

**FOCUS ON PRIVATE EQUITY**

# THE POLITICAL BULL MARKET AND YOUR PORTFOLIO

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**In the eight years since the financial crisis, we have been in what I call a *political bull market*—a time when the thinking, decisions, and activities of political actors have had a disproportionate impact on the performance of companies around the globe. By “political actors,” I mean elected officials, other policy makers and NGOs as well as critics of business and the increasingly restive populations we see in various parts of the world.**

**As far as the coming election is concerned, we see some areas of business where the impacts could be quite different depending on outcome of the vote (see page 2). But the bigger issue—the politicization of business—isn’t going to diminish, no matter whether the next president is Donald Trump or Hillary Clinton. In fact, all indications are that it will not only continue, but accelerate. Grasping this is especially important for investors in private equity, real estate, and any other asset class involving long-term commitments.**

Look at Pfizer’s proposed combination with Allergan, an Ireland-based company, earlier this year. At the time it was announced, some critics were saying such inversions should not be allowed. The Secretary of the Treasury’s response was “There’s nothing we can do to stop it, but we would if we could.” That was the word from our country’s top authority on the matter. Yet because of the political reactions, new authority was discovered to make the deal so complex and expensive that Pfizer dropped its bid for the firm. Another example is Carrier, which announced plans to move a facility to Mexico. Even though such moves have been common for the past 40 years, trying to stop Carrier’s relocation is one of the few issues on which Secretary Clinton and Donald Trump have agreed.

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This article is excerpted from a recent Altegris-KKR webinar, *Politics & Your Portfolio*. The next two upcoming installments will focus on how ESG initiatives can enhance private equity portfolios and how private equity fits into investor asset allocation in a low return environment.

*The views expressed are the personal views of Ken Mehlman of Kohlberg Kravis Roberts & Co. L.P. (together with its affiliates, “KKR”) and do not necessarily reflect the views of Altegris.*

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## A GLOBAL PHENOMENON

These are just some of the results of this political bull market. It's affecting industries, it's affecting companies, and it isn't going away, no matter who wins the election. In the next year and a half, major elections will be held in Italy, Germany, France, and the Netherlands. Each of those nations has a rising populist party that is anti-trade, anti-immigrant, anti-globalist. In the U.S., too, we are seeing much more disruption and unrest around free trade and immigration policies than in the past. These are long-term trends with long-term forces behind them.

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## SOME DIFFERENCES THE ELECTION COULD MAKE

	Clinton	Trump
Financials	<ul style="list-style-type: none"> <li>• Some regulatory relief for regional banks</li> <li>• More regulation of large national banks</li> <li>• Higher capital requirements for SIFIs (systemically important financial institutions)</li> </ul>	<ul style="list-style-type: none"> <li>• Some regulatory relief for regional banks</li> <li>• More flexible enforcement of Dodd-Frank for SIFIs</li> </ul>
Energy	<ul style="list-style-type: none"> <li>• Expanded subsidies for wind and solar</li> <li>• More restrictions on fracking on federal lands</li> <li>• More regulation of coal</li> <li>• Continue Obama's push to regulate utilities</li> </ul>	<ul style="list-style-type: none"> <li>• Expand leasing on federal land</li> <li>• Expand production on outer continental shelf</li> <li>• Push to reverse some regulation of emissions</li> </ul>
Healthcare	<ul style="list-style-type: none"> <li>• Status quo on Medicare, Medicaid, Affordable Care Act</li> </ul>	<ul style="list-style-type: none"> <li>• More premium support, flexibility</li> <li>• Reduce Medicaid</li> <li>• Potential Medicare buy-in at 55</li> <li>• Provide off-ramp from exchanges</li> </ul>
Telecom	<ul style="list-style-type: none"> <li>• Status quo on net neutrality</li> </ul>	<ul style="list-style-type: none"> <li>• More flexibility on net neutrality</li> </ul>
Labor Rules	<ul style="list-style-type: none"> <li>• Status quo</li> </ul>	<ul style="list-style-type: none"> <li>• May address policies on overtime, labor organizing, collective bargaining</li> </ul>

If you study American history, you can see three strong parallels between the period of the 1880s and 1890s and our climate today. The first is industrial revolution. We had one back then, and today we're seeing the energy industry, the legal industry, the hotel industry, the taxicab industry and many others being upended in a similar way. That creates great opportunities for investors and the advancement of society, but is destabilizing for humans who might lose their jobs to outsourcing or automation. Secondly, our world is being transformed by new ways to communicate and acquire information, as it was in the 1880s and 1890s. Back then it was the proliferation of local newspapers, known as broadsheets. Today the radical transparency of the internet is challenging every company. The third major force at work is the demographic revolution that is occurring in this country, as well as in Europe and China.

These factors all combine to create an environment which increases populism and thus considerations loom much larger for investors than they have in the more recent past. That's not going to change, no matter who is elected President. So, how do we, as investors, understand and manage those risks? And how do we position our private equity portfolios in light of the political upheaval around us?

## LOOKING AROUND THE CORNER

At KKR, we created a structure, called [The KKR Global Institute](#), expressly to focus on those ongoing issues. It's a process that began when I joined the firm in 2008, expanded when Henry McVey joined us, and was further refined into the KKR Global Institute when General David Petraeus joined our firm a couple of years ago. As we consider investing in a company or an industry, we apply the same thorough bottom-up and top-down analysis we'd use to assess its financials and positioning, only we view it through the lens of geopolitical, public policy, macroeconomic, societal, and stakeholder trends.

In essence, what our team does is to understand at a very granular level those things you can't put into an Excel spreadsheet. We want to understand those trends in a way that allows us to look around the corner. This is particularly critical in private equity and in other parts of our business where we're making bigger bets over a longer period of time with more committed capital, including special situations, real estate, and infrastructure.

Every year we systematically look at the likely or potential public policy, regulatory, stakeholder, and other issues those companies might face. We sit down with every company in our portfolio, partnering with them to anticipate, manage, ameliorate, and sometimes even take advantage of trends at every level. We also look for ways we can proactively help companies advance in areas such as green solutions, responsible sourcing, and employee wellness.

Whatever dimensions of the issues we're exploring, we work to understand the larger context—and that's the challenge facing any serious investor. We need to look beyond the upcoming election to the reasons why Donald Trump is the Republican nominee, why Bernie Sanders got as many votes as he did, and why Brexit happened.

During the period from the end of the Cold War to the financial crisis and BP oil spill, business still had the wind at our back. The burden of proof was in our favor and against more restrictions. That has now reversed itself. If you don't understand that phenomenon, and how it plays out with specific industries and companies, you are going to make investment mistakes. If you do understand it, you will have some great opportunities to do very well.

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## **RISKS AND IMPORTANT CONSIDERATIONS**

*It is important to note that all investments are subject to risks that affect their performance in different market cycles. There are significant differences between public and private equities, which include but are not limited to, the fact that public equities have a lower barrier to entry than private equities. There is also greater access to information about public companies. Private equities typically have a longer time horizon than public equities before profits, if any, are realized. Public equities provide greater liquidity whereas private equities are considered highly illiquid.*

*It should be noted that private equity may not be suitable for everyone. As with any investment, there are numerous risks to investing in private equity including the possible loss of principal.*

*Nevertheless, for those investors who understand the risks, and have available risk capital, private equity can provide an opportunity to enhance their portfolio returns.*

*An important part of understanding and implementing private equity today is assessing the potential benefits as well as the risks. Equity securities are subject to market risk, or risk of loss due to adverse company news, industry developments, and general economic decline.*

*In addition, private equity is considered speculative therefore subject to a unique set of risks. These risks include, but are not limited to, liquidity risk and lack of a secondary market to trade securities, management risk, concentration and non-diversification risk, foreign investment risk, lack of transparency, leverage risk, and volatility.*

## **ABOUT ALTEGRIS**

Altegris is an investment research firm, with deep expertise in alternative manager selection, structuring unique solutions, and providing portfolio management and oversight. Beginning with an analysis of the current and anticipated investment environment, our solutions are based on themes that we believe solve the most important client needs. For more information about the Altegris family of alternative solutions, visit [www.altegris.com](http://www.altegris.com).

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