A Trump Economy

RICK VILLARS, CFA

The following saying has become common in the aftermath of the election. "While Donald Trump's detractors took him literally but not seriously, those that elected him took him seriously but not literally." So his impact on the economy depends largely on which Donald shows up as President. The market seems to have responded to the kinder, gentler one that showed up for his acceptance speech. So we should start with the base case that the market is right.

While it is easy to project personal opinions on any analysis, it is far more effective from an economic and market standpoint to neutralize that opinion. The objective from an investment standpoint is to try to figure out what is likely to happen rather than what you think should happen.

Some of the policies that may have an economic and market impact are;

1. Anti-trade has been a cornerstone of his campaign and is heavy in his "First 100 day contract". Long-term this could prove to be significant problem, but short-term its impact might be muted. At least the market appears to think so.
   a. He has stated that day one he will declare China a "currency manipulator". By itself that does not have a huge economic impact except to create bad feelings with a trading partner that currently plays a large role in economy. But it gives his administration the power to declare tariffs on Chinese goods. The market seems to be indicating that he will be pragmatic about this and try to use the threat as a negotiating tool without ever actually implementing tariffs. I tend to think that may be the case because I am not sure what his proposed remedy would be. At the present time China is supporting their currency, which keeps it from falling faster. Ceasing to manage the Yuan would result in the currency dropping even further and faster, which is the opposite of his desired effect. Additionally, the effect of tariffs will raise the cost of goods for US consumers so following through with this threat in a dramatic way would highlight the downside of this policy platform. So short-term this negative might be deferred. But anti-trade is still a part of his platform so we should not expect it to just go away. It is still a long term negative.
   b. Renegotiating NAFTA is also a top priority in his stated plan. These negotiations would take time; therefore, it is unlikely to be a significant issue short -term. However, the long-term implications on supply chains for goods in the U.S. is problematic if the negotiations go poorly or President Trump chooses to withdraw from NAFTA. Article 2205 of NAFTA allows for a party to withdraw from the agreement with six months notice. It should be noted that the U.S. has not actually withdrawn from a trade agreement since 1866.

2. The President elect has proposed a number of spending plans.
   a. Infrastructure is high on his list and stocks related to this activity have rallied strongly. Near term spending is apt to disappoint the optimists as shovel ready projects are elusive and the most needed spending will probably take some planning. However, long-term investment is a positive ingredient for economic growth. Not only does it create jobs, but it also helps future productivity. I see this as more of a long-term positive than a short-term.
   b. Military spending is poised to rise. It is a priority for both the President and a Republican Congress.
   c. Energy infrastructure and looser policy is another expected initiative. Once again this is likely supported by a Republican Congress alignment. In some ways this will be self correcting. A large increase in energy spending will increase supply, pushing prices down. Oil and gas prices will have to stay high enough for this policy spending benefit to be fully realized.

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d. All three of these initiatives are likely to be put into policy. They may end up being a longer term business benefit as opposed to the quick boost that is currently expected by the market.

3. Aggressive Tax reform, including significant cuts, has been highlighted. There may be some easily passable provisions accomplished in the first 100 days, but comprehensive reform may prove to be a much longer negotiation than anticipated by the administration. These early reforms should be simulative. Long-term reform economic benefits will depend on the final form a full reform bill takes. The market likes the idea of tax cuts because they are stimulative. At least in the short-term.

4. Reduced regulation is also proposed to help streamline business activity.
   a. He has been a bit volatile in his views on financial regulation, in one speech pledging to repeal or revise Dodd-Frank, while in the next threatening to break up large institutions with a reversal of Sarbanes-Oxley. Short-term loosening of Dodd-Frank is likely as he believes it is holding back lending, which he feels is key to higher growth. Longer term it is not clear his views will always be bank friendly. So far the market really likes bank prospects.
   b. Repeal of the Affordable Care Act is controversial and he seems to have softened on his position a bit. While it has been an expensive proposition for businesses it is not clear what a replacement will look like. We suspect this will take more time to sort out than is currently being projected. The low hanging fruit for immediate actions on ACA would be purchase of insurance across state lines and elimination of the "minimum qualified plan provisions." The exact cost benefit of interstate purchasing is unclear but any changes to soften the minimum plan provisions will undoubtedly bring less expensive options to the marketplace.
   c. An initiative to reduce the number of regulations is part of his long term plan, but will probably not yield immediate business efficiencies.

The market has probably reacted appropriately to the potential for spending stimulus and reduced taxes in the short-term. Fiscal stimulus has been long overdue as far as the market is concerned. It may be disappointed in the magnitude realized in the near term. Longer term, there are still a lot of unanswered questions. President elect Trump apparently has long had protectionist leanings, which ultimately may result in damage to global trade and the supply chains that have become an integral part of business.

His policies are inherently inflationary. Tariffs and on shoring have the effect of increasing prices for goods. Fiscal deficits are a boost to the economy, but are often inflationary as well. If inflation begins to accelerate, especially wages, the Fed could get much more aggressive about rate increases. While the economy/ market can handle a rate normalization, if a tightening becomes too aggressive it may be a shock to the system.