November Outlook – Trump, the Economy and Markets

Most investment professionals such as myself try to invest in assets (stocks, bonds, commodities, real estate) that are undervalued, and wait for them to get to fair to overvalued and then liquidate. The problem for us value/fundamental investors is that most stocks and markets are currently overvalued, and this market is in the late stages of this economic and market cycle.

The conditions and trends of the economy impact these assets, so we try to understand economic, fiscal and monetary policies. Many of these will be changing dramatically with the new Trump administration, so there is uncertainty among economists, investors and analysts. For now, investors and analysts are giving the new administration the benefit of the doubt.

Some of the changes may include:

- Moving from monetary policy (the Federal Reserve money creation aka quantitative easing and low interest rates) to fiscal policy (lawmakers pass spending and tax reduction bills)

- Changing from consumer friendly to business friendly

- International view and interconnectedness to nationalism

- Low inflation and interest rates to higher inflation and interest rates

- Gridlock in Washington to Republican control

What are the Markets Indicating Regarding the New Administration?

One of the best predictors of the economy are the markets. What are the markets indicating? Below is a chart of the last two years.

Let's review the above chart:

- The markets have been moving sideways for about the past two years. The last few months have an upward bias.
- When the markets move in 90 degree angles, they are normally hard to sustain, and they are normally followed by profit taking. We see that in the circled areas.
- During the summer, the markets did breakout when rates fell in most countries, and some countries' interest rates went negative. Global money moved to the U.S. dollar, bonds and dividend stocks (bond proxies).
- The markets prefer uncertainty versus change and uncertainty. The markets, and analysts are also concerned about Trump's proposed tariffs and isolationism, and his personality.
- Most pols gave Clinton the edge during most of the presidential campaign. In late October the FBI announced they would re-open their investigation of Clinton emails. Clinton falls in the polls, and Trump gains momentum.

- On November 6, the FBI clears Clinton, and the markets recover.

- Now we see a 90 degree angle move since the election. As mentioned above, these types of moves are hard to sustain. They are also a sign of speculation.

- Once profit taking occurs, and early next year we can expect more volatility in the debt and equity markets.

  This means investors and traders will have to be more active. I spelled out my strategy for these markets in my August Market Outlook. Click here to read the article.

Valuations longer term are more important than price movements, and again the markets and many stocks are overvalued.

Here is what happened in the futures market the night of the election:

On the night of the election when it looked like the Donald Trump was going to win, the futures markets crashed about 5% (the Dow Jones Industrial Average futures fell almost 1,000 points at one point).

Donald Trump's victory speech was conciliatory, so the markets did recover.

Before the markets opened, some of Trump's economic advisors were on the cable financial channels pounding the table that Trump's economic policies were pro-growth, pro-business and good for the economy and investors.

More of his economic advisors and supporters continued during the market day touting his economic plans, and the markets, investors and traders were persuaded, and the markets finished November 9th strong.

Many traders, money managers and investors are conservatives and Republicans, so their fear and uncertainty transformed into bullishness. The market has been in rally mode since November 9th.

The question is which market is correct, the pre-election market, or the post-election market.

The Bullish and Bearish Case for the Economy and Markets (So Far)

The equity markets are acting positive. Unfortunately they're headwinds developing including: rising interest rates (good for banks, insurance companies, pension funds, seniors and their income producing investments and savings accounts), a rising dollar that makes our products and services less competitive overseas.

One of the hardest jobs of an investor is to forecast and understand the future. No one can consistently and accurately predict the future. So, let's look at some knowns. Republicans will control the Presidency, Congress, Senate, and the Supreme Court.

The new administration and Republicans economic priorities include:

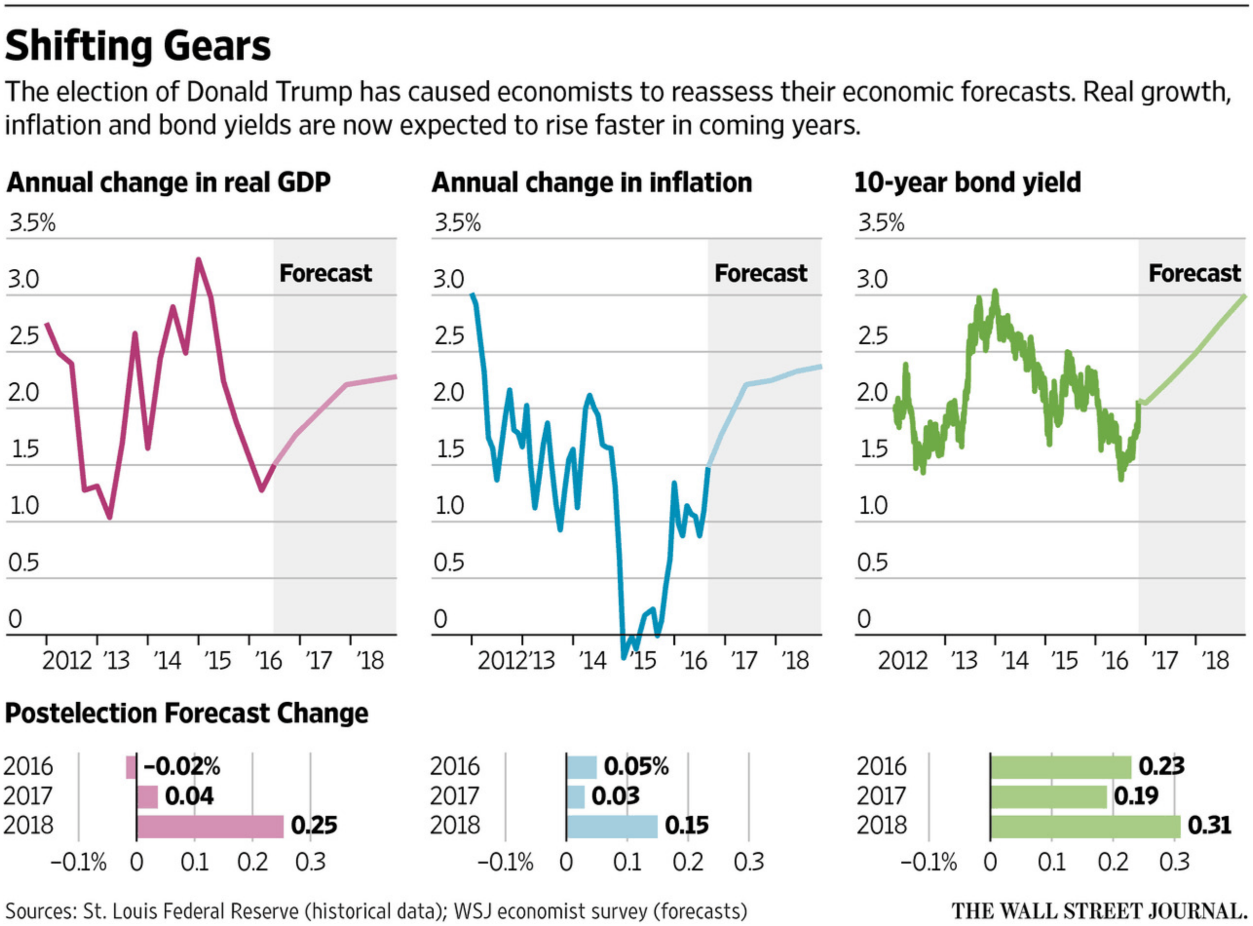
- Infrastructure spending
- Tax cuts for individuals and corporations (infrastructure and tax cuts may be as high as $4 to 5 trillion)
- Deregulation
- Repatriation of $1 to $2 trillion parked overseas by U.S. corporations.

Most of these policy changes should be stimulative to the economy, and would be tailwinds. We don't know when these proposals will be implemented, or how big these proposals will be.

President elect Trump and his administration has other priorities including repealing the Affordable Care Act, the southern border and immigration, spending on the military.

One of the main unknowns is what will the new administration look like? Ronald Reagan said that "personnel is policy." This is a real wild card. Will they be the most qualified or loyalists, extreme or middle of the road, ideologues or data driven decision makers?

Below are some early consensus forecasts from a consensus of economists:



President elect Trump did say in his campaign that his goal was to grow the economy about 4% to 6%. At this point, a consensus of economists are forecasting growth of 2.3%. Also, as mentioned above inflation and interest rates are forecasted to move higher.

I wrote a research article, "Update on the New Normal", about the view that the U.S. economy has been and will face slower growth. Click here to read the article. I'm not surprised to see GDP forecasts below historical growth rates.

My outlook for the markets has not changed much. The U.S. economy is fine, but there are many concerns outside our borders: China, Brexit and other European elections, Japan, North Korea, the proxy war in Syria, ISIS, Iran, and potential trade wars with some of our trading partners.

I'm also concerned about overvaluation of the markets and most stocks, the aging of this economic and market cycle.

The markets are doing well for the following reasons:

- A new administration that is pro-growth and pro-business.

- Pro-business policies include: lower taxes, infrastructure spending, less regulation, repatriation of capital by businesses of the cash they have parked overseas.

- The markets and some stocks are making new highs. Once prices break to new highs, it is normal for prices to continue to make new highs because all the supply, resistance of the previous high has been taken out, making it easier for prices to move higher.

- Money managers that have weak performance this year will have to move into the markets, equities to try and improve their performance. The better performance can help them achieve higher bonuses, and for some to keep their jobs.

- Trend followers and momentum players will continue to jump on the bullish trend.

For now, investors are giving the new administration the benefit of the doubt. There are sobering concerns for investors:

- Markets and stocks are overvalued.

- Slower global growth

- Economic and political dysfunction in Europe, Japan, China, Brazil, Venezuela….

- Potential trade wars with Mexico and China. Trade wars could lead to a global recession.

- Potential wars with ISIS, Syria, and Iran. Some of the picks military picks for the new administration are considered more confrontational.

- An increase in deficit spending and government debt. When we issue more debt, we will have to raise interest rates to attract investors. All the new debt could crowd out other borrowers hurting the economy. This also means higher interest rates that could derail the markets and slow the economy.

- Rising rates and the dollar. This could have a bearish impact equity valuations. Bond prices have gone south with the rise in rates and trend could continue.

- There is a strong likelihood that the Fed will raise rates in December and in future months.

- Social conflicts if some of Mr. Trump's more controversial proposals are causing social conflicts and they could get worse. Some of Trump's picks do indicate that some of these proposals could be implemented.
- There is always the grey or black swan events (events that have low probability/hard to predict, but have a high economic impact) that could happen, but can't be predicted.

Summary

- The Republicans will control all branches of the government, and their economic priorities are known and they include: lower taxes for individuals and corporations, infrastructure spending, lower regulations, repatriation of overseas corporate profits.

- For now, investors and analysts are giving the new administration the benefit of the doubt providing bullish conditions for the markets. I doubt our trading partners and global foes will do the same thing.

- Market dynamics are also bullish for the year end: new highs create new resistance/supply for the markets, a melt up of the markets and stocks by professional money managers, trend followers and momentum players jumping on the band wagon.

- They're many potential and real headwinds: high valuations for stocks, slower global economic growth especially China, the potential for trade wars, we are in the late stages of this economic cycle, potential military conflicts in the Middle East and North Africa, rising interest rates and inflation expectations, a rising dollar, the prospect for greater U.S. government deficits and debts.

- Once the current rally sees profit taking, we can expect continued volatility in the markets.

For the remainder of this year and early next year I will analyze the above listed economic priorities