Down to Business: the Outlook for Stocks in the First 100 Days of the Trump Administration

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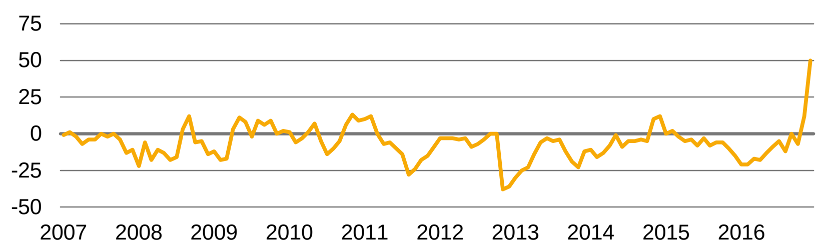
In the immediate aftermath of the U.S. Presidential Election, stocks rallied on the hope that President Trump's campaign promises of deregulation, lower taxes, and infrastructure spending would provide a tailwind to the U.S. economy. To further explore what effect such policies might have on both the economy and the stock market, we recently sat down with Marc-Antoine Collard, Chief Economist, Dan Oshinskie, Chief Investment Officer, as well as portfolio managers Mark Tavel and Luis Ferreira.

Q. Now that President Trump has taken office and begun the task of policy making, clients are reviewing how they are positioned. Starting at a high level, what is the outlook for the U.S. economy?

Marc-Antoine Collard: My view is aligned with the consensus in that we will see accelerated growth in the U.S., but for the wrong reasons. While consumer confidence remains strong and the outlook among small businesses has recently shot upward (see chart below), I am concerned that we will see inflationary growth and deficit spending. Protectionism and a stronger dollar could also create headwinds for growth, and world trade growth has already been in a downward trend.

Small Business Outlook: Percent "Better" minus "Worse" Expected General Business Conditions



Source National Federation of Independent Business, Datastream, Rothschild

Rothschild Asset Management

> “America is a country that defies all calculations.”
>
> James de Rothschild 1792–1868

Q. Setting aside global trade and the potential feedback loop for the moment, let’s stick with the domestic angle. Dan, Luis, and Mark, are you seeing the same level of optimism in the conversations you have with corporate management at the companies you invest in?

Dan Oshinskie: Business confidence is critical; without it, companies don’t hire new employees or restock inventory. Importantly, the business leaders we meet with are encouraged, and there’s the sense that we’re on to bigger and better things.

Mark Tavel: There’s certainly been a turn in optimism in the business community; it’s real and it’s tangible. There is the feeling that this could be a new era, one that could be very pro-business and positive for stock prices.

Q. Improved sentiment is clearly a positive; how do you expect that to translate into business activity?

Luis Ferreira: That’s the main caveat. When we hear corporations talk, there’s excitement, but they’re all waiting to see what the actual policies will be. Sentiment could continue to tick up, but seeing that translate to increased spending might not come as fast as hoped.

Q. The potential for infrastructure spending and other fiscal stimulus has resonated with some investors, with bridges and roads needing repair, and as accommodative monetary policy may have worn out its effectiveness. Marc-Antoine, some have suggested that Trump’s stimulus package could perhaps add 1% to GDP growth; do you agree?

Collard: To answer that question, you need to consider a number of factors. For example, infrastructure spending sounds like a great idea, but there may be little appetite in Congress to finance it through debt. Even with Democratic control of Congress, the Obama Administration’s initial stimulus package proposed an infrastructure expenditure in excess of $800 billion, but the final actual spend was closer to $100 billion.

When analyzing the potential effectiveness of fiscal stimulus, you also need to consider where it is directed and where we are in the business cycle. In the financial crisis, when unemployment was higher, you can produce more with lots of capacity and not be inflationary. Likewise, independent [nonpartisan] analysis suggests that close to 50% of the share of Trump’s tax cut stands to benefit the top 1% of income earners[1], who are more likely to save such a windfall than spend it.

Taken together, a potential stimulus of $500 billion could translate into an additional 0.25% to 0.30% growth in GDP.

Notes

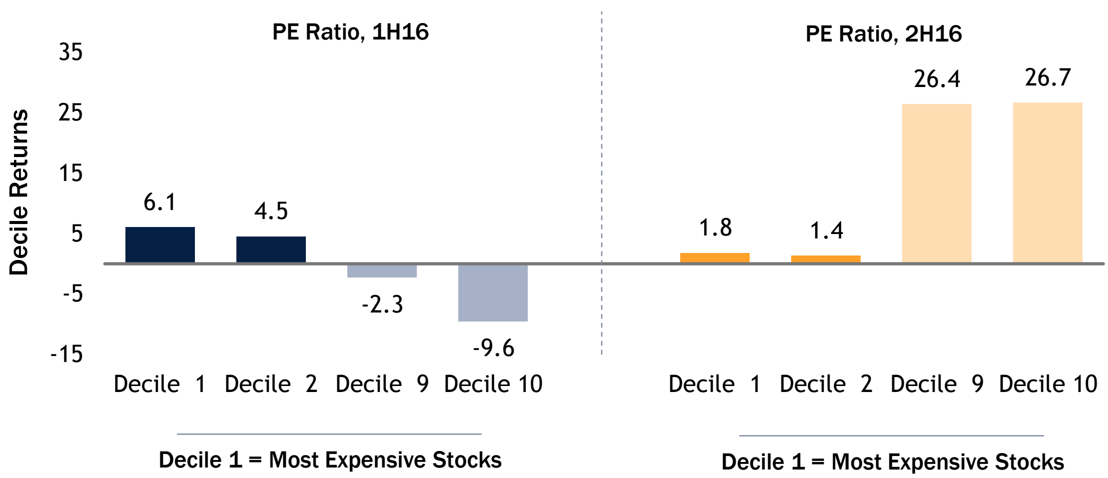
1 Donald Trump’s Presidency: A Look at His Proposed Policy Shifts, The Wall Street Journal, Tax Policy Center, January 20, 2017

Q. Will all sectors of the economy benefit equally? What are you seeing in the portfolios you manage?

Ferreira: Financial Services stocks have rallied, with JP Morgan and Bank of America up 31% and 41%, respectively, in the fourth quarter. Some of this is related specifically to the Federal Reserve Open Market Committee's decision to raise interest rates at its December meeting. Quanta Services, (up 25%) an engineering and construction firm, is expected to benefit from the proposed infrastructure spend. The recently-approved Keystone pipeline is a tangible near term project that helps the outlook for the Quanta.

Equally important, the market is starting to recognize value, and the obsession with yield-at-any-price has abated. Under the lower-for-longer paradigm that dominated 1H2016, dividend yields acted like a fixed-income surrogate, and the best performing stocks were actually those that were the most expensive (see chart below). Now, after a period of extremely easy money, it appears that interest rates and monetary policy are likely to continue to normalize. This normalization has continued into the fourth quarter, with fundamentals like valuation increasing in importance. It's been a big reason we've been able to beat our benchmark six months in a row.

A Tale of Two Halves: Performance of Stocks in the S&P 500 Index by Price-to-Earnings Ratio



Source: FactSet, Rothschild analysis

The performance returns represent past performance of the stocks within the respective index, and do not represent the actual performance of any of the portfolios managed by Rothschild Asset Management. An investment cannot be made directly into an index.

Oshinskie: We've seen similar developments in the small- and mid-cap segments of the market. Although not as strongly as in the large cap space, small- and mid-cap bank stocks have rallied on rising rates and expected loan growth. We were slightly underweight to the regional banks, so we added two such stocks during the quarter. Our Small/Mid-Cap Core strategy outperformed for the quarter, and while we underperformed for the full-year, we were able to close the gap.

Q. Marc-Antoine, let's return to the global picture. We live in an interconnected world; how could Trump's policies possibly create headwinds for the U.S. economy?

Collard: The first immediate effects of the Trump presidency were that the dollar rose and the 10-year Treasury yield increased. Investors are betting that Trump will enact a large stimulus and the Fed will be forced to abandon a gradualist approach in favor of a more hawkish one.

These two developments could be a toxic mix for emerging market economies, many of which have in recent years accumulated increased debt—much of it dollar-denominated. Debt levels in China and Brazil are at or above those in the U.S. at the start of the housing crisis, with interest rates headed higher.

Meanwhile, emerging markets have very important links with Europe, in terms of debt as well as trade. While the U.S. is not immune to these links, they matter more for a country such as Germany, whose exports to emerging markets tend to be in cyclical industries, whereas American food exports are more stable.

Q. At the time of writing, the S&P had rallied 10% since the election before taking a breather in late January. Are the expansionary effects fully exhausted?

Oshinskie: It's important to stress that we are bottom-up, fundamental investors, so we're not looking to time the market or take a top-down view. But my gut instinct tells me that clearly the market has built in some level of optimism. Expansionary fiscal policy should lead to economic growth, and improved corporate earnings. The market has priced in some of this, and it may take time to enact these policies, but business leaders are talking reasonably optimistically.

Tavel: Trump's proposals aside, the corporate earnings outlook is improving, with the S&P 2017 earnings projected to head even higher. Optimism reigns until someone takes the punchbowl away.

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