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Investments, Inc.

Post-Election Market Outlook
"Out over its skis"

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Though many market mavens predicted otherwise, following the US election, the broad market surged upward, reflecting investors' repositioning into and out of select industry groups. The initial winners were defense, financials, materials, and pharmaceuticals. Losing industries included consumer staples, hospitals, REITs, technology and utilities. In the currency markets, the US dollar index posted its largest weekly rally in over five years. In fixed income, the 10-year US Treasury yield rose to its highest level since late 2015. Following this market rotation, the Dow Jones Industrial Average advanced to all-time highs, as the NASDAQ composite sold off. In our view, the market is anticipating a friendlier business and regulatory environment. However, to borrow a skiing analogy, it is "out over its skis;" i.e. getting ahead of itself.

The new administration's general economic platform is growth-oriented. The success of this program will be better evaluated as the President-elect provides clarity regarding his policies to achieve economic stimulus. Additionally, in the coming months the new administration will announce senior personnel who will be implementing this fiscal agenda. In the interim the market is re-pricing macro US economic fundamentals; namely, upward pressure to interest rates and more emphasis on stimulus, with less reliance on monetary policy.

Meanwhile, ongoing geopolitical challenges are entangled with economic uncertainty. Global growth is encumbered with historic debt levels - particularly in the Pacific. China's aggregate debt exceeds $30 trillion while debt to GDP is now estimated at 300%. With the Obama administration's recent abandonment of the Trans-Pacific Partnership (TPP), China is aggressively advocating adoption of both the Free Trade Area of the Asia Pacific (FTAAP) and the Regional Comprehensive Economic Partnership (RCEP) trade agreements. So, while US leadership is in transition, Beijing seeks to fill the void and rewrite the rules of international commerce. Diminishment of US influence in formulation of global trade policy could undermine confidence in strategic military alliances that have effectively served as a counterweight to China's expansionist aspirations.

The timing of TPP's demise, coincident with the possibility of more collaborative relations between Washington and Moscow, may further destabilize Middle Europe. The potential for unilateral relaxation of US sanctions on Russia, without a complete withdrawal of Russian occupation forces in Crimea and the Ukraine, could further weaken the political framework central to a strong NATO alliance.

In general, we do not believe a transactional approach to national security promotes stability. The complex issue of burden sharing between NATO allies transcends disagreements over strict defense budget restraints. From a European perspective, budgets must include such burdens as funding the 1.3 million Syrian refugees now finding shelter there.

Geopolitical uncertainty is further dependent upon the new administration's policies for defeating ISIS, preserving stability on the Korean Peninsula, preventing nuclear escalation in the Middle East, maintaining the North American Free Trade Agreement and supporting the Paris Accord. These are policy prescriptions yet to be defined in the context of governance, as opposed to the hyperbole of an election campaign. A deliberate methodic approach to these complex and profound global issues could justifiably inspire investor confidence.

Domestically, a Republican-controlled congress enhances the probability of a growth agenda. This would include a less onerous regulatory climate, corporate and individual tax reform, a lowering of the repatriation tax to facilitate the return of US corporate monies back into this country, and a robust infrastructure investment. These policies should promote higher intermediate-term growth to 3.5% for 2017-2019. This constructive outlook is tempered by long-term issues that confront the country: globalization, the disruptive nature of technological change, entitlement reform, and a $20 trillion national debt that is likely to increase.

Investors should be mindful that this seasonally strong period of money flows into equities (November – April) masks the uncertainties we have described. Moreover there is confirmation of extended valuation metrics. For example there is a clear market disconnect between the elevated S&P price index and declining revenue growth. S&P 500 median valuations are near all-time highs, with some indicators in bubble territory.

Paradoxically, levitating financial assets may persist, aided by the unlikelihood of a US recession in 2017 and unprecedented Central Bank policies. The global economy is in a period of uneven growth, marked by sustained and reasonably accommodative interest rates. US GDP is poised to rise should congress pass pro-growth legislation. However, restructuring entitlement programs on a bipartisan basis, and the resolution of a comprehensive immigration reform package would unlock the pent-up underlying potential (5% growth rates) of the US economy.

We look to take advantage of market volatility and will continue to invest opportunistically. Our long-term strategy remains unchanged: own qualitative companies at appropriate valuations, with stalwart balance sheets, strong earnings and dividend growth. Relative to the broad market, we are confident that our portfolio composition is well positioned to weather change and provide enduring, attractive returns.

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