Economic and Market Insights
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Donald Trump's November Surprise: Where Do the Markets Go from Here?

The financial markets have quickly adjusted to their initial uncertainty regarding the surprising Republican sweep of Tuesday's presidential elections. Equities pulled back from their 800-point overnight futures plunge after the election fireworks and are now trending in positive territory (at least for the moment). 10-year bond yields swung a whopping 30 basis points (1.0% equals 100 basis points), first falling from 1.85% to 1.71% in overseas trading, and then rising to just over 2% this morning.

So why all the volatility?

Let's face it. Tuesday's election was a loud anti-establishment shout heard around the world similar to Great Britain's now famous "Brexit" vote last summer. And like the Brexit vote, most investors were betting on a different outcome based on all the polling data and the "take" of all the well-connected election forecasters who felt Trump had, at best, a one-in-three chance of winning the presidency.

Like the Brexit vote, the markets' first reaction is a "risk off" trade when they are surprised with a flight to higher quality securities (sell stocks, buy Treasuries). But after some quick reflection (an hour or two?), the markets get more comfortable and adjust to the likely biases going forward, recognizing the future political landscape changed, but the world's business would continue no matter who is in charge.

So what does it mean for the economy and our financial markets?

That probably depends on which Trump shows up day to day in the media. The Pragmatic Trump, who graciously accepted his win last night and calmed the downward spiral in the stock market futures, or the Populist Trump, whose anti-immigration, Fed-bashing and protectionist calls tend to scare the markets.

But stepping back and taking a longer-term outlook, we would suggest the following: From an economic policy perspective, we believe President-elect Trump, with the help of a Republican Congress, will likely focus on three priorities.

Job 1 – **Jump start the economy.** In Trump's acceptance speech he pushed for an immediate spend on infrastructure. We think this will take some time, but it seems likely that almost either candidate might have convinced Congress that doing nothing would no longer suffice and we believe something on the order of a $300-plus billion spend out is likely, largely paid by lowering the tax on foreign cash repatriation. At the margin we view this as mildly inflationary, thus pushing bond yields up a bit while being positive for those deeper cyclical companies in the heavy equipment and mining space.

Job 2 – **Reform the Affordable Care Act ("Obamacare").** Note we said reform rather than repeal, even though those were the "populist" words that accompanied the campaign rhetoric. This will likely take the form of affording states more control of their own programs with fewer federal mandates, giving individuals more freedom of choice as well as more flexibility with regard to their participation in the plan. And finally, the government will engage in some type of cost controls. This will likely cause material dislocation within the healthcare space, negatively affecting hospitals and insurance providers while providing some relief to the drug companies who had been anticipating a "Democratic smack down." We wouldn't be surprised if there wasn't an eventual "Republican smack down" someday either.

Job 3 – **Taxes, regulatory reform and the Fed**. We think it highly probable that corporate tax rates are lowered. There will be some type of change to individual's marginal tax rates particularly with regard to the way we are funding the Affordable Care Act. And the taxation of foreign earnings will be lowered, affording some of those cash hoards held by the Apples of the world to come back to the United States to be spent on investment, stock buybacks and dividends to shareholders. In addition, we will likely get material Dodd Frank legislative reform, a positive for financials. There may also be some relief regarding the use of coal and oil, a positive for the energy sector. And Trump is pro-defense, a positive for the Lockheed Martins and other defense contractors of the world.

Relative to the Federal Reserve, it is important to remember that while Trump criticized the dovish Fed, his administration might need their help as well. When is the last time you ever heard any President asking for higher interest rates? So Janet Yellen will likely be on the job until her term ends in February 2018. But there are two Governor vacancies right now and President-elect Trump will get to fill them, perhaps with slightly more hawkish members. At any rate, Trump's policies at the margin are pro-growth and slightly inflationary, so we think the Fed will be perfectly positioned in December to follow through with their telegraphed rate hike.

Going Forward

As the election proved once again, predicting the future is more luck than science, no matter how compelling the rationale or argument. Quite obviously the financial markets are no different. But at the margin, the market's initial take on the Trump victory has been mildly positive for banks and financials, energy and deeper cyclical companies. It's been tougher on healthcare and insurance as well as those companies that could be hurt via protectionist type policy.

With regard to the bond market, we have believed for some time the Fed would be able to raise rates in December, and barring a financial market meltdown, that rate hike is coming. As for the rise in bond yields in general, we continue to see modest pressure, but the long-term rise in rates will come slowly as overseas rates remain low.

The Fed will maintain its independence and indeed President-elect Trump will have his influence eventually, appointing two Governors immediately and a new Fed Chair and Vice chair in 2018, but by then he'll likely begin to appreciate the Federal Reserve's rather adroit handling of our economy. We would continue to caution our investors that stock prices in aggregate remain expensive and future returns are likely to be substantially below-historic norms.

And quite obviously with bond rates low and likely slowly rising, returns from bonds will be in the low single digits. But finally, with either a Republican or Democratic government in charge, the business community in our country finds ways to work through any particular roadblocks thrown their way by simply focusing on their own bottom line. In aggregate it is that self-interest motivation that affords our country its economic growth and prosperity no matter who is in charge. Our financial markets historically have shown no particular governmental bias either.

Takeaways:

- Let's not let an election get in the way of fundamental asset and risk allocation and a longer-term perspective on your investment portfolios.
- If you are feeling any anxiety over your portfolio, you should call your Commerce portfolio manager, who would be happy to discuss your particular investment strategy.
- The markets will settle, but this election result will not interfere with the probable Fed rate hike for December.