BALLENTINE PARTNERS

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The Trump Rally—Impressive, but selective

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Since Donald Trump's upset victory in the 2016 Presidential election, financial markets have been on a tear. Or have they? A casual observer of the business press would probably conclude that stocks and bonds around the world are rallying around President-elect Trump's pro-growth, business-friendly, tax reform policies designed to "make America great again." The reality, however, is somewhat different.

While US stocks (as measured by the S&P 500) have risen 7.1% since the election, the rally has been concentrated in just a few sectors viewed as benefiting the most from Trump's expected priorities. (All performance data is as of December 13.) The prospect of faster growth and higher interest rates has been a boon to financial stocks, which have lagged the market for most of 2016. The financial sector ETF is up almost 15% since the election. Another big winner has been the energy area, as Trump has nominated several individuals with a decidedly pro-fossil fuel bent to a number of key administration positions.

On the flip side, both technology stocks (viewed as more highly exposed to a potential trade war as a result of their large overseas operations) and health care stocks (impacted by Trump's plan to eliminate Obamacare and a tweet from the President-elect about his concern over the high cost of drugs) have posted only modest gains. Income-oriented sectors such as utilities, telecom, and REITs have also lagged.

Outside of the US stock market, returns were more mixed. The sharp rise in interest rates since the election led to the worst monthly performance for bonds in more than a decade. Municipal bonds, impacted by the double whammy of higher interest rates and the likelihood of lower tax rates next year (making them relatively less attractive versus taxable fixed income) were hit especially hard.

A stronger US economy is likely to attract foreign capital flows, putting upward pressure on the US dollar. This, in turn, increases pressure on foreign corporations with large dollar-denominated liabilities and limited US revenues to service this debt. In addition, ongoing worries about the stability of the European Union since the resignation of the Italian Prime Minister and renewed concerns over the decline of Chinese foreign currency reserves have tempered interest in international stocks. That would account for the relatively weak showing from developed and emerging market equities since the election.

So where do we go from here? Our view is that the US stock market basically has it right in favoring those sectors that will flourish under a Trump administration. But we are concerned that the market is pricing in a host of future events that are likely to be late in coming, if at all. Tax cuts for businesses and consumers are likely to pass, but the actual economic impact may not be felt until 2018. Trump's plan for a large boost in infrastructure spending is likely to meet significant resistance from deficit hawks in his own party. And his plan to stem the tide of immigration may actually lower the potential GDP growth rate by limiting the pool of available labor.

On balance, we believe the US stock market is poised for further gains in 2017, but the road ahead is likely to be bumpy and uneven. Bonds are facing significant headwinds from the threat of higher inflation and the Fed's attempts to limit it by raising short-term rates. Expectations are low and valuations are reasonable in selected emerging markets. If Trump's protectionist tendencies can be stifled by Congress and the dollar stabilizes, we could see a strong year for emerging market stocks. In any case, the dramatic policy shifts in Washington are likely to make for a very interesting year in financial markets.

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Bruce rejoined Ballentine Partners in June 2016 as Managing Director and Director of Portfolio Research after more than 5 years as Chief Investment Officer of City National Rochdale, LLC, in Los Angeles. City National Rochdale, a wholly owned subsidiary of City National Bank, serves family clients across the United States with a staff of nearly 100 investment professionals. Before moving to Los Angeles, Bruce served as Chief Investment Officer of Ballentine in our Waltham office for three years. Prior to that, Bruce spent four years with Morgan Stanley Private Wealth Management in New York and eight years with Glenmede Trust in Philadelphia as Chief Investment Officer and Portfolio Manager. Bruce received an MBA with a concentration in Applied Economics from George Washington University and a BS degree in Business Administration from Penn State University. In addition to working directly with a number of family clients, Bruce serves on the Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. Bruce holds the Chartered Financial Analyst (CFA) and the Certified Private Wealth Advisor (CPWA®) designations. He lives with his wife in Palm Beach Gardens, Florida.