CORE Comments
ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

November 11, 2016

Investing for a Trump Administration

Mr. Trump ran a radical campaign. What will his administration do and how will its actions affect investment markets?

Like most people, I was stunned with the election's outcome; like half of the voters, I was dismayed. This election campaign and the incoming administration will most likely alter many things, social and political, that many had taken for granted about America. However, I will leave it to others to discuss these political and social ramifications and, instead, discuss in this letter what are the investment issues now before us.

Trump's campaign, which can only be described now as brilliantly effective, was quite short on specific policies. However, a few policy prescriptions loom large: In a striking manner, Trump's campaign differed substantially from what we have taken to be orthodox Republican strategy. His campaign appealed to blue-collar white voters by blaming their job losses and low wages on globalization. He also departed from traditional Republican views by declaring that the federal government would engage in large scale public works spending and by abandoning fiscal austerity. His proposed tax cuts, coupled with his increased federal spending on infrastructure and defense will, if enacted, cut revenues and raise spending such that the federal debt might rise by $5 trillion, an increase of well over a third in only a few years. Ironically, with respect to these broad policy prescriptions, Clinton was the fiscal conservative in this campaign and Trump the free spending, big government liberal.

Mr. Trump promises large-scale spending on public works. This will stimulate the economy, causing the Fed to raise rates. This, in turn, will cause the dollar to appreciate. In general, infrastructure spending will be a boon to US stocks.

A risk to American investments is the possibility that Mr. Trump will interfere with the Federal Reserve. His campaign rhetoric was ambiguous.

We can probably believe that Mr. Trump will push forward on public works. He has business experience in debt-financed building projects and it will be a quite visible way of demonstrating support for those whose support propelled him in the election. If he acts on these policies and if the Republican majorities in each house support him, as seems likely, the investment effects will include lower bond prices and higher inflation. Given the crumbling condition of roads, bridges and the like, infrastructure spending will be very good for the country and for the economy. Inflation has been creeping up this year already and recently Core took a position in TIPs, inflation-protected government bonds. Then, after the election, we sold clients' remaining positions in US treasury bonds. (Note that when bond yields rise, bond prices fall.)

The incoming administration and the Federal Reserve. During his campaign, Mr. Trump was very critical of Janet Yellen, the chair of the Fed, and of the low-interest-rate policies of the Fed. This may have been campaign rhetoric and, indeed, at early stages of his campaign, Mr. Trump had declared himself to be a 'low-interest-rate guy.' Political independence of central banks is widely regarded as an important public good, but political attacks on the Fed are hardly rare. We have written extensively about the Fed and its policies since the financial crisis of 2008 to 2009; there is no question that Fed policy has been absolutely essential to the performance of investment assets, including stocks, bonds and real estate. If the new administration is hostile to the Fed, the result will be market turbulence and lower asset prices.

By

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At present there are vacancies at the Fed, which the president can fill. His appointments may be an indication of his administration's real views. Moreover, the upcoming Fed meeting in December will show us whether the Fed is willing to act. Prior to the election, it had been deemed likely that the Fed would announce another quarter percentage point rise in the Fed funds rate. The state of the US economy appears to support an increase, but the condition of financial markets in coming weeks will be important. If they are very volatile, and in particular if stocks and bonds should decline sharply, the Fed may choose once again to wait.

Possible effects on stock markets. Mr. Trump's anti-trade and pro-tariff rhetoric was very striking. The question is whether his administration and Congress will act in ways consistent with his campaign rhetoric. A president has wide authority to act on his own initiative and without Congressional approval on matters relating to trade, to immigration, and to climate change and other energy policies. (Witness President Obama's executive orders relating to these matters.) It is widely reported that Mr. Trump's staff is working on executive orders, perhaps to be signed on January 20th, that will reverse many of President Obama's initiatives. If executive orders include such things as Mr. Trump's promised 45% tariff on Chinese goods, the economic effect may be dire. The Smoot Hawley tariffs enacted in 1930 worsened the Depression. High tariffs on imported goods would, of course, raise their prices in the US, hardly a benefit to those who voted for Mr. Trump. They might also kindle retaliatory actions by the exporting countries, including China, worsening geopolitical relations. At the very least, stock markets in the US and abroad would be adversely affected.

Mr. Trump's administration is likely to be more favorable to banks, oil and gas and coal companies than Obama's has been. Health care is uncertain.

Mr. Trump's campaign rhetoric criticizing the Dodd-Frank legislation was favorable to banks. Related to this was Ms. Clinton's harsh criticism of pharmaceutical pricing practices. Thus, pharmaceutical and biotech stocks, as well as banks, have risen in the three post-election trading days. Similarly, Mr. Trump's administration is likely to be more favorable to oil, gas, and coal industries than was Mr. Obama's, and far less favorable to clean energy and renewables. It is reasonably likely that these industry groups will prosper in coming years.

Anti-globalization and tariffs on imported goods were a key to his campaign. If Mr. Trump imposes high tariffs, the effects on the economy and markets will be negative.

Mr. Trump's campaign criticized the Affordable Care Act (Obamacare) in strident terms. Republicans in the Senate and House have opposed Obamacare since its enactment. What will be the outcome? Republican legislators would probably be loathe to repeal the legislation without meaningful replacement health care enactments. Twenty million people, previously without health care insurance, are now insured because of Obamacare; the pre-existing conditions obstacle to health care insurance is now history. Depriving the previously uninsured of their health-care coverage would seem to be a singularly self-destructive political act. Thus, as for healthcare in general, it is too early to make a judgment about stock market effects.

Even Mr. Trumps' most radical policies, if enacted, will not derail America's strong and resilient economy.

Core's investments. Although I had expected that Hillary would be our next president, uncertainty argued for a fairly conservative stance going into the election. As noted above, we sold clients' remaining position in long-term US treasury bonds after the election. The proceeds will be held in cash, on the notion that there are likely to be some very volatile trading days ahead of us as the world adjusts to the notion of President-elect Trump. It will be remembered that Mr. Trump often presented himself as thin-skinned when criticized and he startled all of us on many occasions in this last year. Although in the closing weeks of the campaign, he appeared to stick to the script and despite a circumspect post-election speech, there is no terribly convincing reason to believe that the volatile Mr. Trump is finished surprising us. His surprises are likely to trigger some wild days in financial markets.

A perspective. As noted, I supported Hillary Clinton and am disappointed in the outcome. Let us remember, though, that the United States has durable democratic institutions that have thrived over generations and through serious crises. It is possible that Mr. Trump, who has demonstrated political skills, may also reveal a capacity for governing well. More important, though, is the strength, success and resilience of the American economy. Mr. Trump may pursue policies detrimental to the economy, including the threatened imposition of tariffs. The American economy and our political institutions are strong enough to overcome the effects of poor policies. America's economic success will continue and investments in American assets will also be successful.

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