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WHAT DOES TRUMP'S FIRST WEEK SAY ABOUT THE UNORTHODOX FINANCIAL FUTURE AHEAD?

Due to the lack of a filibuster-proof Senate majority, Trump was never likely able to get much passed through Congress except for revenue-neutral budget bills, but he will clearly continue to use his quite broad executive and regulatory powers, as well as his "bully pulpit," to re-shape the globe. The analysis below concisely explores the areas where his policies can be most fully implemented and how his presidency may affect investors going forward:

Economics and Fiscal Policy

The most important topic ahead is the border adjustment tax, and in my opinion, there are many reasons to expect that it will not be enacted, except in the case of a global crisis:

- It would require more regulation, not less (and is likely too complicated to explain to voters).
- It is not in Trump's original plan and he is trying to fulfill his promises as rapidly as possible.
- He is not a full-blown protectionist but wants fairer trade with Mexico and China (a border tax, which is of questionable legality, is much more protectionist than targeted legal retaliatory tariffs) and will punish US companies who move jobs abroad. His main plan is to lower both corporate taxes and regulation so as to encourage production in the US, rather than use protectionism.
- It would be labelled a hugely regressive consumer tax hike, ruining his reputation with voters and giving his opponents significant ammunition.
- Countries would likely retaliate into global protectionist war.
- Inflation would be likely even if the USD rose, which would raise interest rates and thus the Treasury's interest expenses so much that most of the tax's revenues would be erased.
- It would de-emphasize his power to target specific unfair tactics and decrease the number of victorious "deals." Already, using Teddy Roosevelt's "bully pulpit" style, he is achieving success in moving production to the US without regulation.
- He will not totally reject the border tax concept for the time-being because he can use it as bargaining chip/stick against countries, saying "at least, I can save you from Paul Ryan's more protectionist plan."
- Although the legality of such is debatable, a special border tax for US companies that move jobs abroad is possible, but such should not raise much revenue. A special border tax against Mexico is also a possibility, but is more likely just a bargaining threat.

If a border tax, which at 20% was estimated to raise $10 trillion over the next decade, is unlikely, then, in order to maintain the ten-year deficit neutrality required for the reconciliation process (which only needs a 50% approval in Congress), Trump will likely only start with a mildly lower corporate tax rate (not as low as he would like and perhaps phased in over several years) and lower personal income taxes targeted at the lower-middle class, both starting in 2018 (later than he had hoped). This would be funded with a mandatory corporate profit repatriation tax, greater US corporate tax base coverage, expenditure cuts and "dynamic scoring" (assuming the resulting economic growth will raise more revenue).

Retaliatory trade measures, already greatly increasing under Obama, will likely accelerate further, with China continuing to attract the vast majority of the cases due to its massive over-expansion in several industries that has attracted retaliatory measures from many countries, both developed and emerging. While there is less concern about across-the-board tariffs on Chinese goods due to currency manipulation, such are likely if the CNY devalues. It is also possible that the Trump Administration deems politically-motivated capital flight to be a non-economic factor and that for trade purposes, the CNY's current "managed peg" is at excessively weak levels, as shown by the country's large trade surplus.

As with many countries, infrastructure improvements will likely be accomplished by PPPs (Public-Private Partnerships) and incentives rather than directly by the Government. This is primarily due to fiscal budget constraints. In this regard, it is noteworthy that the budget deficit already is set to widen significantly after 2018 due to increased entitlement spending associated with the aging population.

Regulations

It is unlikely that Trump can change any social laws, as his conservative Supreme Court justice nominations will be filibustered by Democratic senators. He will, however, be able to appoint many Republicans to justice positions lower than the Supreme Court, as such do not require 60 votes in the Senate. Thus, the interpretation of many laws will likely become somewhat more conservative. Many other budget and regulatory cuts are certain, but such will need to conform fairly closely to the current budget allocations. As mentioned previously, passing any non-budgetary laws will be filibustered by Senate Democrats, at least for the intermediate term.

Environmental regulation will clearly be reduced. States and localities can continue to block some deregulations, but there is great danger that Federal funding will be withheld directly or indirectly from them. Deregulation would boost oil production, as well as some industrial and mining sectors, especially coal, significantly contributing to GDP. Not much has been said on nuclear power, but it is highly possible that Trump will reduce regulations for the construction of new reactors.

Foreign Policy

Both geopolitical and economic/trade factors will play equally large roles in Trump's foreign policy, while Obama emphasized economic factors more greatly. Clearly, relations with China will be tumultuous but it is highly probable that Trump is setting out a hard negotiating position, with compromise and negotiation.

As for Russia, the US will likely cooperate on ISIS and other factors in which there is common interest. As for Mexico, the outlook will likely continue to be tumultuous. Japan, if it can forge compromises, can actually greatly improve its ties with the United States. Relations with the UK will likely be strong, but those with the Eurozone will continue to deteriorate, although if Trump stops encouraging countries to exit the EU, not too much damage might result. The fact that Germany has agreed to start paying its mandated share for defense means that Trump can be satisfied with NATO's burden being fairer and concentrate on encouraging its anti-terrorism effort.

Both Japan and the Eurozone will need to be careful that their policies are not considered "monetary manipulation." Trump has recently mentioned this phrase and has spoken out against Japanese monetary and currency policies as a trend that will be strongly countered, so what his Administration deems manipulation will clearly be a major policy decision for the world, including the Federal Reserve.

The Fed

As long as the FOMC does not become too disdainful of her leadership, Yellen will likely complete her term early next year, although likely very uncomfortably so. Who Trump appoints to the Board and as Chairperson, however, will be a key factor in how FOMC policy evolves this year, as they likely will be quickly approved by the Senate. A few traditional Republican names have been broached by experts, and Trump has shown some support for Kevin Warsh, but a more unorthodox choice is highly possible. Most analysts think that Trump will seek very dovish candidates, but as he complained about Yellen's Fed being too dovish (although she has suddenly become more hawkish out of fear of fiscal stimulus, despite budget reconciliation likely being revenue-neutral), he might seek a moderate candidate. Such might also protect the bond market from losing faith in the Fed. Although he has courted some Wall Street titans during the transition, it seems unlikely that he would choose one to lead the Fed. Lastly, he likely prefers a reduction of the Fed balance sheet than aggressively raising interest rates.

The US Equity Market

Clearly, the US equity market has appreciated Trump's economic policies. The corporate tax cut is the most important factor in raising equity prices, but fewer regulations and stronger economic growth are also crucial. The market's expectation for earnings are likely much higher than the current bottom-up or top-down consensus estimates, as few analysts are willing to incorporate a corporate tax cut into their projections until they can be sure of its parameters. Portfolio managers and speculators, however, are forced to predict that such a cut is more likely than not and, thus, have bought stocks. We too see such as likely, and thus, valuation ratios are likely much lower than consensus, with a PER on 2018 earnings of near 16 compared to nearly 18 for the latter.

We see continued upside by the end of the year, but there may be some disappointment and market corrections in the coming months as Trump needs to accept less tax rate cuts than he wishes. Within the equity market, those predicting a border tax, and, thus, major earnings growth for domestic producers, will likely be another cause for a market correction. As stated in the Teddy Roosevelt theme mentioned in earlier pieces, investors expecting laissez faire policies by Trump in matters of mergers, non-competitive price hikes or other oligopolistic practices will likely be severely disappointed and may also play a role in a stock market correction.

Summary

There is little doubt that Trump's domestic and foreign policies conform to the "you are with us or you are against us" theory, as opposed to Obama's conciliatory "new world" tenor. Such large pendulum swings can be very disruptive. Clearly, it is difficult to define Trump in political terms, as although nearly all of his cabinet members are either very conservative or of military background, his unorthodox conservative-populist vision, which is often loathed by Republicans, will control the agenda. Domestic unrest certainly could occur, but so far, there has not been such to a disruptive degree and it is very unlikely that if such were to expand that they would dissuade his actions or those of Congressional Republicans. Globally, the outlook is most precarious with China and much will depend upon new geopolitical agreements, which certainly can be achieved via negotiation and compromise.

Important Information