Insights from our Chief Investment Strategist

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John Portwood, CFA | Chief Investment Strategist | Hancock Horizon Investments

President-elect Donald Trump and "Regime Change"

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Given the reaction of the "status-quo elites" in Europe and the U.S. to the election of Donald Trump, imagining that a movement to replace the existing social and economic order is underway, does not seem farfetched.

Anti-establishment political populism on the left and right has been on the march in Europe since the eruption of the Eurozone financial crisis in 2011. After Brexit, the common term for the withdrawal of the United Kingdom from the European Union following a referendum held in June 2016, Trump's victory has brought on a wave of media reports and white papers from the region asking if global capitalism can be saved, and expressing fears that America's new leader threatens the entire geopolitical Western system that has evolved since World War II. So great is this fear that the comments of some of the authors are tinged with hysteria. The German weekly news magazine Der Spiegel headlined "It Is the End of the World…as We Know It." And perhaps it is, as far as European unity is concerned. Trump's economic/political vision, validated by the electorate, adds impetus to the anti-globalist, more nationally focused political parties that have been gaining strength for years. Upcoming referendums/elections in Italy, Austria, and France could accelerate the slow-motion disintegration of the existing Eurozone monetary union and further complicate efforts to bring about structural reforms to faster growth and replace reliance on European Central Bank (ECB) stimulus schemes of increasingly questionable merit. Reforming the rules-bound bureaucracy that drives the system, however, is akin to disentangling the Gordian knot. There has been much reform talk, but bold action required to cut through the regulatory morass is unlikely, perhaps impossible. Not surprisingly, maintaining the status-quo and issuing retaliatory threats against current discontented and soon to be former (United Kingdom) members of the club seems to be the preferred policy. ECB President Mario Draghi recently said the recovery in the Euro-area remains dependent on continued monetary support. Under the circumstances, the European Union will likely face continued discord with moderate economic growth prospects at best.

Populist movements in the U.S. have historically been characterized as socialist/collectivist, but populist rhetoric, including identity politics, characterized the campaign of both Bernie Sanders and Donald Trump. Their message reflected the economic and political polarization that has been growing for many years and has not yet peaked. Using recent Gallup organization polling data from a November survey designed to measure perceptions of the country as united or divided, "77% of Americans, a new high, believe the nation is divided on the most important values while 21% believe it is united and in agreement."[1] With the exception of the years immediately following the 9/11 terrorist attacks, respondents to this Gallup poll have perceived the nation as more divided than united for more than 20 years. Economically, this can be tracked by flattening median incomes versus inflation, the "Occupy"

[1] http://www.gallup.com/poll/197828/record-high-americans-perceive-nation-divided.aspx

movement, and the outsourcing and elimination of jobs due to globalization and automation. Politically, a Pew Research study reviewed by BCA Research showed a widening divide between Republican and Democratic voters to the extent that "45% of Republicans and 40% of Democrats now regard the other party as a threat to the nation's well-being".

While the U.S. faces more political and social discord following the election, there are fewer roadblocks to regulatory reform and fiscal stimulus compared to the European Union. The benefits of a political union, as opposed to an exclusively monetary union, are quite evident. However, questions concerning how much can be agreed upon, how quickly programs can be implemented, and what the impact will be on the economy, are yet to be answered. As President, Donald Trump aims to provide for more meaningful employment opportunities and economic growth by lowering/restructuring taxes on corporations and individuals, increasing defense spending, creating a public/private partnership to promote productivity enhancing infrastructure spending, across the board regulatory reforms, replacing/restructuring of the Affordable Care Act, and redefining trade policy to the greater benefit of the U.S. Broadly speaking, these goals are admirable and on the surface the long-term implications are positive. Unfortunately, the devil is in the details. Are the decision makers willing to compromise and carefully consider the international and domestic ramifications of more spending and tax cuts in the face of accelerating entitlement outlays and the potential for a substantial increase in federal borrowing and budget deficits? What is "acceptable" concerning international trade agreements?

A careful and deliberate approach to policy implementation would be preferable to hasty action that might lead to poorly designed programs with unintended consequences. Acting in haste and repenting at leisure, however, has been a typical feature of the democratic process for millennia. Economist Thomas Sowell calls this Stage One thinking, arguing that politicians tend to focus on the next election and the immediate result of an action without adequate consideration of what might happen down the road. In today's interconnected world of slow-growing, heavily leveraged economies, however, perceived policy consequences are likely to quickly trigger reactions in the financial markets.

In the weeks since the election, for example, the markets have decided that "reflation" is coming. Economic growth will quicken, profits will rise, prices will rise and interest rates will rise. Therefore, the primary investment themes included buying U.S. domestic stocks, selling international and emerging market stocks, and selling bonds. But as Carter Worth at the Cornerstone Macro research organization put it, not everything made sense with "surges in some financial assets, plunges in others, abrupt pivots, shocking resets, (and) mayhem, frankly."

Strategic investment thinking was overwhelmed by short-term "ready, fire, aim" response. It was as if the structural headwinds of demographic aging, declining labor force growth, and excessive debt were instantly wiped away, but below average economic growth after almost nine years of massive monetary stimulus suggests there are no quick fixes available. Nothing has changed fundamentally. We can guess that the populist social mood trends now underway and the political reactions to them will ultimately have a significant impact on economies and markets, but investors should avoid leaping to conclusions, maintain a disciplined approach in keeping with long-term goals, and consider hitting the pause button if the pressure to act immediately becomes intense.