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Our First Take on "Trumponomics"

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> "Our clients' portfolios remain mildly pro-growth. The results of the election have not changed our views materially, but we have made some modest changes to take advantage of various trends we see unfolding. Relative to benchmarks, our portfolios have continued to perform well since the election and we expect that trend to continue."

On November 8, 2016, Donald J. Trump was elected President of the United States, a historic moment in American politics. Trump is the first person elected president without any government or military experience.

By taking votes from traditional "blue" Midwest States like Wisconsin, Trump surprised pollsters, forecasters, and commentators, who had assumed that voters would favor caution over uncertainty.

With Republicans now in control of the U.S. Senate and U.S. House of Representatives, many sweeping changes could come to pass. And with only a few seats to defend in the Senate in the 2018 mid-term elections, the Republicans may well stay in power at least until the 2020 general election.

Many of Trump's policy positions during the campaign still lack detail, but areas such as taxes, infrastructure, immigration, energy, healthcare, trade, national security, and regulation may see significant changes. Trump hasn't been a unifying figure inside the Republican Party and has alienated factions of the political establishment during his campaign. Only time will tell if the Republicans can work together, among themselves or with Democrats, to get things done, but so far, conciliatory talk from Donald Trump and early selections for his cabinet have been encouraging.

This article will focus on the key issues that could have implications for investment portfolios.

Tax Reforms

During his campaign, Trump proposed substantial cuts to corporate tax rates (from 35% to 15%) and personal tax rates (taking seven tax brackets to three). He also proposed a one-time repatriation holiday of U.S. corporate earnings trapped overseas. Common ground may be found among politicians in this area but many "establishment" Republicans are deficit hawks and may object to unfunded tax cuts.

Infrastructure Spending

The Trump campaign promised $1 trillion of infrastructure spending (over an unspecified time frame). While details have not been given, it has been estimated that this could add at least half a percentage point to GDP annually for years to come.

Federal Reserve
Trump has been critical of the Federal Reserve policy, claiming that rates have been kept low for "political reasons" and that low rates have created "bubbles". Federal Reserve Chairman Janet Yellen is expected to stay until the end of her four-year term (in Q1, 2018), but with two seats on the Federal Open Market Committee yet to be filled, inflation hawks may be given priority. That could force the Federal Reserve to raise rates sooner and more aggressively than currently priced in by the markets.

Trade
Trump's view that globalization is to blame for job losses and low wages certainly resonated with blue-collar white voters during the campaign. To combat globalization, Trump has suggested increasing tariffs, shredding trade agreements, and accelerating deportations. These actions would hinder, not advance, prosperity, in our opinion. First of all, protectionist policies toward our trading partners could well lead to retaliation and trade wars. Secondly, protecting domestic companies and workers at the cost of higher consumer prices and larger government subsidies may not be ideal.

Trade is a wild card, mostly because presidents can use executive directives to take wide-ranging actions without congressional support.

Market Reactions and Portfolio Implications
Our clients' portfolios remain mildly pro-growth. The results of the election have not changed our views materially, but we have made some modest changes to take advantage of various trends we see unfolding. Relative to benchmarks, our portfolios have continued to perform well since the election and we expect that trend to continue.

Here is a recap of how markets have reacted to the election results so far.

Bonds
Bond yields rose substantially in the days following the election, especially for longer maturities. Pro-growth initiatives dependent on fiscal stimulus (infrastructure spending and tax cuts) are inflationary and debt/deficit unfriendly. Therefore, they are negative for bonds.

Inflation-protected securities, short-term bonds, and senior bank loans are the three largest allocations in the fixed-income portion of our clients' portfolios. As a result, our clients are well positioned for an environment characterized by higher inflation and higher interest rates.

Equities
The biggest surprise after Trump's win was how quickly equities shrugged off losses of about 5% in the early morning hours of trading following the election results.

In the days following the election, the sectors most sensitive to rising interest rates - real estate, utilities, telecomm and staples - sold off sharply. Because these sectors have been used in recent years as bond proxies by investors searching for yields, they were overvalued and therefore subject to a sell-off. Our clients' portfolios have underweight positions relative to the benchmark in all four of those sectors.

In coming days and weeks, much will hinge on the market's evaluation of key cabinet appointments (in particular Treasury Secretary), as well as appointments to the Council of Economic Advisers and trade-related staff positions. The people chosen to fill those roles should give us a better sense of what Trump's real policy priorities are.

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