The Knowledge and Experience to Build Your Wealth

*Thursday, November 10, 2016*

# A TRUMP PRESIDENCY

*What Does it Mean For Your Investment Portfolio?*

- We don't create your portfolio based on who is the president; we create your portfolio based on your goals. That being said, there are changes to consider.
- Nobody was expecting a Trump presidency – not even Trump! It's ok to freak out a little bit.
- This is not an ideological report. We're just helping you try to make sense of any potential changes, if any, in your portfolio in the days or weeks to come.

We should all probably freak out a little bit. Ever hear the term "Black Swan"? It's when something happens that just really shouldn't have happened. And, no, I'm not making a political statement. If you are looking for me to celebrate or cry about an election, then you've come to the wrong place. Today we're talking about investments, not ideology. So, yeah, based on pretty much any poll known to mankind there was no way that President Elect Donald Trump could find a path to 270 electoral college votes. And that's a big surprise and a big deal. And since investment is in large part the art of forecasting things correctly, yeah, when it comes to your portfolio you should be freaking out.

We don't create your portfolio based on who is the president; we create your portfolio based on your goals. ***Your money isn't a score card, among other things it's a means to offer you security and comfort and a means to do what makes you happy in retirement. That being said, obviously there will be some changes happening in most people's portfolios.***

Now, let's keep our freaking out to a reasonable level of freakiness. If Mr. Trump was not your candidate of choice, you may have been one of the folks who made the Canadian immigration website crash (I'm not making that up; so many Americans immediately looked to get out of the country that the website crashed.) So I get it – a lot of you are worried. But while a lot of people may be fleeing to a land with a more similar belief system, there is no reason to flee from the US economy.

***President Elect Trump will be inheriting a healthy economy***, one which will not change immediately based on the casting of ballots. Many parts of America's balance sheet are very strong. The banking system has high levels of capital and liquidity. Household balance sheets are absolutely terrific relative to the last few decades. And while corporate profit growth has been punk over the last six quarters, profit margins have been high enough to keep their cash levels near record levels. ***We're good for now. In fact, not only are we good now, but opportunities exist.***

Of course the biggest questions are about which Trump policies will become reality. And we need to think about this because the answers to these questions will dictate which changes will come to your portfolio. With Republicans retaining their majorities in the House of Representatives and the Senate, the party will have the ability to control the agenda in Washington. And although there have been few sample sizes to make it statistically relevant, the combination of a Republican president and Republican Congress has produced above-average market gains.

***A Trump presidency will mean a different composition of growth in the US economy which will come from infrastructure spending, tax cuts, defense spending, trade, and budget deficits*. *That's a lot of change to consider. That's why you should be freaking out a little bit. And that's why portfolio changes are in the making.***

***Let's start with what will likely be a combination of easiest to get passed, most talked about, and most stimulative* – infrastructure spending.**

In his victory speech, Mr. Trump said, "We are going to fix our inner cities and rebuild our highways, bridges, tunnels, airports, schools, hospitals. We are going to build infrastructure, which will become, by the way, second to none. And we will put millions of people to work as we rebuild it."

Secretary Hilary Clinton supported this and had called for a $275 billion package over five-years. Mr. Trump had called for $1 trillion over ten years. That's ambitious (to be kind). The American Recovery and Reinvestment Act of 2009 was "only" $831 billion and that was coming out of the Great Recession where it was needed and there was unprecedented political support for it. Nonetheless, the point is $275 billion seems to be the low estimate at this point. Even House Minority Leader Nancy Pelosi responded with "We can work together to quickly pass a robust infrastructure jobs bill."

There is the issue of paying for it. We suspect the repatriation of corporate profits will go a long way in doing so. Estimates of repatriation revenues are in the $180 – 250 billion range. Applying an economic multiplier (i.e. money gets spent once it is brought back to the states) that bumps revenue up to something like $300 billion to $400 billion.

***A substantial expansion of government spending would come at a time when the US is reaching full employment, likely building upward pressure on inflation, nudging the Federal Reserve to be more aggressive in tightening monetary policy by raising interest rates.***

After eight years of the Federal Reserve maintaining a zero interest rate policy, the aggressive monetary policy has largely run its course. For some time now fiscal policy has been needed for the handoff from lower to higher rates. ***The magnitude and timing of such a spending plan can be a game changer for the path of interest rate raises. Previously the path was expected to be low and slow. Now the trajectory has a higher probability of being higher faster***. Inflation would be expected to rise as metals and materials are put to work to rebuild America. Not only would the infrastructure spending be stimulative to growth (helping the Fed achieve its growth mandate so they don't have to keep rates low), but it could push the Fed's preferred interest rate metric, the Personal Consumption Expenditure (PCE) above its two percent goal (thus having to raise rates to satisfy its other mandate of keeping inflation stable).

**Higher inflation and higher interest rates *means a change to bonds and "bond proxies" (ex. Utility stocks, REITs, dividend pays). Longer-term maturities on bonds should be shortened. And the chase for yield by owning utility stocks and REIT equity is winding down and allocation of cash will be treated better in different sectors and asset classes. That is not to say dividend payers should be shunned, but the preference will be to companies that are growing their dividends and not just paying dividends.***

Economic forces aside, there are also political forces in play that could create a higher faster path for interest rates. Mr. Trump has been vocal about the zero interest rate policy and critical of Fed Chairperson Janet Yellen**.** Her term does not expire until February 2018 but Mr. Trump has said he would not support her for a second term. It seems likely that Mr. Trump would appoint someone who would have an approach varying from Ms. Yellen's. But a lot could happen to the Fed before February 2018. The two open seats on the Federal Reserve Board will probably be filled by more hawkish governors. Not that this makes it impossible for Chair Yellen to follow her desired course as most governors tend to fall in line with the Chair, but the pressure will be there.

Of course, the Federal Reserve moves short-term interest rates. Longer-term rates are moved more by inflation, credit concerns (which could be an issue with further) deficit spending, and growth. Longer-term rates would be expected to move up more than short-term rates, thus steepening the yield curve over time. This would be a big plus for financial companies and banks in particular who make money by borrowing at short-term rates and lending at long-term rates.

***By itself the steepening yield curve could be reason enough to invest more heavily in financial company stocks*** (and, by extension, the S&P 500 as the sector represents over thirteen percent of the index). Secretary Clinton was supportive of many of MA Senator Elizabeth Warrnen's anti-bank efforts. Major negative changes were on their way for the financial industry, such as the proposed "bank tax" that called for taxes on transactions, and targeting the so-called "shadow banking" sector, including hedge funds, insurance companies, and asset managers.

Now that those industry threats have been removed a headwind has become a tailwind as Mr. Trump promised a rollback in financial regulation. We won't waste your time getting into the details of legislation, but Mr. Trump was looking to remove the elimination of the so-called Volcker Rule that restricted banks trading for their own accounts, and weakening the Consumer Financial Protection Bureau. Mr. Trump will be able to appoint regulators who are more industry friendly than those appointed by President Obama. Whether you agree with those moves or not, it translates to more profitability to banks.

***However, anti-bank sentiment is the US is strong. We would expect the first attempts at reform to be tested at the community level, allowing regional banks to see the most benefit.***

***Similar to financials, simply by Secretary Clinton not winning the White House significant headwinds have been removed from the Health Care and Biotechnology sectors.*** Both sectors have been underperformers under the rhetoric and expectation of a Clinton presidency. We had been expecting a sell-the-rumor-buy-the-news scenario where the sectors would begin to perform more similarly to the market after the election, but a Trump presidency adds to that potential price boost to health care stocks.

Mr. Trump and Secretary Clinton both agreed that there could be solutions to accessing medicine at cheaper rates. Mrs. Clinton wanted to take a hardline approach and regulate prices, going so far as to propose creating a task force that would monitor price gouging. Mr. Trump suggested easier access for Americans to buy drugs in Canada, where they are often cheaper. Also, a proposition in California to regulate drug pricing failed in Tuesday's election, eliminating another potential headwind.

It is also expected that defense spending would have risen under either Mrs. Clinton or Mr. Trump relative to President Obama. However*, **Mr. Trump had taken the more traditional view of Republicans that spending on defense is both good for jobs and the economy, as well as our national safety.***

Much has been said about Mr. Trump's Energy policies helping the sector. The lifting of restrictions and fewer regulations tilt positive for the sector. However, more important to the sector will be US economic growth. ***Energy demand will pick up with a growing economy***.

It may immediately sound cynical to suggest that Russia will be a beneficiary to a Trump presidency, but it really seems more so just stating the obvious. ***Trade relations with Russia will improve. Period***. The rise or fall of Russian stocks will have more to do with valuations and growth, but a renewed relationship with the US is a definite positive. After having recently rebounded after intermediate-term price suppression, the timing is a plus for Russian stocks.

***A loser in a Trump presidency is China***. He wants to label China as a currency manipulator, which then puts sanctions on the country. Mr. Trump has also spoken of bringing unfair subsidy cases against China to the World Trade Organization, as well as implementing tariffs due to "theft of American trade secrets".

***Mr. Trump and Mrs. Clinton were both anti-trade. Mr. Trump was more positive on Russia and more neutral on Europe, and more negative on Mexico.***

***The heavy weight of diminished trade favors small- and mid-capitalization stocks, whose companies benefit more from domestic trade.***

## Bottom Line

We believed the polls, and thus we were caught off guard with Mr. Trump winning the presidency. The creation of a portfolio is based on your specific goals. But part of that means holding investments that help us accomplish those goals. We had done so under one set of assumptions. But those assumptions changed. And as John Maynard Keynes said, “"When the facts change, I change my mind.”

Berkshire Money Management doesn't make it a practice to chase returns. We make it a practice to protect your money. But a Trump presidency does potentially change the way in which we protect your money. And that's not a "Trump thing" or a "Clinton thing"; it's a policy-affecting-the-economy thing. And, more importantly, it's a YOU thing.

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The Dow Jones Industrial Average (NYSE: DJI, also called the DJIA, Dow 30, INDP, or informally the Dow Jones or The Dow) is one of several stock market indices, created by nineteenth-century Wall Street Journal editor and Dow Jones & Company co-founder Charles Dow. The Dow average is computed from the stock prices of 30 of the largest and most widely held public companies in the United States. Clients of BMM may have portfolios that differ substantially from the composition of the DOW and therefore, their performance may vary significantly from that of the Dow. The Dow is used for illustrative purposes only, as one indicator of the overall US economy, and its past, present, or future performance should not be viewed as an indicator or comparison point for BMM client performance.

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BERKSHIRE MONEY MANAGEMENT

*The Knowledge and Experience to Build Your Wealth*

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