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Best Rally in Decade May Slow as Obama Faces Congress on Tax (1)
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(Updates futures in fifth paragraph.)

By Inyoung Hwang, Whitney Kisling and Nikolaj Gammeltoft

Nov. 7 (Bloomberg) -- Stock and bond investors enjoying the biggest advance in more than a decade under Barack Obama may see the momentum fade as the rallies age and the president confronts Congress over spending cuts and taxes.

Obama will continue to support the Federal Reserve's interest-rate policy, according to Brian Jacobsen at Wells Fargo Advantage Funds and Bruce Bittles of RW Baird & Co., which oversee a combined $294 billion. At the same time, his re- election endangers tax breaks enacted a decade ago on dividends and capital gains. The advance in the Dow Jones Industrial Average that began just after Obama took office is five months away from matching the mean length of bull markets since World War II, data compiled by Bloomberg show.

While Obama's victory in 2008 spurred the biggest plunge ever for the Dow on the day after an election, gains for American assets over the past four years are among the best in the developed world. Fed Chairman Ben S. Bernanke's actions to revive the economy after the worst recession in seven decades helped send the Dow up 67 percent and U.S. bonds to a total return of 27 percent, data compiled by Bloomberg show.

"There are different sections of any bull market and we're probably entering the continuation phase versus the initial expansion," Larry Gilbert, who helps oversee $25 billion as managing director at Chicago-based HighTower Advisors, said in a phone interview. "The market returns depend in part on how the next president deals with the structural economic issues in this country. We're very cautious."

U.S. Recovery

Futures on the S&P 500 reversed a loss of as much as 1 percent after Obama claimed victory. Contracts expiring in December climbed 0.2 percent to 1,428.6 at 10:04 a.m. in London.

Obama has been president during the weakest post-recession economic recovery since World War II as unemployment averaged
9.1 percent and the housing market stagnated until this year.
Economists forecast gross domestic product will expand 2 percent in 2013, a slowdown from this year's 2.1 percent projection.

Treasury yields were already at record lows when Obama took office and have fallen as Europe's debt crisis boosted demand for dollar-denominated assets. The S&P 500, up 111 percent since March 2009 amid 10 straight quarters of earnings growth, would reach the average length of bull markets since World War II in April, data compiled by Bloomberg show.

"This is going to be a bumpy ride in 2013," Matt McCormick, who helps oversee $7.3 billion as a money manager at Cincinnati-based Bahl & Gaynor Inc., said in a phone interview.

Biggest Gains

CBS Corp. in New York, owner of the most-watched TV network, Cincinnati-based Fifth Third Bancorp and Expedia Inc.

in Bellevue, Washington, the second-most valuable online travel agency, posted some of the biggest advances among S&P 500 stocks since the market bottom in 2009, rising more than 900 percent. Wyndham Worldwide Corp., the franchiser of Days Inn hotels and Super 8 motels, increased almost 17-fold to lead gains in the index.

The Dow slipped 5 percent the day after Obama beat Republican John McCain in 2008 at the height of the credit crisis that erased $11 trillion from American equity values. The decline wasn't made up until July 2009 after Bernanke dropped the benchmark rate to a record low and Obama signed a $787 billion economic stimulus package.

Now that the election has been decided, investors will turn their focus to the $607 billion of tax increases and federal spending cuts set to kick in automatically in January, the so- called fiscal cliff. The Congressional Budget Office has said the U.S. economy would slow by as much as 0.5 percent next year if Congress fails to keep the increases from taking effect.

Dividend Tax

The rate on dividends for high-income taxpayers will rise to 43.4 percent from 15 percent and the top rate on capital gains to 23.8 percent from 15 percent. For an individual with $10,000 invested in the S&P 500, payouts would fall to $120 a year from $180.20 should the old rate be reinstated. An investor who sells the stock at a $5,000 profit would face capital gains obligations of about $1,190 compared with $750 now.

Utilities and phone companies, the industries with the highest dividend yields in the S&P 500, had the worst performances in the index yesterday.

Obama's victory "will make the fiscal cliff more difficult to deal with," Bittles from Milwaukee-based RW Baird said.

The victory preserves the status quo for health-care providers and the price impact on the stocks will be limited, according to Les Funtleyder, a fund manager focused on the sector at New York-based Poliwogg.

Obama's industry overhaul, which was approved by the Supreme Court in June, is designed to expand health insurance coverage to at least 30 million people.

Alternative Energy

Shares of alternative energy suppliers, discount retailers, hospitals, specialty pharmaceutical companies and communications infrastructure providers are among the industries that will benefit from an Obama win, according to a note last month from UBS AG's chief U.S. equity strategist, Jonathan Golub. Had Romney been elected, coal companies, oil drillers, railroads, defense stocks and larger banks would have gained, he said.

Credit Suisse Group AG said clean-technology companies such as Cree Inc. and First Solar Inc. would do better under Obama.

Education stocks from Apollo Group Inc. to Strayer Education Inc. may be hurt by the Democrat's re-election, it said.

Races as close as this year's have historically generated rallies between Election Day and the end of December. The S&P 500 advanced about 5 percent when one candidate led by about 3 percentage points or fewer in polls, according to Deutsche Bank AG. Obama led Romney 48 percent to 45 percent in a survey last week by the Pew Research Center.

Bull Market

The bull market will last another year as individuals regain confidence and return to equities after withdrawing money since 2007, Laszlo Birinyi, the president of Birinyi Associates Inc. in Westport, Connecticut, said last month. Investors have sent more than $1 trillion to fixed-income managers since January 2009 while pulling $350 billion from funds that invest in U.S. stocks, according to data from Washington-based Investment Company Institute.

Low valuations may also attract investors, with the S&P 500 trading at 14.4 times reported earnings, a 12 percent discount to the historic level, data compiled by Bloomberg show. Price-earnings ratios have stayed below the five-decade average since May 2010, the longest stretch since the 1970s.

"The stock market should benefit as policy uncertainty recedes," Howard Ward, chief investment officer of growth equities at Gamco Investors Inc. in Rye, New York, said in an e- mail. His firm oversees about $36 billion.

Equities and bonds rose together under Obama for the first time since Bill Clinton's second term ended in 2000, data compiled by Bloomberg show. The Dow has gained 3.9 percentage points more than the MSCI All-Country World Index since Obama's inauguration, beating 16 of 24 developed countries.

Government Debt

U.S. government debt securities have returned 24.3 percent since the end of October 2008, including reinvested interest, or 5.57 percent a year, Bank of America Merrill Lynch's U.S. Master Index shows. That compares with 21.6 percent for government debt worldwide, according to the firm's indexes.

For the bond market, the composition of the Fed and whether it continues to purchase assets is the top concern, said Jason Brady, a managing director at Thornburg Investment Management in Santa Fe, New Mexico, which oversees $83 billion.

Romney promised not to reappoint Bernanke when his second four-year term ends January 2014 because "the amount of currency that he's created" with purchases of debt securities haven't added enough jobs. The central bank chief is unlikely to seek another term even if Obama is re-elected, a person close to the chairman who declined to be identified said on Oct. 25.

While down from 10 percent in October 2009, the U.S. unemployment rate climbed to 7.9 percent in October, the first increase in three months, from 7.8 percent in September, according to a Labor Department report on Nov. 2.

Bernanke Term

"Under Obama, I think Bernanke would serve another term even though there's speculation he wouldn't run or Obama wouldn't reappoint him," Jacobsen said. "In his academic writings he has recognized that monetary policy is a long-term experiment and not something he is going to walk away from.
We're in unexplored territory for the most part and he doesn't want to abandon the laboratory prematurely."

All 21 primary dealer firms that act as counterparties to the Fed in the bond market expect the central bank's latest quantitative-easing measures to be expanded to include government securities, according to a survey conducted Oct. 15-19 by Bloomberg News.

When announcing the mortgage buying plan on Sept. 13, policy makers said they would keep pumping money into the economy until there was "ongoing, sustained improvement" in the labor market.

Fixed Income

From Treasuries to mortgage securities to corporate bonds, returns on U.S. fixed-income assets have averaged 6.5 percent a year in Obama's term, exceeding the 4.6 percent during the previous four years under George W. Bush, according to Bank of America Merrill Lynch indexes. America's fixed-income assets yield seven basis points less than the global average, the data shows.

The increase in U.S. government debt means neither candidate will have tools to boost growth, according to George Feiger, chief executive officer of Contango Capital Advisors Inc., the San Francisco-based wealth management arm of Zions Bancorporation.

The deficit this year is projected to reach $1.1 trillion, marking the fourth consecutive year the government has run trillion-dollar shortfalls. Federal debt has climbed more than 75 percent in the past four years.

At $11.3 trillion, or 73 percent of the nation's gross domestic product, publicly held debt is projected to reach the highest level since shortly after World War II, according to the CBO. Moody's Investors Service warned in September it may join S&P in downgrading the U.S.'s Aaa credit rating if lawmakers don't agree next year on a deficit-reduction plan.

"Look at the constraints these people are under," Feiger, who manages $3.5 billion, said in a telephone interview on Nov.
2. "We have fiscal cliff coming and we need a bipartisan compromise. The things that have to happen to get a solution have such tight boundaries that it doesn't matter who is elected."

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