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

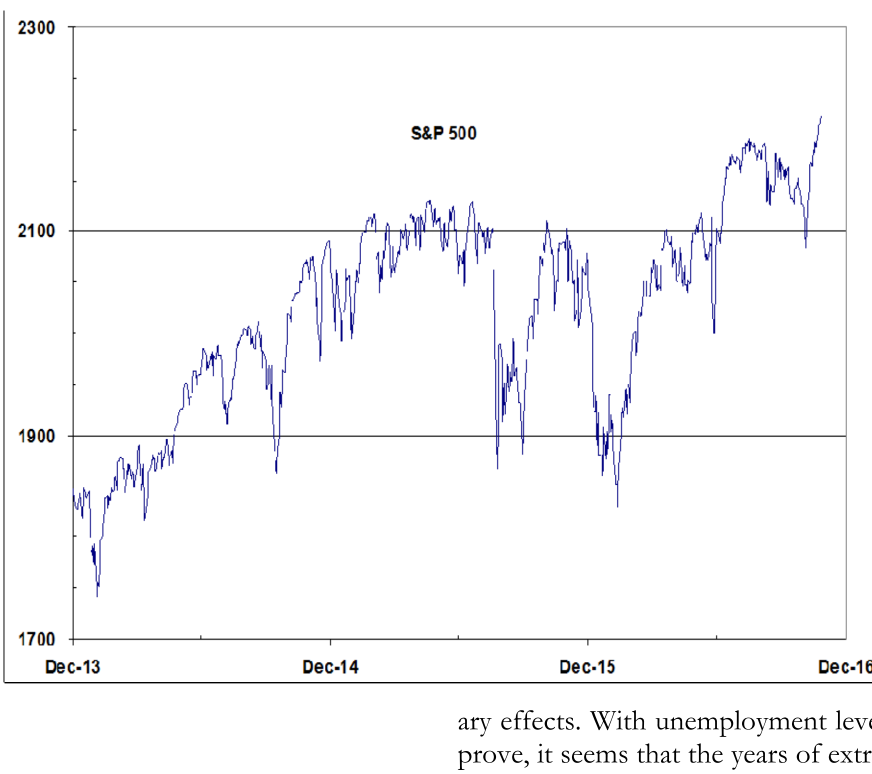
November 26, 2016

Investing for a Trump Administration—Part II

In the two and one half weeks since the election, stocks and the US dollar have rallied sharply while bond prices have tumbled. Will these sudden and swift moves continue?

In the short time since the presidential election, the character of stock and bond markets has changed dramatically. Stocks have rallied very strongly, while bond prices have fallen sharply and bond yields, which move inversely to price, have risen. What accounts for these changes and what do they portend?

Just prior to the vote, polls indicated that Mrs. Clinton would win the election. Both the Trump and Clinton campaigns had the same view. As the evening wore on and Mr. Trump's election became likely, financial markets trading in Asia and electronically showed sharp downward moves in stocks. However, by the time US markets opened on Wednesday morning after the election, sentiment had changed and stocks began their strong, post-election rally and bond prices began their tumble.



In the two years before the election, stocks had barely advanced, whereas bond prices had risen to heights never before seen. (See *Core Comments* of August 4, 2016, and the accompanying charts.) On matters of fiscal policy--taxing and spending by the federal government--Republicans in control of Congress blocked the Obama administration's proposals for infrastructure spending to rebuild bridges, roads, ports, and the like. The Federal Reserve used its monetary policies to keep interest rates low, to foster employment and economic activity. In their respective campaigns, Mr. Trump and Mrs. Clinton both proposed substantial spending on infrastructure and some markets began during the summer to reflect the reflationary effects of fiscal policy stimulus. The election results, with both houses of Congress maintaining Republican majorities, suggested to markets that Mr. Trump's expansive public works plans would be enacted. Big public works projects are likely to boost economic growth with inflationary effects. With unemployment levels already quite low, with wages beginning to improve, it seems that the years of extremely low inflation are coming to an end, pushing bond yields higher and bond prices lower.

By

Jack Mayberry

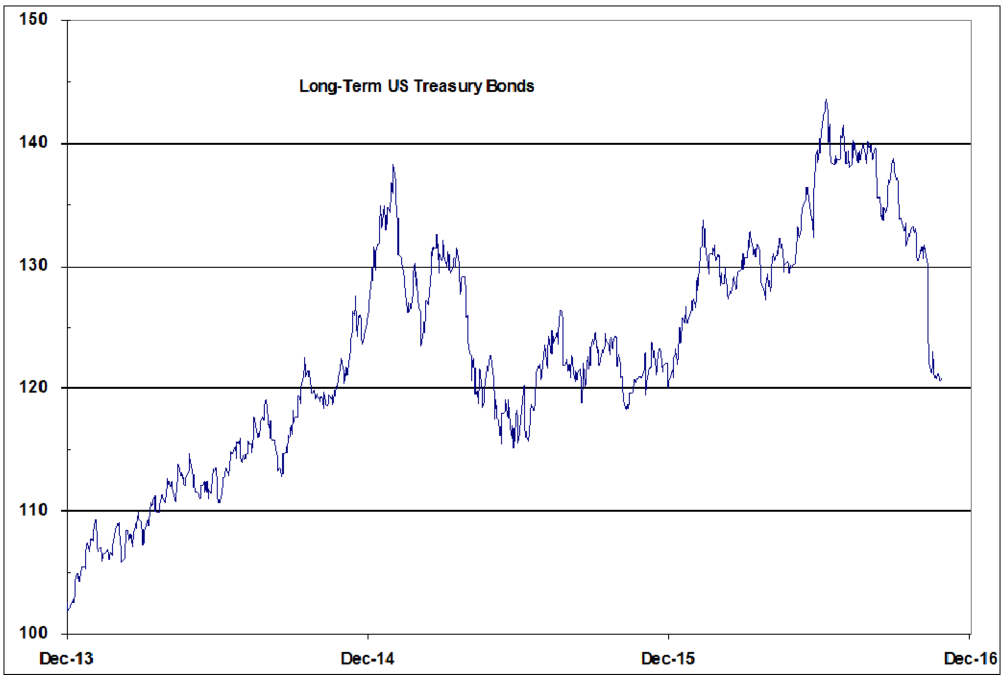
In the two weeks since the election, prices for various indices of stocks and bonds have moved very rapidly. After such swift moves, there is often a reversion to the mean, whereby the rapid moves are, at least in part, reversed. So in the short term, we should be unsurprised if we see stocks and bonds move opposite to their immediate post-election impulse. The more important question is whether these recent moves will persist through 2017 and beyond. I think it likely that the expected economic and

The chart of the S&P 500, shown on the first page, and that of long-term US treasury bonds, shown below, both reveal the sharp, post-election moves, up for stocks and down for bonds.

The moves make sense, but they probably have gone too far too fast. The uncertainty engendered by Mr. Trump's unpredictability warrants a cautious approach.

inflationary boost from expanded fiscal policy will persist, unless and until it become apparent that the public works spending will not be enacted, or unless and until it is shown that infrastructure spending will not give the economy and inflation a boost. In Core's view, the post-election changes of higher stock prices and lower bond prices likely will continue.

In sum, several of the likely policies of a Trump administration are good for stocks, including corporate tax cuts, deregulation, infrastructure spending and other fiscal stimulus. Proposed policies that are negative for bond prices include fiscal stimulus, tighter immigrations controls, higher tariffs and other anti-globalization policies. These are all inflationary and lead to higher interest rates and lower bond prices. Moreover, higher interest rates and higher inflation are likely to cause the Federal Reserve to raise US interest in a more rapid and sustained manner. Given the weaker economic outlook in Europe and Japan and the correspondingly accommodative policies of their central banks, the US dollar has strengthened markedly against other currencies and, on a trade-weighted basis, stands at a twelve-year high. The stronger dollar will, to a degree, favor US small company stocks that do their business mostly in the US. Globally-oriented large companies that do business outside the United States will see their foreign activities hindered by the strong dollar and their foreign earnings translated into fewer dollars as the dollar strengthens. Hence, small company stocks will outperform the global giants.



If the link that ends this letter is not active, copy and paste it to your browser. Then you may read the transcript of the Trump interview with the Times.

Core's investments. Since the election, we have made some changes to the investment accounts we supervise, by reducing investments in bonds and in gold, while adding to investments in stocks, the dollar and cash. As stated, we believe that bond prices will fall further and that stocks and the dollar will rise. However, the very swift and sharp moves since election night give us pause. We have not made all the investments we anticipate and we have increased cash levels so as to be able to invest when prices fall. The very over-bought conditions in the stock market and the very over-sold conditions in bonds lead us to believe that there will be better opportunities for the trades we have in mind.

It is far too early to make confident predictions about the policies that will emerge during Mr. Trump's administration. By contrast to Mrs. Clinton, Mr. Trump had not—and has not—articulated a coherent set of programs to pursue. It is probable that some of his most inflammatory campaign rhetoric about intended policies will probe to be rhetoric only. For example, during his campaign he promised to deport eleven million illegal immigrants. In his Sixty Minutes interview, he retreated from that undertaking. He visited the publisher, editors, columnists and reporters at the New York Times during the week just past. The transcript is very revealing about the way he sees issues. The most flattering way to characterize them is to say that his perspective on major policies is from a very high level; he expresses his general feelings without permitting himself to be pinned down to specifics. Buckle up. (See http://www.nytimes.com/2016/11/23/us/politics/trump-new-york-times-interview-transcript.html?hp&action=click&pgtype=Homepage&clickSource=story-heading&module=b-lede-package-region&region=top-news&WT.nav=top-news&_r=0.)

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