This article contains some thoughts in regards to tonight's election results. RIA Pro customers will receive a cheat sheet today in which 3 election scenarios are analyzed and the expectations, based on the 3 scenarios, for stocks, bonds, the economy, and monetary policy are discussed. To gain access, please sign up for a 14 day free trial at [RIA Pro](RIA Pro).

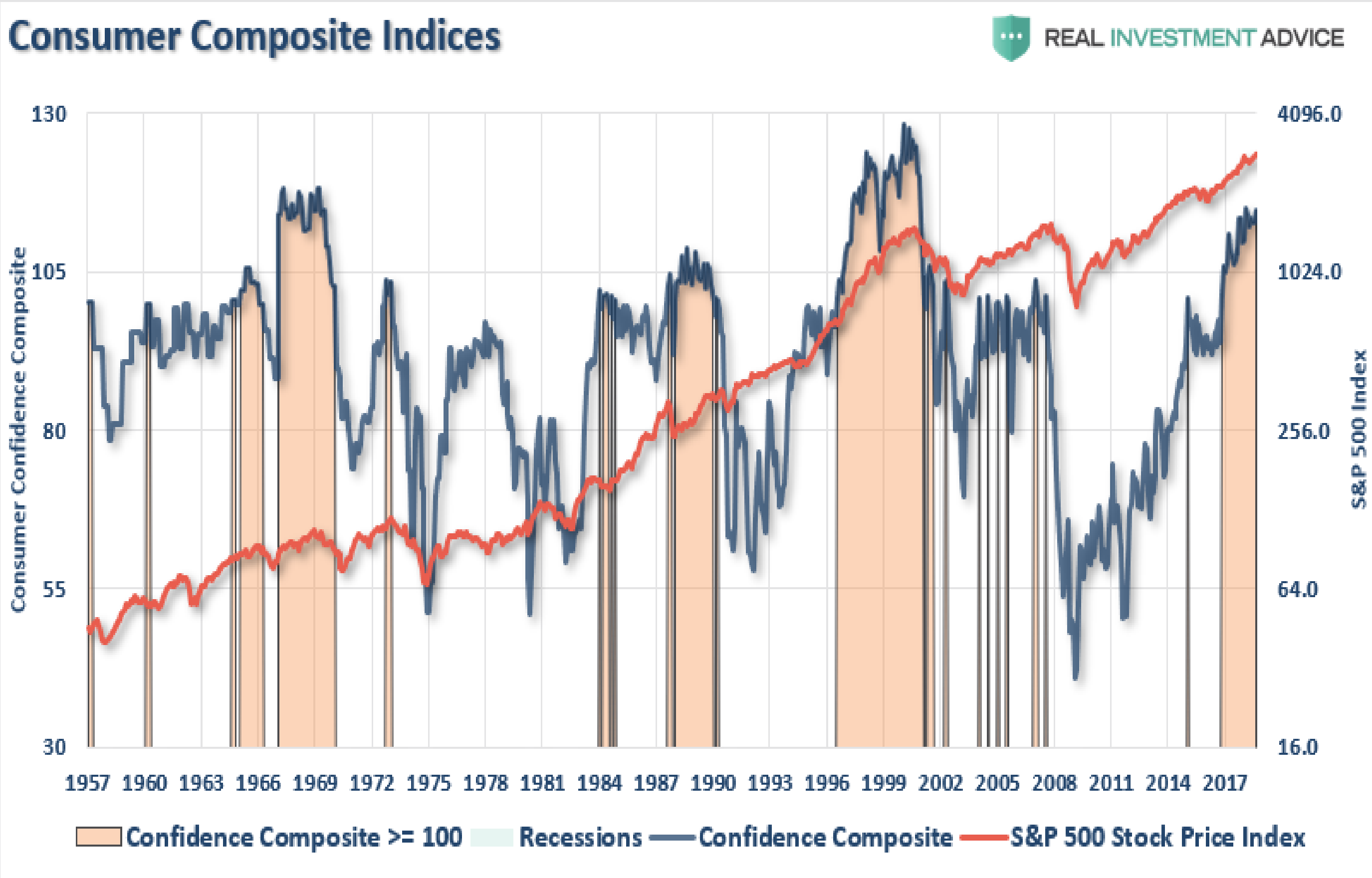
In this past weekend's newsletter, I noted Raymond James' Kevin Giddis' three possible outcomes for the mid-term elections:

> **?***What could a potential change do for bonds and stocks? There are many possible scenarios, so the devil is in the details. I will lay out a couple of them for you: 1)* ***The Republicans could lose the House,*** *or the House and Senate. Either of these possibilities could derail the President?s agenda, leading us back to a period of gridlock that has plagued this country in the past.* ***This would likely be good for bond prices and bad for equity prices.*** *2)* ***The Republican majority remains intact,*** *and the President pushes forward his plans for another tax cut, among other items as well.* ***This would likely be good for stocks and bad for bond prices.*** *3)* ***A complete rout that not only gives the majority of both the House and the Senate****, it gives them the power and the votes to take on the President. If this happens,* ***bonds could rally in price, the economy could lose its momentum, and the Fed would likely alter its monetary policy.*** *In the end, however, this turns out, the markets are likely poised for some big changes come next Wednesday.?*

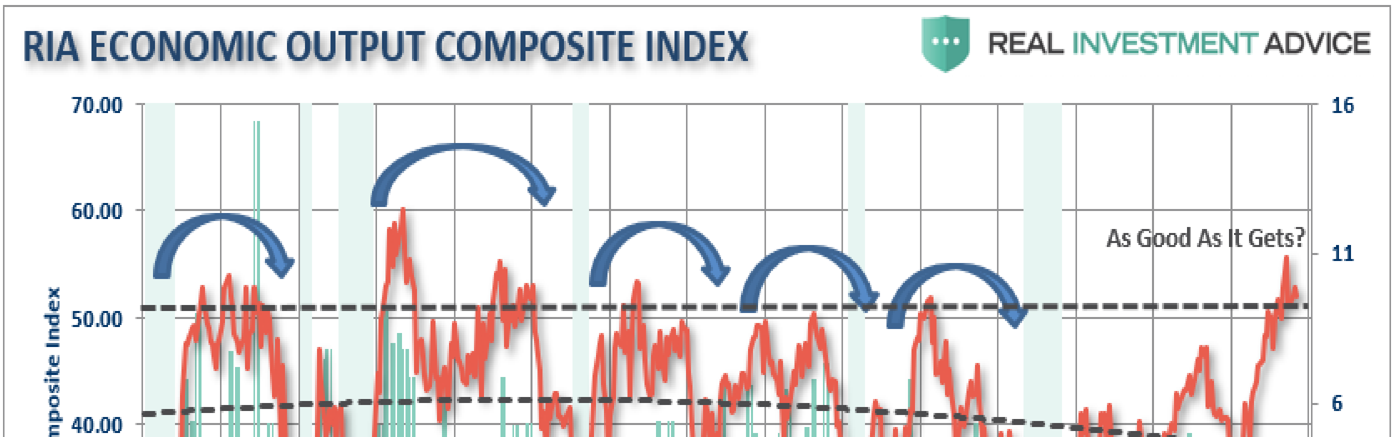
Currently, early voting turnout across the country has been extremely heavy and polls are suggesting that Republicans will retain control of Congress. **So, that means #2 is the likely outcome and we should just sell bonds and go *"all in"* on stocks. Right?** Maybe, but let's not get too far ahead of ourselves just yet. You don't have to go too far back in history to see polls which predicted Hillary Clinton was going to be the *"walk away winner"* of the 2016 Presidential election. Or, remember the polls that suggested if Donald Trump won, the market would crash? **Neither happened.** Personally, I think the outcome of the election has a lot less to do with the markets than most think, but let's walk through Kevin's reasoning. If we assume the Republican majority remains intact, they are going to continue to increase deficit spending through further tax cuts and potentially an infrastructure program. **This will require a substantial increase of debt issuance.** The problem will be pushing the deficit well beyond $1 Trillion, which is going to be difficult for many conservatives, will make passage of this agenda a much more difficult process than most believe. However, if the bond markets assume that new spending legislation is passed, then Kevin will likely be proved correct as rates will rise sharply as the supply of bonds exceeds demand and inflation concerns increase. **The problem is that with rates already at levels which is crimping economic activity, it will simply accelerate the timing to the next recession.** If the Democrats sweep control of Congress, a low probability event, then I agree that we will likely see a complete reversal of the economic confidence that we have seen in recent reports. This isn't because of policy changes as much as it will be from the uncertainty over the function of Government as an "*all-out war"* between the President and Congress will likely ensue. Such an outcome will serve only to quickly accelerate the next recession as confidence retreats. The safest outcome for the markets, and the economy, is what is most likely. The Republicans will likely retain control of Congress but will lose enough seats in the House to make passage of any of the *"Trump agenda"* unlikely. This will result in Congressional gridlock which will limit any substantive changes over the next couple of years. **The markets have historically favored gridlock and would likely be a short-term positive for stocks.**

So, Buy Stocks?

As I stated, I think the election will actually have a lot less impact on the markets this time than it did in 2016 for a couple of reasons. Going into the 2016 elections, confidence while improved, was still very weak. That is no longer the case as confidence measures are back to levels more normally associated with market/economic peaks.



Economic activity, which has been supercharged due to a series of natural disasters, increased deficit spending, and tax cuts, has simply pulled forward future spending for short-term benefits. This surge in economic activity can be seen in the RIA Economic Composite Index. The index is an extremely broad indicator of the U.S. economy *[it is comprised of the Chicago Fed National Activity Index (an index comprised of 85 subcomponents), Chicago Purchasing Managers Index, ISM Composite Index (composite of the manufacturing and non-manufacturing surveys), the 4-major Fed manufacturing surveys, Markit Composite Manufacturing Survey, PMI Composite Survey, Economic Confidence Survey, NFIB Small Business Index, and the Leading Economic Index (LEI)],* is near record levels currently.

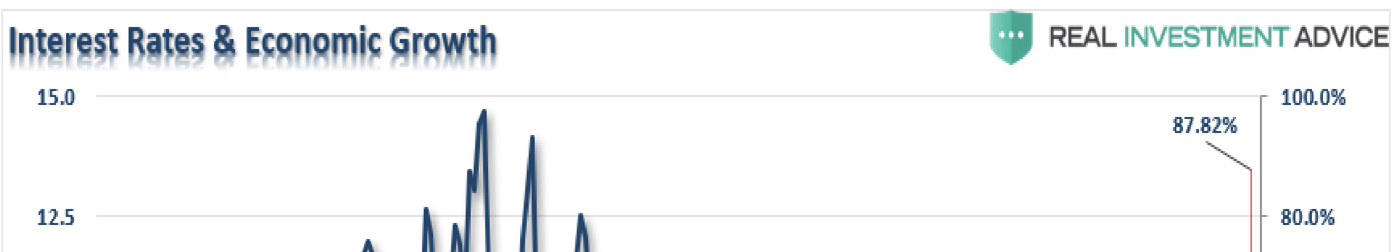


The problem, as noted, is that these levels occur at the peaks of economic cycles, not the beginning of one. The other issues of Fed policy, corporate actions, earnings, and government spending have all started shifting from tailwinds to headwinds. ***(I will delve more into these issues in my next report on Thursday.)*** **For all of these reasons, I suspect the outcome of the election will not be as important to markets as many believe.** As I wrote previously, the markets are sending a pretty clear message that the *"tenor"* is changing from bullish to bearish. The failure of the market to break out of the current trading range this past couple of weeks sets investors up for disappointment. It is critically important the market does not violate the trading range lows on a weekly closing basis. More importantly, there is a tremendous amount of overhead resistance at play at the 2750-2775 level as both previous rally peaks and the long-term moving average are now coinciding. *(Also note that a major difference between the current selloff and that in February is the break of the bullish trend line. This is symptomatic of a market topping process.)*

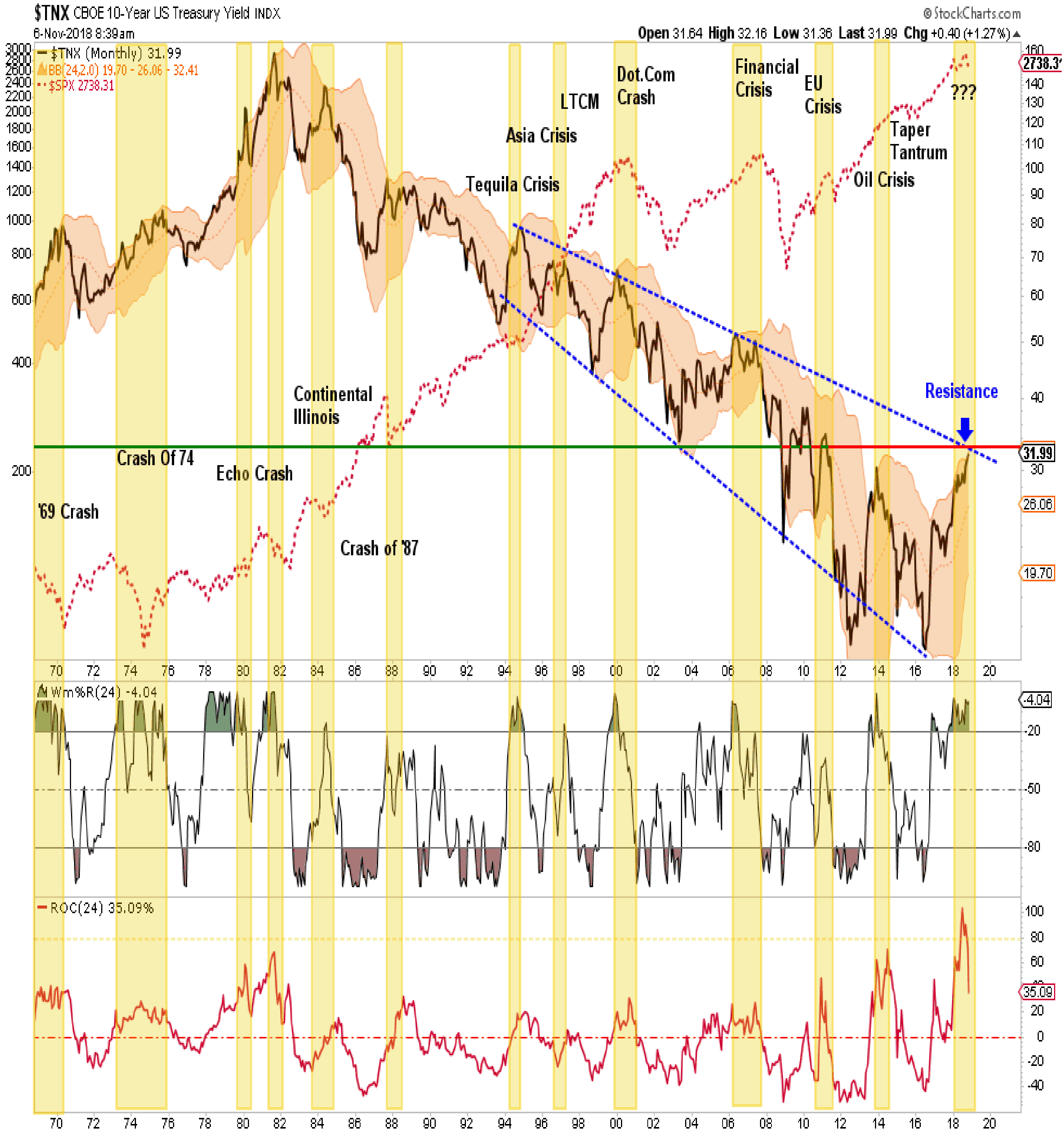
With respect to the importance of the breaking of longer-term trends, we are witnessing the same process which has only been witnessed two other times this century. The chart below shows how today's market stacks up against the bull market peaks of 2000 and 2007 in regards to breaking bullish trend lines and the wedge-like topping pattern. The stock market is currently on an important sell-signal from a very extended level combined with deteriorating relative strength.

The risk to the market remains interest rates. Throughout history, interest rates are at the heart of every cyclical recovery and decline. As I discussed in ?Did Something Just Break??:

> *?With housing and auto sales already a casualty of higher rates, it won?t be long before it filters through the rest of the economy. The chart below shows nominal GDP versus the 24-month rate of change (ROC) of the 10-year Treasury yield.* ***Not surprisingly, since 1959, every single spike in rates killed the economic growth narrative.?***



I urge you not to fall prey to the *?This Time Is Different?* thought process. **Despite the consensus belief that everything is "*booming*", there is mounting evidence of increased strains rising throughout the financial ecosystem.** The biggest risk to the stock market, with respect to the election, is an outcome which spooks the bond market. As I have written previously, **you can NOT have a *"stock bull market"* and a *"bond bear market"* simultaneously. History is littered with the *"dead bodies"* of those who believed it was possible.**



This is especially the case in an environment where economic growth averages 2%, debt burdens are at historic levels, both corporate and investor leverage is at records, and the Government is issuing debt at an accelerated pace. It all works when rates are at lows and are being artificially suppressed, it is a different story when rates spike to levels that impairs economic feasibility. After having raised cash last week, we will continue sitting in a bit more defensive position until the election passes and we can assess both the outcome and the probabilities of what happens next. However, I highly suspect it won't make much difference and the market may well be already telling us that.