AFTER THE ELECTION

We can break this down into four parts and describe how each may impact specific asset classes and market sectors.

INFRASTRUCTURE

Both candidates for president discussed the need for infrastructure spending while on the campaign trail. Even Federal Reserve board members have been vocal about getting more fiscal spending to help with the economy’s meager growth rate. Recently, Fed Governor Evans asked “Infrastructure spending is something it strikes me we need to do anyway, so why not do it when interest rates are low?” The question really is: How much spending will there be and how quickly can the dollars be spent wisely?

During the campaign, Donald Trump indicated that he was in favor of $550 billion in spending on infrastructure. It is not likely that this would be spent in year one because it will take some time to approve and there aren’t likely that many “shovel ready” (yes, that phrase is back) projects. Let’s say it is split across all four years of the administration’s term. Using the estimate of $19.895 billion for the 2018 fiscal budget, we would see a .7% increase in GDP growth each of the next four years.

Spending would include the likes of roads, bridges, airports, and schools. Stocks that benefit from an increase in this kind of spending rallied hard last week. As an example, concrete firm Vulcan Materials was up over 10%. Engineering and construction firms will also likely be beneficiaries regardless of the size of the

As individuals we can be political. As investors, we cannot be partial to political parties; rather it is important to understand how the changing political landscape will impact our investments. We need to think about how the recent elections may transform the landscape for public policy, and what impact that could have on global markets and our investment decisions.

There are two things that make the process more difficult this time around. First, we have a President-elect who has never held public office and we need to discern what may be the difference between his campaign rhetoric and his policy. Also, while the Republicans have managed to gain control of the White House and both Houses in Congress, there are substantial policy differences within the party (keep in mind they started with 17 presidential candidates). In addition, the Democrats retain a meaningful number in both Houses of Congress and will present vocal opposition to Republican prescriptions for policy change.

Still, the President-elect has talked about almost $4 trillion worth of fiscal stimulus in the form of infrastructure spending and lower taxes. Sorting out the potential winners and losers is something the markets are good at over time. However, a note of caution: The markets’ reaction during the last week of trading may, in some cases, have been an overreaction and in others, too muted. Time will tell. Here we take a look at what we know and discuss how markets may be affected by the heavily unanticipated sweep by Republicans.
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program that is finally approved. Equipment makers like Caterpillar and engine manufacturer Cummins would also benefit.

It will be critical to see how the spending is paid for. Remember, there are plenty of “Tea Party” Republicans still in office and focused on smaller government and lower deficit spending. As a result both Trump and those Republicans in favor of an increase in spending will have to come up with a way to pay for this plan. One option could be a temporary increase in the gas tax. Suffice to say, that while Democrats will be in favor of the increase in spending, not everyone will be in favor of raising the deficit.

REGULATION

One of Trump’s first acts will be to remove those executive orders that created an increased burden on organizations in the form of regulation. The likely sectors that benefit immediately are the carbon based energy industries including those companies in the coal business, natural gas production and oil exploration and production.

Reducing regulation should allow the building of natural gas exporting infrastructure to move forward at a faster clip providing new markets for fuel and raise prices.

Trump and the Republicans will favor energy independence over a greater reliance on renewable energy sources. During the campaign, Trump suggested that government spending on renewable research would end and only private sector investment would be encouraged. At the same time, he indicated that he would maintain a policy of keeping public lands open to exploration and make it easier for frackers to continue to build out their infrastructure.

Financial services is the other industry that will benefit -- possibly for two reasons. First, it is likely that the Dodd-Frank legislation that has hindered the financial industry’s growth since it was passed in 2010 will be reviewed. In spite of the fact that many conservatives have called for its repeal, this isn’t likely. While spending policies can be passed with a majority in the Senate, regulatory legislation would likely require 60 votes to overcome the filibuster. The Republicans have 52! Still the environment for financial regulation should improve.

The cost of the regulatory burden has reduced the return on equity for the industry. The new environment may make banks and insurance companies able to return to a double digit ROE in the next several years.

The other potential benefit for financial services companies could come from higher interest rates. If the new administration is successful in passing its proposed tax cuts and infrastructure spending, that could raise the specter of inflation which may cause interest rates to move higher. This would improve profitability, particularly for banks and insurance companies.

TAXES

Trump and the Republicans are in favor of lower taxes. Both the President-elect and the Speaker of the House have put plans forward that describe their view of what tax reform should look like.

Again, keep in mind that the Republicans have a slimmer majority in the Senate and the House and tax policy change is among the most difficult to make.

Both policy prescriptions suggest a less complicated tax structure with only three tax rates, the highest being 33%. In addition, Trump has suggested a tax cut for everyone, regardless of income. Both policies also call for the elimination of the estate tax and a reduction in the top rate small businesses would pay.

However, the cost of the Trump tax program is almost $1 trillion per year. Of course, the notion is that a reduction in taxes would increase consumption and business investment raising the economic growth rate. The question is: Can it raise the growth rate enough to pay for the tax breaks? The government’s budget office suggests that the resulting growth would increase by 1 to 1.5%. That would only add approximately $180 to $190 billion per year, short of the increase needed to offset the cost of the relief program.
As mentioned earlier, given the large contingent of ultra-conservatives in the House, any increase in deficit spending, even if it comes in the form of tax breaks will likely be watered down by the time it passes.

Small business owners will be beneficiaries in any case. The reduction in their taxes should improve the outlook for employment growth as well as the type of consumption seen by those who own these businesses. Small cap companies should benefit from these changes as well.

**TRADE**

Ripping up 20 year old trade agreements, building walls and labeling countries “currency manipulators” can get someone elected. However, if the policy prescriptions the Trump administration follows includes some of the more draconian prescriptions mentioned, then unlike the three aforementioned areas which were good for economic growth, this one could be very negative.

Global companies in particular would have a difficult time investing in their businesses and growing overseas if the policy landscape became very uncertain. The largest companies in the U.S. would find themselves unable to manage their business risk in the uncertain environment and that would likely not be good for those stocks.

However, it remains to be seen if the promises made on the campaign trail and the decisions made in the West Wing of the White House produce the same policies, so we should be cautious jumping to conclusions about the impact of trade policies. This will be an area the new administration focuses on quickly though, so we will get some insight into what reality looks like in the first quarter of next year.

The asset class that seemed most affected by the outcome of last week’s election was bonds. The yield on 10-year Treasuries rose over .4% driving prices lower. It seems that bond investors will see bigger deficits and faster economic growth resulting in higher inflation from the infrastructure and tax cut policies that are potentially in our future. However, as mentioned earlier, we need to be careful to assess policies as they near completion and are released to determine just how much of an impact they will have. Keep in mind the comments made by Fed governors mentioned earlier this year. They have been looking for some help from the fiscal policy makers, i.e. Congress and the administration, to provide some additional stimulus for the economy. They may have their wish in the outcome of last week’s election.

The markets will react and overreact as policies are debated and become clearer. We will continue to monitor the outcomes and the potential impact on asset classes and market sectors to determine who might be the winners and losers, and adjust our strategy accordingly.

As Chief Investment Officer, Brian Andrew leads Johnson Financial Group’s investment strategy to provide consistent, actionable investment solutions for our clients.