

Mitch on the Markets

Post-Election Shock: What Should Investors Do Now?



By Mitch Zacks
Portfolio Manager

The United States shocked the world and just about every pundit and pollster with the election of Donald Trump as the 45th president. But the reality is: *maybe no one should have been surprised at all.* If you consider Brexit and the rise of populist movements across Europe, it is clear that citizens of developed nations are fed up with what they increasingly see as ‘empty’ promises associated with globalization and economic cooperation amongst nations. Governments in developed nations have failed to adequately explain the benefits of trade, and more importantly, have failed to ensure that offshored jobs are replaced with new training and job opportunities for the displaced. The fruits of trade have not been distributed to low-skilled workers, and in the case of the U.S. election, that segment included more people than anyone anticipated.

I’ll come right out and tell you my investment advice: *stay put.* I would encourage investors to maintain maximum equity exposure pursuant to your investment objectives and risk tolerance. That was my advice to start 2016, and it remains my advice today. Economic fundamentals both here and abroad support that approach, in my opinion.

President-elect Donald Trump has the opportunity to make some constructive changes, but at this stage it is merely talk. Governing is much, much more difficult than campaigning. New presidents often learn quickly that policies presented on the campaign trail have to be watered-down and negotiated considerably if they stand a chance of surviving the crucible of Congress’s legislative process. Republicans control the White House, Senate, and House of Representatives, so the mandate and opportunity to legislate exists, and we expect significant policy changes as a result. But a smart investor, in our view, will make portfolio adjustments on known

quantities – not on speculation. If you consider how much a policy proposal can change before becoming law, it makes sense to wait.

Patience is the Right Investment Approach, but *the Analysis Starts Now*

President-elect Trump will likely have the ability to advance at least versions of his ideas. So, we think it makes sense to start considering what the macroeconomic effects might be. The tax cuts and spending increases that are likely to be passed would tend to boost near-term growth, inflation, interest rates, and the dollar. These benefits, however, assume we avoid large increases in tariffs and any related trade war – a major uncertainty.

Still, the base case for taxes going down and spending going up should be stimulative in the near term. Given the economy is near full employment, however, it also suggests higher rates and higher inflation, both of which could adversely impact the consumer.

Three sectors we think could be particularly affected by Trump's intended policy shifts are Financials, Energy, and Infrastructure.

- **Financials** – Financials rallied in the days following the election, perhaps in anticipation of less stringent regulation and higher rates under a Trump presidency. Republicans in Congress and Trump have argued that Dodd-Frank should be repealed or

significantly modified, and that would include eliminating or weakening the Consumer Financial Protection Bureau and potentially lifting the SIFI designation for regional banks. Rolling back such policies could result in a tilt towards tighter monetary policy and more market volatility, but the medium term impact to Financials would be positive.

- **Energy** - Trump has made it clear that he intends to promote domestic energy production and rollback the Obama administration's aggressive stance toward fossil fuels. The near-term macroeconomic effects are likely to be positive, with increased output of oil and gas, higher employment in related industries, and higher exports of refined products and possibly crude oil. The supply and demand dynamics in the oil and natural gas sector, however, still do not indicate much higher price points, thus limited the earnings impact.

- **Industrials** – Trump's initiatives to substantially increase infrastructure spending should provide a tailwind for companies in the Industrials sector and provide a small boost to GDP.

The biggest macroeconomic risk we see today relates to trade policy. The president has enormous power to alter trade policy unilaterally, which means that Trump's hard lines on threatening large tariff increases and withdrawal from trade agreements are possible and perhaps even likely. President-elect Trump will likely receive strenuous

pushback from Congress and business leaders, but it remains to be seen what line he actually takes. Tariff increases would effectively fall on domestic consumers and businesses, amounting to a large tax increase. This would add to inflation, disrupt supply chains, and generally reduce profits for global firms impacted by any new tariff regime. It is perhaps the most critical macroeconomic factor to watch.

Bottom Line for Investors

For the very near term, increased policy uncertainty is likely to restrain growth, or at least increase downside risks. This slightly lowers the odds of a December tightening, but we believe the path to normalizing interest rates is upon us given strong employment gains and the likelihood of increased spending in the New Year. While a decline in personal tax rates could be made retroactive to January 1 and impact growth that year, most of the other parts of the fiscal policy proposals most likely will not be seen until fiscal 2018. Nevertheless, once enacted, they likely would give growth a boost. The effects of changes to energy policy, i.e. contributing to stronger growth, could also be felt in 2017.

At the end of the day, however, this is all hypothetical until we know what policies are proposed and how they ultimately take shape once negotiated in Congress. Until then, it makes sense to hang tight, and maintain an optimistic near to medium-term view for equities.

-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.



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