CLEARVIEW WEALTH SOLUTIONS

DONALD IS NOT RONALD: BLIND OPTIMISM IN STOCKS

By some measures, the stock market has had quite a run since the election. In the two-week surge post-election (through November 18), stocks of several different capitalization size ranges appreciated as follows:

Small Caps	**10%**
Mid Caps	**6%**
S&P 500 (Large Caps)	**2%**
Smallest 50 in S&P 500	**8.8%**

Clearly this was mainly a small/mid cap rally (small caps tacked on another 2% Thanksgiving week). Investors are correctly assuming smaller companies will benefit the most from Trump's proposed reduced regulation and lower taxes.

Thus far, the stock the market has discounted positive Trump policies (positive defined as a potential boost to economic growth and profits) while ignoring the negative (those that could damage the economy) such as reduced trade. Trump will have substantial power to unilaterally withdraw from trade pacts and impose tariffs. Retaliation from trading partners could become a serious risk if these powers were employed.

Policy uncertainty aside, there has been a rush by investors to buy "Trump" stocks including banks, insurers, materials, defense and energy holdings. The recent rally has left many of these sectors overpriced. Meanwhile, "Obama" stocks (including health care, consumer staples, utilities and telecom stocks) are being discarded from portfolios though in many cases their business prospects remain solid and valuations attractive.

We think investors are overreacting to both groups of stocks. Trump stocks are overbought in anticipation of a faster growing economy. Obama stocks are being sold as a source of funds. No one knows how Trump's presidency will play out; which policies will be favored by Congress, and which will be rejected. Many of Trump's proposed programs would materially increase the federal deficit which Congress will oppose in large part we suspect. And what will Trump actually do with trade (campaign rhetoric aside)?

There have been comparisons made of Trump's pro-growth policies with the Reagan presidency that saw economic growth take off along with corporate profits. Are these comparisons justified? We think not. The economic and market backdrops associated with the Trump and Reagan presidencies are very different. Importantly, the Reagan rally didn't start until March of 1982–a full fourteen months after the inauguration. Today's investors are pricing in Trump policy successes even before he takes office!

Reagan presided over a persistent, multi-year bond market rally (falling interest rates), with the stock market's capitalization about 40% of GDP. In stark contrast, the current stock market

The top individual tax rate at Reagan's inauguration was 70%, or about twice the current top bracket. Tax cuts, from today's levels, will have less impact. Reagan substantially increased the federal deficit just as Trump's agenda is expected to do. But under Reagan the deficit was about 30% of GDP while we now have a far larger deficit of nearly 100% of GDP.

The last two factors alone, taxes and deficits, make it difficult to duplicate a Reaganesque boost to growth and profits. In addition, Reagan began with a stagnant economy with high inflation, high unemployment, and double digit interest rates. Today, GDP growth is steady, though disappointedly slow, we are near full employment, and inflation has been replaced by the threat of deflation. As you can see, comparisons between the two time frames is a stretch.

Have we now seen the excessive optimism/euphoria in this bull market's last stage, or is this a brand new cycle? We acknowledge a shift in sentiment has occurred which could extend this rally further but actual policies will eventually matter, as will valuations. We believe the market remains in the late stages of an extended rally. After almost eight years of well above average returns, it is hard for us to fathom the market cycle continuing without an interruption of some sort, mainly because of stretched valuations. Therefore, it is premature to jump on Trump's stock market bandwagon based on hope alone. Chasing overpriced stocks on the assumption they will benefit from policy poses significant risks.

Elections Have Consequences

Trump's surprise election win combined with Republican majorities in both congressional houses is sure to create fundamental change in government. In the near future we expect substantial adjustments to fiscal, monetary and trade policy.

Anticipating market reactions to new administration policy revision is tricky with baffling market outcomes common (as was the case when markets initially collapsed, then rallied dramatically on election night). **Given Trump's brash nature and a lack of clarity on his ultimate policy designs, we believe political risk is at its highest in at least eight years.**

Political risk is a serious concern for investors as it can lead to unanticipated market swoons and periods of heightened volatility. Unexpected market declines can be especially thorny problems for the newly retired as significant losses can impair portfolios forcing diminished withdrawals and thus lifestyles. It can also lead to emotional decision making and behavioral miscues. Therefore, over the next several months we will maintain a more defensive portfolio posture as a common thread across all of our client portfolios. Our goal is to add value in a more volatile, less predictable market.