Navigating the Course Ahead

Post-Election Playbook

November, 2016

November of 2016 is a month people will be talking about for a long time. It started with an instant-classic World Series in which the Chicago Cubs broke their century old "Curse of the Billy Goat" while the Indians remained mired in their "Curse of Rocky Colavito" (it's a thing, you can Google it). Then, as if that weren't enough, Donald Trump rocked the world with his stunning upset over Hillary Clinton and the entire political establishment. All of this begs the question "Now what?!".

The financial markets initially reacted to the Trump victory with resounding disdain. Overnight, S&P 500 futures traded down 5%, the maximum after-hours loss allowed by the Exchange. Dow Jones Industrial Average futures were down as much as 800 points. Then, Donald Trump hit the podium to give his acceptance speech. Perhaps like the Grinch whose heart "grew three sizes" on Christmas morning, the Trump who emerged had evolved from the brash, egomaniacal, combative candidate into a much more conciliatory, rational, and calming President-Elect. He acknowledged a debt of gratitude to Secretary Clinton for her years of service. He spoke of binding wounds, uniting together and leveraging the talents of others. At times he even sounded a bit Reagan-esque with talk of fiscal spending to rebuild schools and the infrastructure to put "millions" back to work and "double" our economic growth rate.

Clearly a lot of uncertainty remains. Will the evolution from President-Elect to President follow the same path of maturation or will "The Donald" re-emerge? What will his polices actually look like, and how successful will he be in getting them through a Congress which is now controlled by (theoretically) his own party? Only time will answer those and many other questions, but at least initially, his acceptance speech seemed to spark a wave of optimism that turned the markets around. From trough to peak, the Dow swung almost 1,200 points and the S&P traversed over 7% as both erased overnight losses, opened relatively flat and closed the day up over 1%.

Since the election, there has been a turbulent rotation of investments as portfolios get repositioned for the new spend and grow regime. Mr. Trump's policies are estimated to boost the economic growth rate by 1.5% over the next two years, in line with his "double" comment in the acceptance speech. They are also expected to add $4.6 trillion in debt over the next decade (the speech writers forgot to mention that). As a result, in the days following the election, global equities have added roughly $1.3 trillion in market value while global bonds have lost $1 trillion. The other $300 million likely came from cash which wouldn't even make a ripple in the $13 trillion Sea of Liquidity that remains on the sidelines. This is a dramatic directional reversal from the last several years. The question is whether the spirit of growth and optimism will gain traction and continue this trend.

We have developed our own strategies to navigate the new environment. We have ridden the Trump wave with some positions already, and are finding significant value in other areas which were left deserted after the tide rushed through. Some specific thoughts are outlined as follows:

Despite the more sanguine tone of the acceptance speech, global political tensions remain elevated.

- Everything from trade deals to immigration to financial assistance is on uncertain ground.
- The defense sector is the likely beneficiary. President-elect Trump will push to eliminate the sequester on defense spending and increase the number of troops, weapons and technology.
- We have had an intentional overweight to companies in this industry for some time but are even more bullish now.

Increased Federal spending on the infrastructure is overdue and benefits the heavy industrial and construction industries.

- This sector was one of the first and most dramatic beneficiaries of the recent market rotation.
- We increased exposure initially, but have stepped back a bit to wait for the names to settle as the short term move may have over-shot the longer term benefits.
- A group that benefits from increased infrastructure spending and from a tougher stance on foreign competition is the domestic steel industry. We like that double-barreled catalyst.

Less suffocating regulation and a steeper yield curve create a double tailwind for financial stocks.

- As the yield curve steepens, it becomes easier for banks to earn a spread by collecting funds with low deposit rates and lending them at higher commercial and personal loan rates.
- Insurance companies also benefit as they can invest their cash to meet long term obligations at higher rates.
- Increases in mergers and acquisitions benefit the investment banks.

There is now less pressure on drug prices than the market priced in with Hillary.

- Pharmaceutical and biotech companies got a reprieve as onerous legislation expected under Clinton will not come to pass.
- Conversely, uncertainty arises over what changes will take place to Obamacare and what the impact will be on the number of people insured. Changes are unlikely to come soon but this battle will create volatility in the sector in the months ahead.
- We see a larger trend in place in the move toward a “pay for results” environment as insurance payers demand more accountability and cost control. This increases the focus on improving the patient experience, lowering costs, and improving the eventual outcome. Stay tuned for opportunities as the landscape continues to shift.

The priority of energy independence means loser constraint on domestic drilling.

- This likely keeps oil prices in the $40-$60 range as the US increases its capacity and supply.
- Recovery in pipelines, storage tanks, and other energy infrastructure has flattened out since this summer. This may prove a catalyst.
- Clean energy companies will suffer if federal subsidies cease. The President-elect is unlikely to continue spending to solve a problem he believes is a hoax.

Small caps have rallied even stronger than large caps yet still look attractive.

- A more business friendly environment will benefit small companies.
- In general, small companies have less exposure to global complications and fluctuating currencies.
- A steeper yield curve incentivizes banks to become more willing lenders, potentially making more liquidity available to smaller companies.

A tax break to bring cash back onshore would benefit shareholders of multinationals.

- In 2004, when corporations were last given a tax holiday to repatriate cash they brought $300 billion back to the states.
- US multinationals now have roughly $2.5 trillion in foreign earnings parked overseas.
- Like in 2004, much of the repatriated cash would be returned to shareholders in the form of higher dividends and increased share buybacks.
- Mergers and acquisitions would also pick up, particularly in the healthcare and technology sector where foreign cash is the highest and buying the cutting edge is often cheaper than developing it.

Growth stocks have been oversold, FANG and other quality stocks have been left behind and now look attractive.

- Since the election there has been a dramatic rotation out of the previous market leaders (Facebook, Amazon, Netflix and Google).
- This creates opportunity in these names and others which will continue to grow their earnings and are now at discounted prices.
- Looking behind the wave often allows us to find the best shells.

In times of conflict and uncertainty, investors seek a safe haven.

- The conclusion of the election has removed one form of uncertainty leading to the recent rally.
- To say that uncertainty has been removed all together with Mr. Trump is an overstatement. To think this will be a bump-free transition seems Pollyannic.
- Traditional safe havens included gold, the U.S. dollar and U.S. Treasury obligations.
- Volatility in bond prices and increased debt on the U.S. balance sheet suggest that gold may reign as the safest game in town.
- We still have some inverse investments in place to protect the downside.

Interest rates have risen dramatically in a short time. Current selling may be overdone, but the bond bull market is over.

- The yield on the 10 year Treasury has jumped from 1.8% at the beginning of the month to 2.3%, an increase of over 25% in 12 trading days.
- This has only gotten rates back to where they were a year ago, wiping out this year's bond market gains. There is more to come just to get back to "normal".
- Improved growth and increased debt point to higher rates in the future.

- President-elect Trump is not a fan of Fed Chair Janet Yellen. Rhetoric over replacing her could cause additional volatility in the bond market.
- We have been "early" in positioning portfolios for higher rates but are not getting any less defensive now.
- Bonds and high-dividend stocks that act like bonds have experienced a strong bull market for quite a while. The tailwind of falling interest rates is over. While the current selloff may be overdone near-term, this is not a wave which will reveal many attractive shells.

<u>Markets are currently underpricing inflation, time to add commodities.</u>

- The price of many commodities has been decimated.
- The incredible amount of liquidity generated by global central banks will eventually work its way into real assets.
- Decreased production has led to less over-supply.
- Trump's spend and grow policies and his protectionist approach add to the likelihood of higher inflation.

November likely marked a paradigm shift in the investing landscape. Individual investment selection has become even more critical as winners and losers become more pronounced. Markets are less likely to strongly lift all boats. New opportunities and pitfalls are taking shape. It has become increasingly critical to recognize both to take advantage of the upside while managing and mitigating risk.

StreamSong clients benefit from our experience as professional fiduciary investors. Thanks to our partners at TDAmeritrade and Schwab Institutional we offer the resources and fortress like safekeeping of large institutions. At the same time we bring the experience, agility and independence of a boutique. Case in point, you may have read many other prognostications regarding the new environment. But, how many mentioned Rocky Colavito?