHENING THE HAND

President Obama's re-election will likely strengthen the hand of regulatory policy, particularly in key sectors like Financials, Energy and Health Care. That will negatively affect efficiency and costs in those sectors.

WHAT DOES IT ALL MEAN?

As we think about our forecasts, our assumptions are largely in line with what's happened to date. We assumed an Obama win and a fiscal drag next year of about $200 billion due to expiration of payroll tax cuts, spending reductions and tax increases associated with the Affordable Care Act.

As we look at the fourth quarter, economic growth was poised to slow from 2% in the third quarter to roughly 1.5% before the election and Hurricane Sandy. I think both developments will add near-term downside risk to fourth quarter GDP. Sandy disrupted activity and the election caused uncertainty that has weighed on business investment. Even with a fiscal cliff agreement, this uncertainty is likely to prevail throughout the fourth quarter and into 2013. Our 2013 forecast resembles 2011 and 2012, with overall GDP growth of 1.5 to 2.0% with some rotation within the components. We'll closely watch the negotiations and statements from policy makers in the coming weeks.

We remain cautious with our cross asset class investment strategy. We are moving to a neutral level in our positioning of domestic large cap equities versus international equities, as we see a trend beginning to favor the relative performance of international equities over domestic. Generally, we continue to favor the higher income and mid-risk strategies over equities and core fixed income. And our absolute return strategies continue to have low exposure to both equity and fixed income markets, focusing on more relative value and relative income positions by pairing long and short positions. And there is increasing incentive to potentially move toward a shorter position on the 5-year portion of the yield curve given yields are near record low levels and debt outstanding is likely to increase in the coming year.

RISKS AND OTHER IMPORTANT CONSIDERATIONS

GPE-ELEHEM-1112P