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Investing in the Age of Trump

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Whether you love him or hate him, it is hard to deny that President Trump has an operating style that is unlike any president who came before him. Investors generally hate uncertainty, and Trump's unpredictability would seem to be a depressant on investor optimism. Yet the S&P 500 Stock Index has returned about 33% since the 2016 election, confounding the analysts who foresaw doom and gloom in an upcoming Trump administration. While Trump apparently views the stock market as a report card on his performance, he has shown no reluctance to press for policies that have rattled investor confidence. Given these countervailing forces, a number of our clients are asking the question: is Trump good or bad for investors?

On the plus side, the tax reform bill passed in late December has been an unalloyed win for market participants. By slashing the marginal corporate tax rate from 35% to 21%, corporate earnings forecasts for 2018 have swelled from 12% year-on-year growth to 19%. First quarter actual earnings clocked in even higher, at an impressive 24%. The big boost in earnings growth has lifted investor confidence and substantially reduced the overvaluation problem faced by US equities at the start of the year. At the same time, real GDP forecasts for the US economy have been drifting up. Full year forecasts are now in the 2.5-3.0% range, with Q2 looking to be close to 4%.

Individual taxpayers are facing more of a mixed bag. While marginal rates were indeed lowered, other tweaks to the legislation, such as the limit of $10,000 on the deductibility of state and local taxes, could result in increased taxes for residents of higher tax states. Nonetheless, retail sales are showing strong gains this year, no doubt in part due to a bump in take-home pay from the lower rates and record-low unemployment.

The other factor that is contributing to investor optimism is the Administration's efforts to roll back regulations on businesses. While the size and scope of these efforts and their long-term impact on consumers and the environment is a subject of some debate, the perception is that these rollbacks are market-friendly. Less regulation means lower costs for businesses.

By far, the most potentially damaging action by the Trump administration for investors is its trade policy. In theory, a realignment of trade agreements with our global trading partners could make American businesses more competitive in the global marketplace and return manufacturing jobs to our shores. Reality is much more complex. Most economists view protectionist actions as a negative for global growth, as it can reduce efficiencies in the system, increase domestic inflation, and encourage retaliation on the part of our trading partners facing tariffs on products imported into the US. Longer term, it could force manufacturers to relocate plants or ship goods through circuitous routes to avoid paying tariffs. So far, the impact on global trade has been limited, but the impact is becoming more visible. For example, the Trump administration's imposition of a tariff on imported washing machines back in January has resulted in a 14% increase in the CPI for laundry equipment, after 5 years of steady declines. At this stage, it looks like tit-for-tat protectionist policies are accelerating, increasing the risk to the global economic outlook.

As the world's largest economy and with a relatively low dependence on trade for growth, one could argue that our major trading partners have far more to lose in a full-blown trade war than the US. That seems to be this Administration's strategy. Only time will tell, but judging from past episodes, enacting barriers to trade has not been good for any of the affected parties.

From an economic standpoint, Trump's tough stance on immigration is another negative for economic growth, since it reduces the pool of available labor in an economy with unemployment at all-time lows. Nonetheless, if as he suggests, a crackdown on illegal immigration results in a reduction in crime, that could be a positive for economic growth.

So far, the benefits of lower taxes for corporations have won the day in investor minds over the growing threat of a trade war. But as the economic jolt from lower tax rates diminishes, the spectre of higher federal deficits loom, and the animosity toward our traditional allies increases, the tide could turn. As President Trump likes to say, "We shall see".

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Bruce is a Partner and Director of Research at the firm. Bruce rejoined Ballentine Partners in June 2016 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 in Philadelphia as Chief Investment Officer and Portfolio Manager. In addition to working directly with a number of family clients, Bruce serves on Ballentine's Investment Management Committee, which is responsible for the oversight of all of the investment activities for the firm. 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. 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.