Pinnacle Capital Management, LLC

Special Edition - President Trump

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COMMENTARY

First we had the Brexit. Now we have the U.S. Presidential election. 2016 will be remembered as the year most of the pundits got it all wrong. Initially, when it became apparent that Donald Trump would win the election, Dow futures sold off, down as much as 800 points. But quickly, they came roaring back. As we write this, nine days after the election, the Dow Jones Industrial Average is up 650 points from the Monday close before the election. Not only did the election results defy the pundits, but so too did the markets' reactions to the election. So, we'll brave the waters and discuss what just happened and what might happen.

First let's start with a disclaimer. Our job is not to focus on what we personally would or would not like to be the outcome. Our job is to deal with outcomes as they are or as they are likely to be and assess the implications for investors. To that extent we may offend some readers for what we say or for what we fail to say. We apologize, but we need to call it like we see it.

Markets and pollsters were obviously expecting a Clinton victory. So first let's just do a little recap as to how they got it wrong. We were surprised by the outcome as well, but we always observed two things. First, there were many Trump supporters who kept quiet about that support. As a result, we always felt the Trump support in the polls was understated. Second, polls depend on predicting not just sentiment, but also who will actually show up at the polls. To that extent, we always felt that given the unusual nature of this election, the turnout forecasts were just an educated guess. In the end, the Trump support was greater than expect and the pollsters misjudged who'd show up and vote. We think it's that simple.

So let's deal with the implications. Not only did Trump win, but the Republicans retained both the Senate (narrowly) and the House. There will obviously be short term and long term implications. In the short term, volatility will likely be with us. The markets hate uncertainty and surprise. We now have both. However, the market gets used to certain things. We recall the early 2000s when the markets took hits from the September 2001 attacks, subsequent major attacks in Europe, and several other terrorist episodes worldwide. In each subsequent attack the markets reacted a little less violently - not because of how horrific the attacks were or weren't, but because the markets adjusted and realized things would come back. Similarly, the initial market reaction to Trump's election was less than what happened after the Brexit vote, and the subsequent recovery was obviously quicker. To nervous investors we'd say, the short term can appear frightening. The conventional wisdom had been that if Trump won, there would be a very sharp selloff in the markets. The conventional wisdom was obviously wrong. Investors' reactions to the short term are typically wrong more often than not. Do not forget that you are investing for the long term, so it is essential that you keep your eye on the ball.

So speaking of the long term, what are the implications? The most obvious impact will be on the Supreme Court. There is already one vacancy, and there will likely be additional ones during Trump's term in office. He has already put out a list of potential nominees. While we are not personally familiar with them, based on reviews we've read, they'd likely be able to pass muster in the confirmation process, especially with a continued Republican Senate. They'd also be less likely to favor an expansive government than had Clinton been in position to select the nominee.

Now what will President Trump do that will impact the economy? He's promised much to many: infrastructure projects, defense upgrade, a wall on our southern border. If the President were dictator, our budget would certainly explode. But our president is not. Congress controls the purse strings. And while much has been written about how Trump would not be beholden to Congress, the opposite is at least partially true. Expect Congress to release money slowly and for markets to act as a brake on excessive spending. For those expecting massive infrastructure spending in 2017 (related stocks have done quite well in 2016), we think it will be less than hoped for.

Moving to other implications, the overall regulatory environment has been getting tougher for businesses in the U.S. Irrespective of whether one might think this regulatory increasing pressure was necessary or not, it has had the impact of forcing businesses to devote resources to compliance and discouraged many - especially smaller businesses - from taking on certain business risks. While we certainly don't expect a return to laissez-faire, the rate of growth of the regulatory environment should slow. This should restore some confidence to business owners, which in turn is good for investment and hiring.

Trade is one area where we have some concerns. We don't expect any major legislation restricting trade, but rhetoric can have an impact. Despite the desire to support national, or even local, economies, economic growth has always been higher when trade flows freely. The risk of increasing trade barriers has gone up with the results of the election, and this is certainly not a positive.

Another area to address is health care. There will be fierce Democratic opposition to any moves to gut Obama Care. There may even be limited Republican support that will give the Democrats effective blocking power. However, there likely will be some changes, as rising health care premiums have made some action necessary. If Clinton had won, there would likely have been further movements toward government control - i.e. single payer - of the health care market. This would be a negative for health care companies, and possibly health care research and development. Indeed, the health care sector has been the weakest of the S&P sectors in 2016. With a Trump presidency and Republican control of Congress, expect less direct intervention. This is a positive for the drug and device manufacturers. Things will remain much more uncertain for hospitals and insurance companies.

We've cited some specifics, but it's hard for us to go much further than this. There are just too many uncertainties - as there always are. Those uncertainties range from economic policy issues, to Trump's geopolitical stance, and to his ability to work with Congress. However, we'd like to remind readers that the President doesn't control the economy. While economic growth has not been particularly strong, we expect the expansion to continue. We see very few excesses in the market and nothing has changed. We feel stock prices are quite reasonable, as equity markets have large risk premiums built in.

This is neither the time to panic nor is it a time for euphoria - at least as far as investors are concerned. Do not confuse your satisfaction or dissatisfaction with election outcomes with your rationale for investment decisions. It is time to remember why you invest. Presumably it is for the long term. If you are a Hillary supporter, the world has not just ended. If you are Trump supporter, there will still be challenges ahead. In either case, stay calm and you are more likely to experience investment success.