Conventional Wisdom Trumped

November 9, 2016

STERLING
CAPITAL FUNDS

Shocker!

The markets (and many others) were surprised by Donald Trump's election as President of the United States and the Republicans' retention of the Senate. Pollsters, the media and the markets were similarly wrong about Brexit last June. Although the markets traded lower in the immediate aftermath, U.S. stocks are currently up significantly, while interest rates are sharply higher.

Populism has been gaining strength over the past decade in the developed world. Economic growth has been very weak by historical standards, which is not unusual in the aftermath of a debt bubble. Corporate profit margins have been at all-time highs while consumer income growth has been stagnant, giving rise to concerns about economic inequality. It is notable that Bernie Sanders got close to 40% of Democratic primary votes, largely driven by the same issues. So, there is enormous voter dissatisfaction with the status quo.

What does this mean for investors? We learned yesterday that the so-called experts were wrong again, and there will remain plenty of uncertainty regarding Donald Trump's plans and policies. However, a few factors stand out.

Out: Austerity. In: Populism.

Despite their many differences, both Hillary Clinton and Donald Trump have campaigned for higher infrastructure and government spending and some rollback on globalization and free trade. There is no appetite for entitlement reform. Minimum wage levels will continue rising. There will be more focus on curbing immigration. Mr. Trump also campaigned for tax cuts and a lighter business regulatory touch. With Republicans taking the Presidency while retaining control of both the Senate and House, many investors perceive a more constructive business environment. They may be wrong in scope, however. Both the Democrats and Republicans have become more populist as their voters have desired. There will be increased focus on Main Street, not Wall Street and corporate America.

We believe there is a decent chance of interest rates trending moderately higher as continued wage gains and more fiscally expansive policies result in higher levels of consumer spending, eventual increased corporate investment as companies respond to stronger demand, and somewhat higher inflation. The dollar should continue strengthening due to the Fed's desire to raise rates (versus the rest of the developed world central banks' commitment to lower rates) as well as modestly stronger economic growth. Multinational profits would be constrained as a result.

Stick to the Plan

Investors often let their political biases dictate their investment outlooks. They also overestimate the President's control or impact on the economy. We recommend investors stick to their long term investment plan.

By: ***Jeffrey J. Schappe, CFA®***
Managing Director