January 23, 2016

Q4 2016 Commentary: Trumped…

Before the election and after the election. One needs to clarify that timeframe when discussing anything about financial markets in the fourth quarter. In the month prior to November 8th, the S&P 500 had drifted consistently lower. On November 9th, the market turned around and took off. One needs to go back to the 1980 election to find such a dramatic and abrupt change in investor sentiment after an election. The stock market rose 9% in the period between Ronald Reagan's election and his inauguration. The Trump rally had a similar dimension. Both Ronald Reagan in 1980 and Donald Trump today promised to "make America great again." We'll see how it turns out this time around.

The post-election turnaround carried the S&P 500 to a 3.8% gain for the quarter. In the bond market, the strengthening economy and the well telegraphed and expected rate hike by the Federal Reserve in December moved interest rates higher and consequently bond prices lower. The 10 year US Treasury yield rose significantly from 1.61% at the beginning of the quarter to 2.45% at year-end. The impact of higher rates drove the Barclay's Aggregate Bond index down 3.0% in the fourth quarter.

The Trump rally is based on faith. Faith that taxes will fall, regulatory red tape will be unwound and infrastructure spending will surge. For now, investors have enthusiastically anticipated what they expect to come. Any or all of these actions are likely to positively impact earnings growth which would support stock prices at current levels. However, it would not be a surprise to see some turbulence in financial markets after the inauguration once the realities of governing are faced. We are not in the business of making predictions, but it feels very much like there has been so much anticipation of the Trump presidency, that any hiccups along the way toward implementing the Trump agenda will be problematic for the market. Until Trump was sworn in anything and everything was possible and investors have embraced what is to come. However, what is possible and what transpires are often very different, particularly in the messy world of politics.

Still, the turn in sentiment in the US has been profound. The National Federation of Independent Business optimism index in December saw its biggest one month increase since July 1980 and the University of Michigan Consumer Confidence index is at its highest level since June of 2004. Confidence in the economy has been sorely lacking since the recovery began seven years ago, and its recovery bodes well for the economy. With expectations running high, if the Trump economic agenda is passed in the coming months the stock market could move significantly higher just on enthusiasm alone.

Further support for equity markets comes in the form of earnings. Earnings growth returned to the S&P 500 in the third quarter for the first time in a year and estimates for the fourth quarter are rising. It is mid-way through this earnings announcement period and FactSet Research forecasts that fourth quarter earnings will grow by 3.4%. Rising confidence, political reform and earnings growth are a recipe for further gains in the stock market. There will be periods of turbulence and market dips that we will view as buying opportunities. Higher stock prices have led to a number of the portfolio's holdings approaching their price targets. Further gains may lead to higher than usual turnover as we reposition the portfolio in the first half of 2017.