MARKET UPDATE

Your information connection

11.28.16

President-Elect Trump and Market Reaction

Over three weeks ago, approximately 127 million citizens of this great country went to the polls to cast a vote for President. Before Mr. Trump had been declared the winner, the capital markets reacted violently to the perceived result. As I watched the various political analysts provide their 'expert' insight, I was surprised by investors' reaction. Approximately four hours before Mr. Trump crossed the 270 threshold to win the Presidency, equity index futures dropped precipitously and reached the 5% decline circuit breaker threshold in effect for afterhours trading.

I remember telling my wife that this is absurd, nothing has changed, yet the market appeared in a free fall. Uncertainty is a common explanation for large market moves. Just as absurd was the 800 point drop in the index futures prices for the Dow the night of the election, so was its reversal the next day and the net 515 point advance the three days following the election. Apparently, investors weren't so unhappy after all.

In his latest memo released the week after the election, Howard Marks, of Oaktree Capital, provided some interesting insights on the equity markets in the context of uncertainty and rationality. We believe more *'investors'* should read Mr. Marks' memos, because he is calm and pragmatic.

- "…on the subject of the market's irrationality. Clearly, the election was the biggest event last week, so it must have been the main influence behind the changes in stock prices. But how could the expectation of a Clinton victory make stock prices rise, and then the reality of her defeat make them rise further?"
- "In the case of the election, it might have been, *"Whatever was good for the market yesterday, its polar opposite was good for it today."* It just doesn't make sense."
- "While people search the market's behavior for logic, there really doesn't have to be any. . . .[S]ometimes the market interprets everything positively, and sometimes it interprets everything negatively. The market often fails to act rationally in the short run, primarily because of the role played by people in determining its course."

In his first three days as President-Elect, Trump met with President Obama, leaders in Congress, and Leslie Stahl, of "*60 Minutes*". Some of Trump's campaign planks were to lower taxes, to revise immigration policy(s), to increase infrastructure spending, to fix health care, and to create more jobs. Details for his priorities have been lacking and that has not changed since his election. On "*60 Minutes*", not only did he not provide additional detail on his priorities, but he also appeared to dampen his urgency to address certain issues. His remarks following his meeting with President Obama and House Speaker Paul Ryan were broad and lacked specificity. *(Continue on back)*

Despite the long runway before any change(s) could occur to help American people and businesses, the equity markets have performed well. It appears the market believes President-Elect Trump will make good on his campaign promises. In general, it has been a 'risk on' market environment. Since the election, from 11/9 to 11/23, the Dow, S&P 500, and Russell 2000 Index returned +4.3%, +3.2%, and +12.4%, respectively. The market priced in positive effects for companies in the Financials, Industrials, and Health Care sectors. President-elect Trump's promises to ameliorate the regulations on companies, to make health care better, and to increase fiscal stimulus boosted prices by +17.3%, +16.4%, and +11.8% in the respective sectors in the small cap Russell 2000 Index and by +11.9%, +7.1%, and +1.2% in the S&P 500 Index. Moreover, the best performing industry group in the large and small cap indexes was Steel, with a return of +21.7% and +32.4%, respectively. However, President-elect Trump's policy objectives that were viewed positively for stock prices were not viewed positively for fixed income investments. Fixed income prices have fallen dramatically, which has resulted in higher yields. As of November 23rd, the yield on the 10-Year Treasury (2.35%) increased 26.6% and 32.2% since November 8th and 4th, respectively. It appears fixed income investors are concerned of increased inflation risk due to more government infrastructure spending supported by more debt issuances.

AQR provided an insightful perspective on the election and the market's reaction in their weekly commentary titled *"Speculation on Speculation"*. AQR's first point is to remember changes do not occur quickly in Washington, even if you know the change. *"[T]here is the long period of negotiation in Congress (even a one-party majority Congress) before new policy can be implemented. And of course, then it takes time for the new policies to take effect, which means that, for now, any talk about policy is merely speculation."* If we take a breath and think for more than a few moments, we should realize we do not know anything about any potential change(s) in economic, tax, and/or social policies that President-Elect Trump may get passed next year or in a years that follow. Therefore, since we (including market participants) have no clue about what policy(s) the Trump administration will ultimately implement, "*any market moves are speculation on speculation."*

We have not and are not making adjustments to client portfolios as a result of the outcome of the Presidential election. Our investment philosophy is rooted in fundamental analysis and, in our view, the fundamentals have not changed. In our opinion, there will be a lot of 'what ifs' to process over the next several months. Instead of reacting to each '*what if*' sequence of new information in a repeating fashion similar to a 'loop' in computer programing, we will remain strategic. As Howard Marks so eloquently stated in his memo, *"no one really knows what events are going to transpire"* and *"no one knows what the market's reaction to those events will be"*.

Please contact us with any questions you may have. Thank you for your continued trust and confidence.▪

Written by: Robert Little, CFA, CPA, Vice President, Investment Strategy and Research