CONWAY • JARVIS LLC
Investment Outlook

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The Election Sets a New Course for the Economy

It's taken the markets and most of the world several weeks to digest the result of the November general election. To be honest, we didn't see this one coming. That could be due to our relying on mainstream financial media for most of our information, and of course believing the vast majority of polls, only two of which correctly predicted the outcome. No doubt, just as the Brexit vote shocked Europe, the Trump win shocked the world.

So, where does that leave us today and where are we, meaning the economy and the markets, headed under a Trump administration? At this juncture of the transition process, we await the completion of administration appointments and among those, the Cabinet positions that require confirmation by the Senate. That work is to be completed by Inauguration Day. With the most prominent of appointments near at hand, we should soon have an idea in what direction the new administration's ideological compass will point.

Many have concluded that the political and economic path has already been set in the rhetoric of the campaign. We're not sharing that conclusion...yet. We've often seen good intentions, so passionately professed in the heat of battle, often forgotten, abandoned, or revised to fit the realities of governing. Thankfully, our governance structure is such that it can temper the rhetoric of a crude election process wrought by a binary political system that caters to its most extreme elements. While there's plenty of skepticism surrounding the new administration, the markets have reacted positively to the expectation that the next four years could mark a welcome departure from our post-crash economic past.

The Near-Term Outlook

Prior to the election, it was assumed by most observers that there would be little change in the direction of fiscal and monetary policy. It was expected that the economy would muddle along at a 2% growth rate with low inflation and a long and low trajectory of interest rate increases. It was also expected that the Fed would notch another interest rate increase in December. For that reason, we allowed our allocation of cash to swell. The idea was to lower risk through the election and deploy that cash following the Fed announcement. The thought was that a Trump surprise might shock the market and not in a good way. The futures on election night confirmed our view, but the sun rose on a market enthralled by the broad and sweeping initiatives flowing from the Trump campaign.

We'll admit to liking the big picture for the economy being painted by Trump but, when looking for details and specifics, we were left with a finger-painted stick figure with two thumbs up. That's why we view the markets' immediate reaction as being purely speculative about what will happen after January 20.

That reaction was fueled by investor expectations that business will be better under the incoming administration. We saw capital flow into those sectors perceived as Trump-aided (Financials, Industrials, Telecom). The advance masked a significant decline in Tech, Emerging Markets, Utilities, REITS, and Staples. As we approach year-end, we would expect those divergences to dissipate as the stock market settles into a trading range, waiting to see what might actually be accomplished under a Trump administration.

We view this election result as a change of course and trajectory for the economy, rather than one of direction. The result has initially given rise to optimism and confidence in the private sector that could ignite a resurgence of CAPEX spending. While nothing has actually been acheived, there's an expectation that a benefit will accrue to the economy prior to the 2018 mid-term elections. It will be several months before we actually have some tangible results for the market to value.

The Longer Term Outlook

We saw business improving regardless of who won the election, but we believe there will now be a more stimulative tone to fiscal policy than could have been imagined under a Clinton presidency. Any proof of that will be evident in the initial budget presented by the Administration to Congress in February. It will address both revenues and expenditures for the fiscal year beginning October 1st. That will begin the discussion of tax reform and program funding, both of which can send any ideological compass spinning.

Much like the administration appointments have provided grist for the media to spin some wildly divergent theories about the nation's future, the budget proposal will do the same. However, the market is the critic that counts when it comes to the economy. If a budget is approved that provides stimulus within a *rational* tax and spending framework, we'd look for the US and global economies to steepen their growth trajectory. "Rational" means tax reform that provides capital and incentive for investment and not just consumption, with attention being paid to the deficit and the Fed's balance sheet. It also means shared sacrifice (remember that one?) by all, rather than just a group conveniently labeled as "privileged".

We hope the current short-term market trend proves to be predictive of the future. What keeps us up at night is Trump's campaign rhetoric directed toward the Fed and its Chair, Janet Yellen. His veneer-deep understanding of the Fed's role in the grand economic scheme raises the possibility that she will be replaced. That would weigh negatively on markets that crave stability and consistency in policy formation. Such a move could increase the headline risk and volatility related to monetary policy and undermine any good work accomplished in the realm of fiscal policy.

Any budget plan perceived as pro-business will be welcomed with enthusiasm by the stock market. The bond market, for now, has priced in higher rates associated with a faster-expanding economy. In politics, the long-term outlook is shaped by the election cycle. If the new administration falls short of its stated objectives for any reason, the balance of power in Congress has the potential to shift in the mid-term elections. The Senate is in Trump's fold, but only by a small margin. A serious misstep in either the economic or social agendas could change that and increase uncertainty in the markets.

Stocks posted marginal new highs in the four days following the election on the weight of active institutional trading. Since then the indexes have diverged and retreated a bit from the highs on weakness in a number of large-cap favorites such as AMZN, FB, and GOOGL. That's a signal that this short-term rally might fade a bit as perspective is gained on what will actually happen in 2017. We'll look to deploy our cash as opportunities present themselves. Long-term investors might best look beyond the Fed meeting in December where it's likely we'll see a .25% bump in key rates. After that, the January earnings season will come into play. The tangible events of next year will have to be viewed through the prism of headlines emanating from the incoming administration. That's likely to bring more volatility to the markets. We suggest that moderate-risk investors stick to a diversified approach, rather than chasing the next hot sector on the basis of what's happening, or not happening, in Washington.

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