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INSIGHT

VIEWPOINT

U.S. Equity Market

Implications of Presidential Election Result

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Mr. Reilly is the Chief Investment Officer of the Equities Group and Director of U.S. Equity Research. He joined TCW in 1992 as an Equity Analyst after working four years in corporate finance at Security Pacific Bank. In 1995, he assumed co-portfolio management responsibility for TCW's Latin America, Emerging Markets and International Equities investment strategies. Subsequently, from 2002-2005, he was co-Portfolio Manager of the Société Générale Asset Management (SGAM) global equities team prior to assuming leadership of the U.S. Equity Research department in 2006. Mr. Reilly serves as a member of the USC Marshall Center for Investment Studies Board of Advisors and the USC Dornsife Board of Councilors. Mr. Reilly graduated valedictorian of the University of Southern California with a BS in Finance and a BA in Spanish and also received his MBA from the University of Southern California. He was recipient of the Rotary Foundation Ambassadorial Fellowship for a year of postgraduate studies at Universidad Complutense in Madrid, Spain. He is a CFA charterholder.

Although President-elect Trump's improbable election victory was widely expected to result in a pronounced downturn in the U.S. equity market due to the uncertain impact of his proposed policies, the markets have steadied, in part, because of the tone of Trump's victory speech. His call for partnership in working with Congress and in dealing with other nations at least signaled an intent to work in a collaborative fashion. Yet, there can be no doubt that his administration will pursue the signature initiatives that formed the centerpiece of his campaign, especially given the fact that Republicans have retained control of both houses of Congress. As such, the investment community can expect a Trump administration to prioritize the repeal of the Affordable Care Act (i.e., Obamacare), pursuit of a tax reform initiative that includes a reduction in the corporate income tax rate coupled with incentives to encourage the repatriation of corporate profits held abroad, and a focus on rebuilding the country's infrastructure and defense.

While it is too early to ascertain the details associated with implementation of Trump's proposed policies, several general characterizations can reasonably be made. First, the emphasis on fiscal initiatives to jump-start the economy is likely to result in a near-term expansion of the fiscal deficit, which can generally be expected to increase inflationary expectations and reinforce the present trend towards higher interest rates. With the Fed already poised to raise interest rates at its December meeting, and with the leadership of the Fed and its composition less certain going forward, the potential for policy error (i.e., recession risk) may potentially be heightened. Second, the regulatory framework governing industries across the board will be placed under review and, in many cases, will be materially modified and recast (e.g., ACA). Third, trade policies, as a centerpiece of Trump's campaign, can be expected to undergo substantial renegotiation, with the implications for myriad industries likely to be uncertain in the near and medium-term.

At the industry level, a Trump administration boosts the prospects for defense firms, pharmaceutical/biotech names, energy firms, and those companies with products and services leveraged to infrastructure-related initiatives. At the same time, financial firms may stand to benefit from a steeper yield curve and a more limited regulatory burden. On the other hand, those stocks which have been beneficiaries of Obamacare, including hospitals and managed care companies, are likely to face a more challenging environment. Also, increased inflationary expectations, unless accompanied by a substantial pick-up in economic growth, can be expected to pressure equities that have effectively served as bond proxies, including certain high dividend stocks and real-estate related names.

To be sure, the tectonic shift in the U.S. political landscape portends major realignments in the policy priorities of the country with broad implications for the economy and financial markets. Since the end of World War II, the equity market has rebounded post presidential elections into year-end by nearly two percentage points 70 percent of the time, regardless of which party prevails, as investors are able to react to the president-elect's policy priorities. While the uncertainty associated with this dramatic shift in the political backdrop is likely to result in heightened volatility in the near term – particularly with respect to specific industries as proposed policy details become known – corporate America is well-positioned to avail itself of the opportunities that develop in the coming months and years, which bodes well for stocks over the medium and longer term. Drawing upon our deep fundamental research effort, we are as committed as ever to identifying the most compelling investment opportunities, consistent with the investment philosophy and objectives of our equity portfolios. ■

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