Mitch on the Markets

How Should Investors React to Trump's Election?

By Mitch Zacks
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No matter who you supported this election, the last year presented perhaps the most grueling and polarizing campaign season in U.S. history. The mood of the country is flummoxed—are we feeling relief, anger, uncertainty, optimism, pessimism, hope, or despondency? It is an interesting time.

Depending on how you felt about the outcome, you may be expecting doom or gloom for the stock market in 2017. My guess is that very few people have a "business as usual" sentiment about the future of the economy and stocks right now. But you should! Here's why.

Forget about the Election for a Moment.

Let's instead return to the real business of forecasting stock prices and the outlook for the economy, by turning our attention away from politics and towards fundamental analysis. Studying fundamentals is wonderful for many reasons, not the least of which is that it is *non-partisan*, data-centric, and once you scrub the numbers, hopeful. Investors could use some of that.

First and foremost, the most underappreciated metric in the U.S. economy today: GDP growth. In the 50-plus years prior to the Great Recession of 2008, the United States grew an average of +3.5% per year. Over the past six years, that figure has dropped to +2.1%, which makes this economic expansion a favorite target for bears and politicians. But the simple fact remains: *growth is growth, and stocks respond to growth*. Zacks Investment Management (ZIM) expects GDP growth to rebound to above 2% in the second half of 2016 as personal income grows, households continue to spend, and firms stop reducing their inventory stocks. ZIM also anticipates that the weakness in business investment will come to an end, as the lingering effects of earlier dollar appreciation and lower energy prices dissipate – though slow foreign growth and trickle-through effects of Brexit may continue to pose a headwind. In all, ZIM expects GDP growth to be closer to trend in the 1.5% to 2% range in 2017 – modest, but still expansionary.

On the employment front, job readings have been sturdy throughout 2016. November's +166K reading was right in the wheelhouse for average growth on the year – in the 9 months through September, U.S. jobs readings averaged +178K a month. That's slower than 2015's +229K, but still quite ample this late in the cycle. These employment gains durably support real U.S. GDP in the +2% range. Once you get below +150K (a level that mostly eats up the annual 2.4-million-person growth in the 159 million strong U.S. civilian labor force), economists begin to worry out loud. Wage growth continues to trickle higher, so the impact to consumer spending may remain modest. Lower gas prices, persistently low interest rates, and personal wealth gains (largely from the stock and housing market) will likely do more to support spending.

The real kicker in our fundamental analysis, though, is earnings growth. Consensus sees -0.2% in EPS growth for 2016, which is disappointing but reflects the nagging Energy drag. 2017 is a different story, however, as consensus points to a "v-shaped" recovery of +6.1% for 2017 with robust revenue growth.

For many investors, these are just numbers on a page – I get that. At ZIM, our job is to pour over the data and analyze it for our clients. That's what they hire us to do. But in our recent Stock Market Outlook, we make mention of the strength in manufacturing and services surveys, both in the U.S. and abroad, particularly in Europe. The feature I find most fascinating about these reports (produced by ISM) are the industry quotes, which to me are the most telling of how things really are on the ground. I think you'll find a few of these interesting, too, and I'll leave you with these:

- "Domestic business steady. Export business trending higher." (Chemical Products)
- "Very favorable outlook in the market." (Computer & Electronic Products)
- "We are looking at a considerable slowdown for October and November. Production is down 20 percent." (Primary Metals)
- "Business is much better." (Fabricated Metal Products)
- "Strong economy driving steady sales." (Food, Beverage & Tobacco Products)
- "Due to the hurricane and other storms, our business is up significantly." (Machinery)
- "Ongoing strength seen in 2016 — it's a good year." (Miscellaneous Manufacturing)
- "Customers continue to press price reductions." (Transportation Equipment)
- "Our business remains strong." (Plastics & Rubber Products)

- "Hard to predict oil price dynamics, but there seems to be a consensus that the market is stabilizing, at least above USD 50 bbl this month." (Petroleum & Coal Products)

Bottom Line for Investors

Volatility in the aftermath of the election – in a positive or negative direction, because remember volatility works both ways – should not surprise you. After all, volatility is normal. So, I would caution investors against reading too much into what stocks do in the weeks or even months following the election. It's better, in my view, to focus on the fundamentals, and let the data do the talking.

Of course, the election outcome matters, because policy can shape how corporations and individuals make investment (and capex) decisions. But passing sweeping legislation is difficult, it takes time, the potential effects can only be assessed once the bill becomes a law. Until then, focus on what you know.

-Mitch

About Mitch Zacks

Mitch is a Portfolio Manager at Zacks Investment Management. Mitch has been featured in various business media including the Chicago Tribune and CNBC. He wrote a weekly column for the Chicago Sun-Times and has published two books on quantitative investment strategies. He has a B.A. in Economics from Yale University and an M.B.A in Analytic Finance from the University of Chicago.