Quarterly Commentary Q4: Trumping the Future

Now that the circus of an election cycle is over and the thank you tours are concluding the Trump administration is beginning to take shape. It is time to look ahead at some campaign promises and try to separate rhetoric from likely implementation.

With the GOP having control of both the Presidency and Congress, the platform to enact changes seems fruitful. Expect the road to be far from smooth, however. The democrats are already digging in and may provide roadblocks for seamless bill passage. It is likely to assume that Trump will rely on executive powers to push through some legislation, in the same vein that his soon to be predecessor did.

Trump's domestic agenda translates into a major challenge. Reforming tax rates (including the elimination of the estate tax), repealing and replacing the Affordable Care Act, building a border wall, bringing jobs and corporate investment back home, loosening financial regulations, opening lands for energy exploration and recovery, and aggressive infrastructure spending are just some of the big ticket items.

The areas where we believe Trump would be successful in pushing his domestic agenda would be in the areas of tax, financial regulation reforms and energy. A push to reduce the corporate tax rate to 15% from its current 35% rate seems unlikely. However, a smaller reduction of 10% may be more palatable and could potentially incentivize global corporations to invest domestically and move overseas profits back home. For individuals in the top tax bracket, Trump's proposal to reduce the tax rate by more than 10%, along with eliminating the alternative minimum and estate taxes, could meet some resistance as fiscal conservatives will voice concern over lost revenues. A more modest reduction with across the board tax breaks would have a better chance at passage.

Financial regulatory reform is an area where the new administration could have a significant impact. Trump's goal is to get businesses the capital they need to invest and expand operations. Dodd-Frank, a target of the GOP as a business inhibitor, would certainly be in the cross hairs. Trump's proposed cabinet picks, including industry leaders and billionaires, will provide a strong push to loosen regulations. Additionally, the incoming administration has promised the renegotiation of trade deals while placing tariffs on imported goods. These promises, while lofty, will be harder to implement in such a manner that proves beneficial domestically without being at the expense of international diplomacy. As an extension of the pro-business promises, energy also stands a chance to benefit. Trump has made clear his intentions of putting domestic energy production as a cornerstone of his platform. We would anticipate a strong push to realizing this campaign promise while taking steps to dwarf the Obama's administration climate change regulations.

Repealing and replacing the Affordable Care Act, building a border wall and investing one trillion dollars in infrastructure spending are areas where the new administration will run into resistance. The Affordable Care Act will be difficult to repeal outright. The newly insured, especially those with pre-existing conditions, will resist changes that negate their coverage. Additionally, an outright repeal and replacement option can only work if a new plan is proposed. To date, no such plan has been offered. With democrats dug in and the newly insured unwilling to give up current coverage, amendments to the existing law seem more plausible.

Building a border wall also has many more challenges than promising outcomes. While the fiery rhetoric works well during a campaign cycle, the logistics on delivering on such a promise is challenging at best. Some of the road blocks, including legal challenges and Mexico refusing to pay for the wall, make the construction unlikely. A more intensive policy focusing on limiting total immigration seems a path of lesser resistance.

Lastly, the investment of one trillion dollars on infrastructure spending will also be met with pushback. While the need for infrastructure spending has been unilaterally agreed upon, the monies to fund the investment will be hotly debated. GOP fiscal conservatives and democrats alike will be resistant unless the bill is paid for without any increase in user fees. Any type of infrastructure bill that gets past will most likely include a mixture of private capital and municipal finance.

The fourth quarter saw rates climb dramatically as the combination of the Federal Reserve increasing its base lending rate, while leaving the door open for additional hikes in 2017, along with unexpected election results equated to a significant sell-off. A Trump administration, being viewed as anti-regulation and business friendly, led to investors moving money from fixed income to stocks. Municipals slightly outperformed US Treasuries, especially in maturities 5 to 15 years, with AAA rated municipals outperforming their lower rated counterparts. Municipals continue to offer relative value as ratios remain above historical norms.

US Treasury Yields			
	9/30/2016	12/31/2016	Change
1 Year	0.61	0.84	23 bps
3 Year	0.94	1.52	58 bps
5 Year	1.19	1.96	77 bps
10 Year	1.64	2.51	87 bps
20 Year	2.09	2.86	77 bps
AAA Municipal Yields			
	9/30/2016	12/31/2016	Change
1 Year	0.74	1.00	26 bps
3 Year	0.89	1.43	54 bps
5 Year	1.05	1.80	75 bps
10 Year	1.52	2.35	83 bps
20 Year	2.11	2.88	77 bps

The prospects of lower income taxes for corporations and individuals, along with the potential utilization of municipalities for infrastructure spending, will weigh on municipal bond investors in the coming year. While uncertainty exists in regards to what the incoming administration may be able to enact, in the end, the only thing we can say with confidence is that campaigning and governing can be unfamiliar bedfellows.

All the best,

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