ThinkAdvisor

NOVEMBER 9, 2016

6 Issues Advisors Should Watch for Trump Action

Many forms of Government have been tried, and will be tried in this world of sin and woe. No one pretends that democracy is perfect or all-wise. Indeed, it has been said that democracy is the worst form of Government except all those other forms that have been tried from time to time."--Winston Churchill

The American public has spoken in a resounding defeat for the political establishment, electing outsider Donald Trump in a close but decisive election. President-elect Trump will be joined by a Republican-controlled House and Senate, a clean sweep that in theory gives Trump ample room to pursue his policy agenda.

Considerable uncertainty remains about what policy agenda Trump will pursue, and constitutional checks and balances make it unlikely that he will have a “blank check” for many of the promises made in his campaign. Trump has few allies in Congress, a narrow Republican margin in the Senate and a House of Representatives filled with vocal Tea Party members – this combination of factors may constrain some of his legislative initiatives.

I am in Denver at a socially responsible investing conference, and observed the mounting disbelief of conference attendees as it became clear that Trump would win the election. While watching Trump’s conciliatory acceptance speech with a group of attendees, several expressed the hope that the nasty tone of the campaign would be replaced by a more statesmanlike approach as Trump prepares to take office.

Investment Implications

Markets initially fell sharply as election results started to come in, with U.S. stock futures falling as much as 5%, while European and Asian stocks fell and the Mexican peso was particularly hard hit. A sharp reversal that picked up steam after Trump’s acceptance speech, however, conjured up memories of the post-Brexit rally by markets. U.S. equities gained in early post-election trading, and European stocks turned mostly positive. The bond market moved sharply, with prices falling and long-term yields climbing in response to expectations of increased government spending, a higher budget deficit and mounting inflation pressures.

Uncertainty about Trump's priorities and governing approach will keep the markets at elevated levels of volatility, though more clarity may be found in coming weeks. There are a few areas worth highlighting given what we know so far:

1: Energy: We expect Trump to emphasize policies that favor oil and coal, rather than the clean energy initiatives favored by the Obama administration. The Keystone pipeline may be back on the table, as a way for Trump to deliver new jobs early in his term.

2: Healthcare: Pharmaceutical and biotechnology companies were big winners in early trading, benefiting from expectations that the Trump administration will attempt to repeal parts of the Affordable Care Act, and will be less likely to impose price controls on the industry.

3: Financial services: Banks, hedge funds and private equity investors were populist targets during the campaign. Although preferential tax treatment of hedge fund and private equity "carried interest" may be a casualty under Trump, his administration is likely to be much friendlier to banks than the Obama administration has been. Banks, unloved and trading at low valuations, may rebound given a lighter regulatory touch and steeper yield curve.

4: Government spending: Increased fiscal spending is likely to boost defense and infrastructure stocks, though Trump may have to scale back some of his spending plans.

5: Corporate tax reform: It's likely that a tax deal will be made to facilitate repatriation of cash held overseas by multi-national companies, potentially a positive for technology and pharmaceutical stocks.

6: Trade: If Trump follows through on campaign promises to abandon trade agreements and start trade wars with China and Mexico, U.S. exporters will suffer as will emerging markets countries that are major exporters to the U.S.

Portfolio Considerations

In a call this morning, JP Morgan's David Kelly pointed out that "in the heat of the battle, people have forgotten that the economy is fundamentally healthy." We generally agree with Kelly's economic assessment, and are optimistic that constitutional checks and balances will protect the country from some of Trump's extreme campaign promises.

The next few months will provide clues as to how Trump intends to govern, as he provides signals about early-term policy priorities, cabinet appointments and his approach to working with both parties in the House and Senate. Policies on trade and immigration will be particularly important, as a turn toward protectionism and a "fortress America" approach to immigration could constrain future growth, increase consumer prices, and exacerbate challenging demographic trends.

We'll also be mindful of the approach taken by the Democratic Party, to assess whether the primary strategy will be to obstruct Trump and position the party to return to the White House in 2020 or whether there will be cooperation for policy considerations where common ground can be found.

Facing a more volatile investment outlook, advisors should consider adding investments that provide a degree of Inflation protection, given expectations for higher fiscal spending, potentially lower tax revenues and a tightening labor market.

The recent increase in bond yields is making bonds a somewhat better source of income, though rates are still below levels that would convince investors to move meaningfully away from equities and into bonds. Asset classes such as real estate may be interesting, as recent price movements may prove to be an overreaction.