

Market Commentary

The upcoming U.S. midterm elections will shift the playing field in Washington D.C. policy-making, offering a new set of investment opportunities. In this outlook, we lay out our views for the 4th quarter, how the midterms could impact policy-making, and how those policies may impact the market.

Before we discuss potential midterm scenarios, we want to highlight the significant role government agencies currently play in setting policy (e.g. FDA drug compounding and Department of Education Gainful Employment Rule). The current Congress has had mixed success in passing legislation, leading to most policy-making being regulatory and not legislative. In our view, the White House and government agencies will continue to play significant role in driving policy under all three scenarios. The question becomes, how will the 116th Congress interact with the White House and government agencies?

Below is a description of the three scenarios EventShares is tracking, our view on the resulting policy environment, and what we prefer to own in each scenario.

Midterm Scenarios

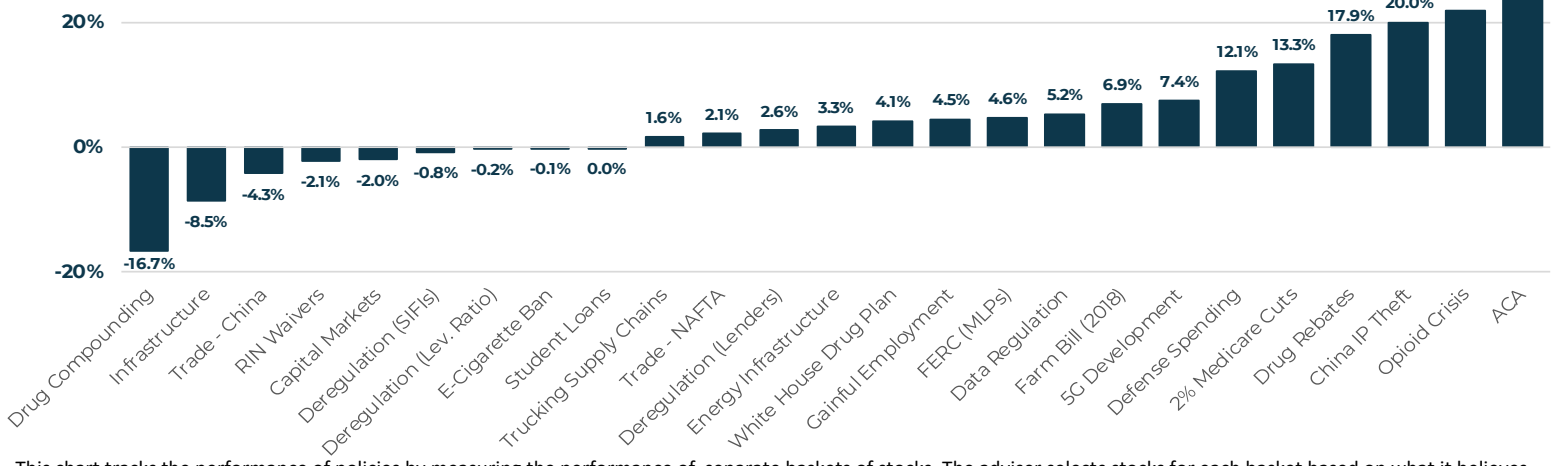
(1) Status Quo: Republicans continue to control the legislative branch and executive branch. From an investor's point of view, this is the **goldilocks scenario** for the markets due to lack of policy uncertainty. Republican-led policies continue to dominate, with minimal threat of government shut-downs or impeachment. Under this scenario, we prefer to continue owning what is currently working, such as **financials** (e.g. banks and non-traditional lenders including CURO, FCFS, GDOT), **defense** (e.g. prime contractors and their suppliers like BWXT, MOG.A, TDG), **energy** (e.g. DK, LNG, SHLX), and **education** (e.g. student lenders and for-profit colleges such as ATGE) companies.

(2) House Flip with Senate Holding Red: Democrats win control of the House, while Republicans maintain control of the Senate. In our view, this materially increases political noise in the market, boosts impeachment probability,

Congressional hearings, and pushback against Trump's expansion of executive branch power. The resulting headlines create pockets of dislocation and opportunity, but the **market likely shrugs off the noise** much like it has under Trump's time in office. In our view, legislative successes would need to be bipartisan, such as infrastructure. Budget stalemates may occur more frequently and will likely lead to an increase \$1 for \$1 in both defense and non-defense spending in our opinion. Under this scenario, we prefer to own companies like in the Status Quo scenario, with the addition of **infrastructure project managers and raw materials** (e.g. FLR, KBR, GVA, MLM, VMC).

(3) Blue Wave: Democrats win control of both the House and Senate. In our view, this leads to a **high degree of gridlock**. Congress assumes a more confrontational stance with the White House, leading to the potential for nasty

Q3 | 2018 Policy Returns



This chart tracks the performance of policies by measuring the performance of separate baskets of stocks. The adviser selects stocks for each basket based on what it believes will be impacted by each policy. See the disclosure section at the bottom of page 2 for a complete list of the stocks included in each policy and the calculation methodology.

Government shutdowns and Trump's increased use of veto power. Washington DC ceases to function efficiently and pushes deals to the last minute, which increases regulatory risk and makes investors more jittery. From an investor's point of view, this is the worst scenario for the markets.

Under this scenario, we would look more to government agencies (e.g. ELD implementation and the switch to intermodal, expanded reimbursement of telehealth, and fewer CFPB enforcement actions), **as well as state legislation** (e.g. California inverse condemnation and dialysis regulation, Medicaid expansion, and state/city-level push back against immigration) **for policy catalysts and investment opportunities. Stocks we'd prefer to own under this scenario include defensive REITs** (e.g. CPT, MPW), **healthcare** (e.g. EHC, HCA, MOH, WCG), **and staples** (e.g. ARMK, COST, KR, THS).

Policy Spotlights

While there are clear policy differences in the scenarios above, EventShares believes three policies continue regardless of the midterm outcomes.

Big Tech Regulation: Congress continues to talk about big tech (e.g. AMZN, GOOGL, FB, TWTR) and data management (e.g. AXCM, CLGX). Various committees in both the House and Senate have called executives from the major tech companies to testify before Congress. Republicans accuse them of censorship, while Democrats are concerned about user privacy. Regardless of midterm outcomes, big tech will continue to be a policy target for Congress in our view.

ACA Insurer Profitability: After years of operating on the government exchanges, insurance companies finally have enough data and risk information to price their policies correctly. The regulatory risk environment has also subsided in our opinion, as the likelihood of legislative action repealing the ACA is low. Republicans have shown they're unable to form a consensus around repeal-and-replace, while Democrats appear to be interested in stabilizing and expanding the exchanges. This decreases the legislative risk for insurance companies in our view, regardless of the midterm outcomes. From a state perspective, Medicaid expansion may be the next growth opportunity for the insurers. Impacted companies include insurers (e.g. MOH, WCG, HUM, CNC), as well as those focused on increasing efficiency and improving patient outcomes (e.g. TDOC, ASGN, EVH, MDRX, OMCL, VCRA, TRHC).

Trucking & Logistics Market Tightness: The trucking industry continues to be impacted by ELD implementation and service hour rules, as well as a historically tight labor market. This is straining the transportation and logistics network at a time when online shopping is increasing. In our view, companies involved in the intermodal market (e.g. NSC, JBHT, UNP, TRTN), third-party logistics services (e.g. ECHO, HUBG, EXPD, XPO, LSTR), and specialized trucking services (e.g. DSKE) will benefit from this mix of labor and regulation constraints.

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The 3Q 2018 Policy Returns (on page 1) are calculated by averaging the performance of a group of stocks that AWA considers to be impacted by each respective policy for the dates of 6/30/2018 to 9/30/2018. The following includes the tickers used for each policy — Defense Spending: LMT, RTN, NOC, BA, HII, BWXT, AVAV, FLIR, AJRD, KTOS, OSIS, UTX, TDG, COL, HXL, HON, TXT, MOG.A, BAH, LDOS, CACI, ICFI, SAIC; RIN Waivers: ANDV, CVRR, HFC, PSX, VLO, ANDE, GPRE, REX, PEIX; Energy Infrastructure: LNG, PWR; FERC (MLPs): SEP, EEP, TCP, WMB; Student Loans: GHC, CHGG, NNI, NAVI, SLM; Gainful Employment: CECO, ATGE, LAUR, LOPE, STRA; ACA: HCA, UHS, LPNT, EHC, MOH, CNC, WCG, HUM, CERN, TDOC, ASGN, MDRX, OMCL, VCRA, EVH, TRHC, MASI; Opioid Crisis: MCK, CAH, ABC, MNK, INSY, JNJ, MYL, ENDP, TEVA; E-Cigarette Ban: MO, PM, BTI; 2% Medicare Cuts: LHCG, AMED, CHE, SEM, MDT, ISRG, SYK, TFX; Drug Compounding: ATNX; White House Drug Plan: AGN, MMK, VRTX, TEVA, MYL, PFE, LLY, GILD; Drug Rebates: ESRX, CVS, UNH; Farm Bill (2018): WMT, TGT, KR, DLTR, DG; Trade - NAFTA: KSU, UNP, BWA, STZ, TAP, COST, PWR, FLR, MGA, ASLN, AXL, APTV; Trade - China: EXPD, MATX, AAWW, CAT, DE, DLPH, BWA, SWKS, QCOM, AVGO, MU, WYNN, LVS; 5G Development: ERIC, NOK, QCOM, SWKS, QRVO, CSCO, ZAYO, AMT, GLW, CCI, UNIT, IDCC, T, VZ, S, TMUS; Data Regulation: FB, TWTR, AMZN, GOOGL, ACXM, CLGX, EFX, TRU; China IP Theft: INTC, QCOM, NVDA, MU, IBM, AMD, TXN; Infrastructure: FLR, KBR, GVA, ACM, PRIM, MLM, VMC, EXP, SUM, USCR; Trucking Supply Chains: DSKE, KNX, WERN, ARCB, SNDR, SAIA, ODFL, LSTR, HUBG, XPO, EXPD, ECHO, RRTS, NSC, UNP, JBHT, KSU, TRTN, TRN, ARII, GATX, WAB, GBX; Deregulation (Lenders): ENVA, CURO, FCFS, GDOT, OMF; Deregulation (Lev. Ratio): BAC, C, GS, JPM, MS, WFC, STT, BK, NTRS; Deregulation (SIFIs): ASB, PACW, ZION, KEY, AXP, STI, BBT; Capital Markets: CBOE, ICE, NDAQ, CME