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Post-election results: Markets gain in optimism

Potential interest rate hikes for mid-December amid strong U.S. dollar

By Daniel Wildermuth

NOW that the rancorous U.S. presidential election has ended with an outcome that was a surprise to many, what should investors expect from the very unique president-elect? Strong post-election U.S. stock market gains signal clear optimism and enthusiasm regarding Donald Trump and his new administration.

While the market appeared ready to swoon as it became apparent that Donald Trump would win the presidency, the Armageddon predicted by some never materialized. After S&P 500 futures plunged down around 5 percent in the middle of the night, the market rose over 1 percent on the first trading day after the election. U.S. markets have mostly continued up since then, setting multiple new highs, as investors buy equities expecting reduced taxes, corporate tax reform and fewer regulations.

A UBS Wealth Management survey of 1,200 wealthy investors immediately before and after the election found that confidence increased significantly after Donald Trump's win. Optimism about the economy jumped to 48 percent from 39 percent three weeks earlier, and expectations of positive returns for the stock market in the next six months more than doubled to 53 percent versus 25 percent before the election.

Data from a completely different source, the University of Michigan's consumer sentiment index, revealed similar findings. The November survey's consumer sentiment index shows Americans as the most hopeful they have been in more than a decade. The consumer expectations index of the survey rose by 8.4 points from October to 85.2 points, providing a one-month gain last exceeded in December 2011.

Households expectations for personal finances and wage growth improvements reached levels not seen since 2006. The percentage of respondents surveyed who expect that the U.S. will experience "... continuous good times" rose a whopping 11 percent from October up to 46 percent, while the share expecting "bad times" fell by 7 percent points to 37 percent. The same survey also revealed that household expectations for improvements in business conditions over the next year rebounded strongly after falling in October, registering the biggest one-month gain since 2008.

Given rapid improvements in optimism and outlook post-election, strong market performance is hardly surprising. Yet, the future of the economy – and markets – are likely to be less sanguine. As much as Trump may want to decrease regulation and improve various sectors of the economy, no president inherits a "magic wand" to implement their agenda. In addition, many of the more costly and injurious drags on the economy initiated by the Obama administration are just starting to take effect, particularly those involving increased regulations. These will present Trump with additional headwinds that have mostly not been factored into the economy.

As a result, investors should expect a rocky ride. In the early days in particular, successes and failures are likely to be overemphasized. Trump's management style will likely generate anxiety for some, and potentially create more volatility. He's willing to take risks and fail, often quite publicly. While this may result in tremendous progress, particularly given the potential to free up vast tracks of the

U.S. economy, it could also create instability, particularly in the short-term.

Investors should also brace for inevitable disappointments, partly because expectations appear to be so high. Various campaign promises ranging from returning Growth Domestic Product (GDP) growth of 4 to 6 percent to restoring manufacturing jobs will be very difficult to deliver. Dashed or delayed expectations could easily fuel negative sentiment.

While many of Trump's economic plans should benefit the U.S., implementation of other campaign promises, such as restricting trade and immigration, could easily dampen growth. Turning to actual data rather than sentiment, promises, and speculation, the U.S. economy delivered its best performance in two years in the third quarter according to the Commerce Department.

The GDP grew at an annual rate of 3.2 percent, significantly higher than the previously reported 2.9 percent pace, and much higher than the average since the 2008 recession. Consumer spending drove the increase along with business investment, home building, retail sales and manufacturing. Gross Domestic Income (GDI) looked even better, with the economy expanding at a 5.2 percent rate amid a corporate profit rebound and rising household incomes. As a result, the average of GDP and GDI, often considered a better predictor of future growth, increased at a 4.2 percent clip in the third quarter, the fastest pace in two years.

Increasing growth, a strong labor market near full employment, and steadily rising inflation will likely drive the Federal Reserve to increase interest rates at its mid-December policy meeting. However, the increase should have little impact on equities, and bonds have largely priced in the increase.

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Numerous economic indicators ranging from economic outlook to labor markets to business outlook point toward continued solid growth. Interest rates, even after an expected increase, remain low, and inflation has hardly budged. Weak global growth and equity market valuations that already appear to have priced in growth expectations are less positive indicators. If there is a concern, it is probably geopolitical risk, particularly as it relates to global trade policy. So far, investors have looked past Trump's promises in this area, seemingly choosing to believe he will ultimately make good trade decisions - time will tell.

Internationally, France seems to be continuing the global trend of electorates voting for change with an emphasis on the economy. Francois Fillon, a socially conservative fan of free markets won France's center-right presidential primaries in late November. He must still navigate another election to become president, but he is widely expected to win. Fillon has promised radical reforms to France's regulation-encumbered economy, vowing to roll back state control and slash bloated government spending. Any change would be welcome and should positively impact greater Europe and the U.S., although he will undoubtedly face stiff opposition from France's notorious labor unions.

With the U.S. election behind us, solid ongoing economic fundamentals, and rising investor sentiment, reasonable equity market performance seems likely. Yet, it also seems wise to temper expectations. International economic and political challenges and threats to global trade continue to pose ongoing risks. While a Trump presidency should be good for the economy and markets longer term, change is rarely smooth and predictable. Investors should probably expect a more volatile future as they adjust to a new and unique administration.

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