CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

March 25, 2017

Politics... cannot be ignored

Once again, we must ground our investment discussion in the political context. Three matters loom large and undercut the confidence investors expressed after Mr. Trump's election.

The unsupported allegations by our new president that his predecessor had wired-tapped his campaign and Trump Tower in New York are one. The second is the question of Russian interference in last year's election and the Trump campaign's coordination with Russia. The last is the failed attempt to 'repeal and replace' Obamacare.

These undercut confidence in the new administration and put in doubt the continuation of the 'Trump rally.'

By

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Previously I have expressed reluctance to write about politics in these letters about Core's investing for its clients. But politics looms so large in US markets these days that to avoid the discussion is to write an investment letter devoid of meaning. So, here we go again. First the politics, then its relationship to investments.

Politics. Matters now include our new president's recent allegation that his campaign and the Trump Tower were subject to surveillance ordered by President Obama. He offered no evidence for this and it has been roundly denied by the FBI, by British intelligence organizations (dragged into the matter by Mr. Trump's subordinates), and by officials at the head of US intelligence agencies last year. Investigations are underway by Congressional committees. The Republican and Democratic leaders of the investigations report that there is no evidence to support Mr. Trump's allegations. James Comey, head of the FBI, concurs. In effect, Mr. Comey and others say that Mr. Trump lies about this.

The second political matter involves reports that the Russian government interfered with last year's presidential election to aid Mr. Trump's campaign and to damage Mrs. Clinton's. The further allegation is that the Russian interference was coordinated with the Trump campaign. This week, Mr. Comey confirmed in Congressional testimony that the FBI has been investigating this matter for eight months. A good deal of information bearing on these quite serious questions has become public. Foreign interference in our elections is grave; participation by a campaign in that interference can be deemed treasonous. This week we learned that the FBI is conducting a criminal investigation of the president's campaign.

The third is the failed attempt by Mr. Trump and House Speaker Paul Ryan to repeal Obamacare and replace it with a hurriedly put-together substitute. The principal 'merits' of the Republican's proposed bill included a major tax cut for the wealthy financed by dropping health care for the needy. Note that after Mr. Trump made a concerted effort to get recalcitrant Republicans to vote in favor of the legislation, it was withdrawn yesterday from consideration and no vote was held. This is a failure by the President and the Speaker to bring to fruition important legislation in which they both invested a big pile of their political capital. The failed project may well render upcoming matters—tax 'reform' and infrastructure spending—rather more difficult to accomplish.

From politics to investments. Mr. Trump's election as president was not expected. But, when the votes were counted, global financial markets switched gears and stocks--particularly in certain industries--began a big rally. For exam-

The rally in bank stocks showed the potency of the hoped-for de-regulation of banks and the weakening of Dodd Frank.

ple, bank stocks rose rapidly on the belief that the Trump administration and the Republican-dominated Congress would undo a good bit of the financial regulation enacted after the financial crisis, the Dodd Frank law. The banks consider Obama-era regulation after Dodd Frank to hamper their desires to do what they will with other people's money. (Indeed, it did.) The new administration can change some regulations and\or simply fold arms and cease enforcement of others. Financial markets anticipated this and bank stocks flourished after the election. And not only bank stocks: At its recent peak, the broad US stock market, as measured by the S&P 500 index, had rallied by 12 percent since Election Day.

The three pillars of the Trump rally have been de-regulation, tax 'reform,' and infrastructure spending. With the political headwinds, tax 'reform' and public works spending seem less likely.

Investors also expected that the Republican-controlled Congress and the Trump administration would (a) de-regulate other industries, as is probably unfolding somewhat beneath the radar, (b) enact tax 'reform' to favor the rich and business interests, and (c) stimulate the economy with big infrastructure spending (formerly known as public works). These three broad factors propelled the post-election rally. Until the sharp selling on Tuesday, the S&P had gone some 109 sessions without a decline of one percent, a placid and persistent rally. It may be the case that the failure of stocks to gain since the beginning of March and this week's sharp selling squall arose from the realization that the political problems discussed in the opening paragraphs will forestall tax 'reform' and the trillion dollar infrastructure building promised by Mr. Trump in his campaign. Without these hoped-for goodies, the fuel for the Trump stock rally has weakened.

Europe and Japan offer opportunities for investment less troubled by the chaos in Washington. Core's investments there are performing well; we expect to add to these.

Elsewhere in the world. The US stock market makes up about half the total capitalization of all the world's stock markets, although the US economy and the US-domiciled companies comprise quite a bit less than half the world's economic activity. For lots of reasons the US stock market looms as large as it does. Some has to do with the political role the US plays with its extraordinary web of global alliances; some with the US reputation for the rule of law and respect for its judicial process; some with its fairness and leadership in global affairs; some with the role of the US dollar as the world's reserve currency. The present administration appears to be turning its back some of these, by disparaging NATO, by antagonizing allies (consider Germany, Mexico and Australia), by picking fights with China, the principal rival power to America, and by denigrating its co-equal branch of US government, the federal judiciary, in the judiciary's review of the patently unconstitutional Muslim bans put forth as executive orders by Mr. Trump. Unless and until we observe Mr. Trump's support for the various pillars of US strength, it is wise for investors to look beyond US markets.

Europe and Japan are the principal markets of world's other developed economies. As noted in recent letters, stock markets there and their economies have been weaker than America's. And, whereas the Federal Reserve, our central bank, has been tightening monetary policy in recognition of favorable economic conditions here, the European Central Bank and the Bank of Japan are still fully engaged in easing monetary conditions to support those economies and--whether intentionally or no--to support their stock and bond markets. These efforts bear fruit: Economies in Europe and Japan are growing and the growth is being reflected in their stock markets. Europe has its own political problems, somewhat akin to those presented in America, including the British vote to leave the European Union, and the rise of 'populists' and authoritarian figures somewhat resembling Mr. Trump in their appeal to the frustrated. Notwithstanding this, the long underperformance of Japan and Europe stock markets, when measured against America's, is turning. For defensive, as well as for opportunistic reasons, we plan to increase our investment allocation to Europe and Japan.

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