FIRST QUARTER 2017 — U.S. GROWTH EQUITY - LARGE CAP

Trump Policies and Current Market Trends

In this edition of *CIO Insights*, we identify several considerations that may be important for investors going forward under a Donald Trump presidency. Certainly, no one factor dictates the movement of a stock, and that is true with regard to the election as well. However, where the electoral outcome reinforces a trend already in place, it is noteworthy. In my opinion, the post-election factors to consider are in the areas of inflation expectations, taxation, labor, and trade. We'll examine each of these and highlight whether proposed policies reinforce pre-existing trends.

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Rising Inflation Expectations

Inflation expectations are rising, as evidenced by higher breakeven inflation rates[1] derived from U.S. Treasuries. A deficit-financed infrastructure program creates demand-related inflationary expectations. What's more, you have to go back to the Vietnam War to find a period when fiscal stimulus occurred in a period of full employment.

Since the 1990s, increased trade has been a deflationary factor given highly competitive global goods and labor markets. As such, trade barriers would imply less competitive goods and labor markets, which could engender inflationary cost pressures.

Lower Tax Rates

Reduced corporate taxes can lift profit margins for U.S.-centric companies that pay relatively higher tax rates. Retailers stand to benefit most from this factor, while companies with large foreign exposures and those that don't pay much in taxes (such as energy exploration and production companies) will see little incremental benefit.

Labor and Immigration

Less competitive labor markets and more restrictive immigration policies may have an adverse impact on industries that rely on foreign labor. The housing and produce industries might see labor shortages that could result in higher costs. Technology companies that rely on H1-B visas may also be adversely affected.

Trade Effects

In the event that tariffs rise across the globe, export-oriented companies may be vulnerable, while companies with long global supply chains may be forced to re-optimize. The global auto and technology hardware industries may be impacted.

And the Potential Winners Are…

Regional banks with commercial loan exposure could benefit from rising inflation expectations and a steeper yield curve.[2] Additionally, this is consistent with the pre-existing trend toward higher rates and less accommodative monetary policy in the U.S. The machinery industry could benefit to the extent that it participates in a U.S.-oriented infrastructure build. Finalizing and passing a highway bill would also reinforce an existing policy trend.

Potential Losers Are…

The housing industry potentially sees headwinds from higher mortgage rates, with the existing trend of rising rates reinforced. Tighter labor markets may also have an impact on cost. The auto industry may also see an impact from rising rates as well as sub-optimal supply chains. In addition, export-oriented companies may see an offset from the impact of a stronger dollar.

Stock Selection Remains Central

These trends have important implications for the markets in which we invest, and we will continue to monitor their effects carefully. Investors can rest assured that we seek to apply our process and identify attractive investment opportunities regardless of macroeconomic conditions. Fundamentally, we believe a portfolio of growing companies who generate and effectively deploy free cash flow will be well positioned to succeed across diverse market environments.

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[1] The difference between the nominal yield (usually the market yield, which includes an inflation premium) on a fixed income investment and the real yield (with no inflation premium) on an inflation-linked investment of similar maturity and credit quality.

[2] A line graph showing the yields of fixed income securities from a single sector from a range of different maturities at a single point in time.

