Beacon Trust

Guiding you forward.

Comments on Market Movements After The November 8th Elections November 21, 2016

Introduction

The proverbial dust has begun to settle following the surprising results of the November 8th elections in the United States. Most pollsters were caught off guard, not only by Donald Trump's victory, but also with the Republicans completing their "sweep" by maintaining majority control in both the U.S. Senate and House of Representatives, collectively known as Congress.

During the early morning hours of November 9th, as the election results became clear, S&P 500 stock index futures plunged 5%. Investors generally dislike surprises be they of the financial or political variety, since risk is often increased. But, by the end of the trading day, stocks reversed course and *increased* in value. Within a week most domestic stock indexes were at or near all-time highs.

On the other hand, bonds plunged in value, shrinking their gains for the year, and face a real prospect of having their remaining gains turn into losses by year end. The purpose of this note is to attempt to explain some of these volatile market movements and to analyze some of the potential economic implications of the new political regime.

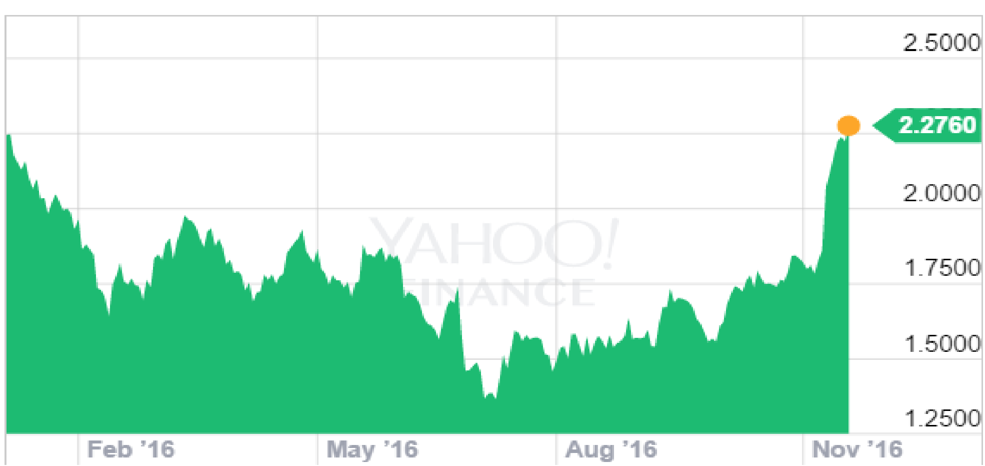
Stocks Surge, Bonds Plummet

The surge in domestic stocks may be explained, in part, by several factors. First, President-elect Trump made some conciliatory statements in his victory speech, and, in subsequent interviews, potentially softening his hardline stance on several economic and social issues. Second, President-elect Trump's economic proposals, if passed by Congress, contain several bullish features for stocks, at least in the short run.

For example, his plan calls for a drastic reduction in the corporate tax rate from 35% to 15%. Personal taxes for most individuals would also be slashed under his proposal, resulting in more consumer spending and ultimately higher corporate profits. His plan also calls for a reduction in business regulations, another bullish feature for most stocks. Additionally, President-elect Trump has proposed a large increase in government spending on items such as infrastructure and defense.

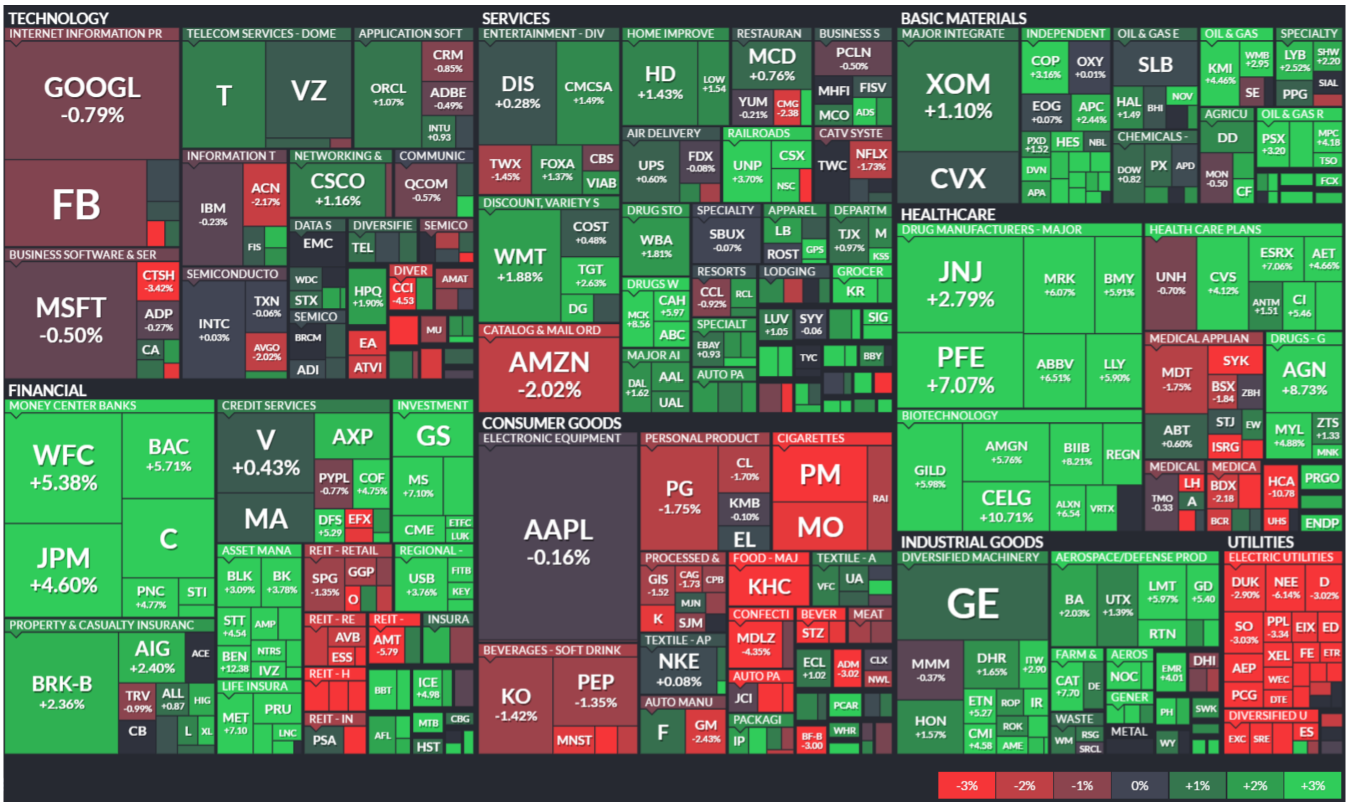
However, some of the factors that may be good news for stocks, such as increased consumer and government spending, may be bad news for bonds. A stronger economy, especially one fueled in part by deficit spending, may result in higher interest rates. Interest rates have surged since the election, with the benchmark 10-Year Treasury Note now at its highest levels of the year, as shown in **Figure 1**. Federal Reserve Chairperson, Janet Yellen, has also given strong signals that short-term interest rates are poised to rise after the December meeting. In short, some headwinds may be emerging for the bond market, after relatively smooth sailing since the early 1980s.

Figure 1: 10 Year Treasury Note Yield, January 1 – November 17, 2016



Source: Yahoo Finance!

The increase in domestic stock prices, in aggregate since the election, masked the substantial volatility that occurred beneath the surface. The market appears to be in a process of sorting out potential winners from losers under a Trump presidency and Republican controlled Congress. Winners in the brief period since the election include Financials, Healthcare, Defense and Infrastructure related companies. Losers appear to be interest rates sensitive securities, such as Utilities and Real Estate Investment Trusts (REITs). Stocks that obtain a significant percentage of their profits from overseas, such as Technology and Consumer Staples firm, have also underperformed since the election. This intra-market rotation may clearly be seen in the "heatmap" of the S&P 500 on the day after the election **Figure 2** below.



Source: Finviz.com

What Might Be Next For Beacon Portfolios?

We believe it is important to emphasize that proposed economic plans often do not turn into *realized* economic plans. Much of the political process of creating bills, laws and budgets is a product of compromise. So despite the Republic controlled Congress, there is no assurance that President-elect Trump's economic proposals, summarized in the **Appendix**, will be implemented. It will take months before any plans are approved, and perhaps years before they are fully implemented.

However, *directionally*, we believe it is likely that some measure of tax and economic reforms will be implemented. In general, they appear to favor an increased allocation to equity-oriented investments and perhaps a scaling down of traditional, fixed rate, fixed income securities. Our Investment Committee and Portfolio Managers are actively engaged in the process of analyzing the implications of the election results and expect to implement any changes by early next year. In the interim, if you have any questions, please feel free to reach out to any member of your Beacon team. We wish you and your family a Happy Thanksgiving.

Appendix

Summary of President-Elect Donald Trump's Tax Proposed Tax Plan

Tax Philosophy	Cut taxes for everyone
Tax Brackets - Ordinary Income	Three - 12%, 25%, 33%. Earlier proposal: 10%, 20%, 25%
Tax Brackets - Investment Income	Three - 0%, 15%, 20%
Net Investment Income Tax	Repeal
Estate Tax	Repeal
Gift tax	Repeal
Impact on GDP	Positive 11% (as estimated by the Tax Foundation)
Impact on Job Creation	Positive. 5.3 million new jobs (as estimated by the Tax Foundation)
Impact on Government Debt	Negative. $10 trillion higher government debt (as estimated by the Tax Foundation)
Impact on Wages	Positive. +6.5% wage growth (as estimated by the Tax Foundation)
Biggest Beneficiaries	High-income earners

Source: Diffen.com

Economic Related Issues From President-Elect Donald Trump's 100 Day Plan

The business tax rate will be lowered from 35 to 15 percent, and the trillions of dollars of American corporate money overseas can now be brought back at a 10 percent rate.

Hiring freeze on federal employees; reduce workforce through attrition.

For every new federal regulation, two existing regulations must be eliminated.

Renegotiate NAFTA or withdraw from the deal under Article 2205.

Withdrawal from the Trans-Pacific Partnership.

Label China a currency manipulator.

Identify all foreign trading abuses that unfairly impact American workers and direct them to use every tool under American and international law to end those abuses immediately.

Lift the restrictions on the production of $50 trillion dollars' worth of job-producing American energy reserves, including shale, oil, natural gas and clean coal.

American Energy & Infrastructure Act. Leverages public-private partnerships, and private investments through tax incentives, to spur $1 trillion in infrastructure investment over 10 years. It is revenue neutral.

Repeal and Replace Obamacare Act. Fully repeals Obamacare and replaces it with Health Savings Accounts, the ability to purchase health insurance across state lines, and lets states manage Medicaid funds. Reforms will also include cutting the red tape at the FDA: there are over 4,000 drugs awaiting approval, and we especially want to speed the approval of life-saving medications.

Cancel billions in payments to U.N. climate change programs and use the money to fix America's water and environmental infrastructure.

Lift the Obama-Clinton roadblocks and allow vital energy infrastructure projects, like the Keystone Pipeline, to move forward.

Source: Adapted from https://www.donaldjtrump.com/contract/

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