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Market Talk with Mike Skoric

The Post Election Investment Enigma

By Mike Skoric, CFA

Whether or not one supports Donald Trump's upcoming return to the White House, one thing is certain – it has caused some excitement within the investment community. Based on the likely economic and geopolitical underpinnings of the future Trump Administration, there are many theories about which companies, sectors, asset classes, or countries will benefit. Yet with each of these we find a double-edged sword situation where the very factor that might make us bullish or bearish, can at the same time result in an opposing bias. For example, one common belief is that a Trump presidency should be beneficial to stocks, especially domestic ones because of expected tariffs, less regulation, and a greater pro-business approach to governing. It is also believed that these policies would likely cause higher inflation, which in turn would ultimately result in higher yields.

One reason for the latest leg of the equity bull market has been that the Fed has finally started cutting rates which is helping to bring inflation under control. However, if rates end up rising again, that could create some pessimism. After the wide level of investor enthusiasm in the first few post-election days, we did see some gains wither away, possibly due to the exact reason mentioned above. Furthermore, if rates do increase meaningfully again and actually stay there as some sort of "new normal" level, with the 10-Year Treasury at around 4.5% or so – then high-quality corporate bonds in the 5-6% range look very attractive. This is especially true in relative terms, knowing that the post-election rally has further inflated an already expensive equity market that now trades at around 24x forward earnings, when the historical norm is closer to 16x forward earnings.

Within asset classes, there is a great deal of enthusiasm around small-cap stocks due to a potentially stronger U.S. dollar. While large U.S. companies typically earn a great deal of their revenue overseas, those same revenues are diluted when those foreign currencies are depreciating vis-à-vis the U.S. dollar. However, similar with the stock-bond example, all is not that simple –because smaller companies are much more likely to finance their operations with bank loans or even lines of credit which are usually floating rate and directly exposed to higher interest rates.

So here again, an initial and seemingly obvious conclusion is much less so upon greater analysis and assessment of all possible outcomes. The key point of this post-election commentary is that although there may very well be some post-election "winners," these are far from certain scenarios and ones that can simultaneously lead to a negative market reaction. Rather than engaging in knee-jerk reactions to near-term hype, it is important to carefully analyze and assess the broader investment landscape.