



Reflections on a Trump Presidency

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Like many others, I was surprised by the results of the election. I guess I was persuaded by the polls that indicated that Hillary Clinton would win, even though the spread had shrunk to something within the margin for error. She also had a significant advantage in the Electoral College going into the race. On election night, I attended two parties given by major donors to the Democratic Party. When I arrived at each the mood was upbeat (one was black tie—preferred in anticipation of a celebratory occasion). By nine o'clock the crowd was becoming despondent and by eleven most had left. I thought I would try to get some sleep around midnight and called a Washington contact whom I knew was staying up all night. I asked him to call me when the outcome was certain. He didn't call, but sent me an email at 1:42 am saying that Pennsylvania had gone for Donald Trump and it was over. Pennsylvania! She had campaigned so hard in that state. What had happened? I thought about the irony: before the election the popular view was that the Republican Party would have to be restructured away from extremism. After the election, it was the Democratic Party that might require restructuring. In the latter case, more toward the left and the ideas of Elizabeth Warren and Bernie Sanders. But in my view, the loss was candidate-specific and not related to party philosophy. The Democrats should remain in the center.

In retrospect, figuring out that two flawed candidates were running against each other isn't so hard. Trump had extreme positions on a number of issues (e.g., immigration) and his personal statements and behavior conflicted with the values of many potential voters. Clinton was more mainstream and sympathetic as a person, but in August 59% of potential voters thought she was untrustworthy. Moreover, that number was probably higher on election day because of the revelation by the FBI of additional e-mails. What was different about the two candidates was the clarity of their central messages. Donald Trump recognized that the country was yearning for change. According to Census Bureau figures for 60% of U.S. households, real income in 2015 was lower than in 2000. They had been losing ground in the new millennium. People often vote with their pocketbooks. Donald Trump was going to make America great again which, to many, meant they would have better jobs and more disposable income. He had a pro-growth agenda with lower taxes, less regulation and fiscal spending on infrastructure.

Hillary Clinton's message was less clear. She was going to continue the Obama agenda, spend money on infrastructure but raise some taxes to pay for it, and maintain liberal policies on social issues. Voters saw her platform as more of the same at a time when they thought the country needed change. Clinton was hurt by her reluctance to be interviewed frequently, while Trump was always available. She also did not visit some key states like Wisconsin during the campaign. Donald Trump may have had personal traits voters had trouble accepting, but they were willing to put that aside in favor of his program to restore growth in the economy. Hillary Clinton may have been the most experienced person ever to have run for president, her personal values and compassion may have resonated with the majority of the electorate (she won the popular vote), but she didn't have a convincing plan for improving the health of the economy and he did.

There may be serious weaknesses in the Trump plan and it may swell the budget deficit to an unmanageable size, but at least it was a set of ideas to put the country on a growth course and that's why he won. Populism dominated the economic landscape in the presidential election. Voters who were dissatisfied with their leadership chose someone who promised a radical approach to existing policies. They knew it was a risky decision but they couldn't accept a continuation of what they believed was a do-nothing establishment. Populism was also clearly apparent in the Brexit referendum on June 23 and it will play a role in the political process in Holland, France and Germany. The result will be above-average volatility in the financial markets.

During the campaign Trump talked about a wide array of initiatives and, when he takes office, he will have to set priorities. He will put the more controversial parts of his agenda further down the list and try to build support across the broad electorate and Congress for programs where there is bi-partisan agreement. I believe he will fill the vacancy in the Supreme Court early in his first term and while his choice will be more conservative than many would like, he will probably pick someone with unquestioned judicial qualifications. The great fear that many have is that the Court will try to overturn the Roe v. Wade decision giving women the right to choose reproductive alternatives. This highly contentious area will not, however, be addressed early by the newly constituted Court if at all. He will try to deliver on his promise to fix some of the weaknesses in the Affordable Care Act, giving insurers the ability to sell policies nationally and providing incentives for

younger healthy people who are currently uninsured to sign up. This will broaden the pool and make the whole program more viable economically. When the Affordable Health Care Act was initiated, 18% of the population was not covered by health insurance; now that number is only 11%. Simply scrapping the existing program and starting all over again with a totally new plan is impractical. Changes in the current plan can be made and approved by a Republican Congress. I think that will be the approach taken by the new president.

Another area that Trump is sure to tackle is regulation. Lobbyists are going to be all over the new administration encouraging officials to terminate restrictions on business operations. Three sectors that should benefit most are energy, health care and finance. We are likely to see more drilling activity on federal lands and more capital spending in the oil and gas industry. The coal industry, which has a significant cost advantage in producing electricity, will see some restrictions lifted. The more onerous provisions of Dodd-Frank are likely to be altered, giving financial institutions more flexibility. The federal government may well be less hostile toward the pharmaceutical industry on drug pricing, recognizing that these companies have to earn a reasonable return on their costly research.

Close to the top of the agenda will be various aspects of the tax code. There is agreement on both sides of the aisle that some incentive must be put in place to encourage companies with huge cash balances stashed abroad to bring these funds back to the United States to be invested or paid out to shareholders. A 10% tax has been suggested on as much as \$3 trillion. I believe this will be folded into a broader plan to lower corporate taxes. The current statutory rate is 35%, but because of deductions the blended actual rate is close to 27%. If the statutory rate were lowered to 20%, that would be a major change and it would have a dramatic impact on earnings for the Standard & Poor's 500. Since 2014, S&P 500 earnings have been between \$115 and \$120. They are projected to be \$125 for 2017 without any tax relief. If the corporate rate were reduced to 20%, earnings for next year could be as high as \$130. This would make the S&P 500 index, currently about one standard deviation above the historical norm, more fairly valued and provide the possibility of appreciation from present levels. In order to fulfill campaign promises, tax relief will be provided for individual tax payers as well.

There is a limited amount any president can accomplish in the first few months of his administration. The next three items are more difficult to change. Donald Trump will be expected to initiate legislation on immigration. He will definitely take steps to secure the border with Mexico and will try to round up undocumented immigrants who have committed a crime in the United States. I don't think an actual wall will be built on the Mexican border or, if it is, that Mexico will pay for it. Trying to deport undocumented immigrants who have been living and working in this country for some time and who have families, including children born in America (thus citizens), would be a nightmare and raise a series of human rights issues. As a result, I believe broad deportation will be given a lower priority.

I do think the new president will try to take steps to improve our infrastructure but this is not an easy task and House Speaker Paul Ryan will keep a sharp eye on its cost. Projects have to be identified, requests for proposal have to be sent out, bids must be submitted and approved and work must commence. This is a several-year-process. President Obama talked about "shovel-ready" projects in his first campaign and very little actually got done. He would go on to blame the Republican Congress which would not appropriate funds for the work, but that was only a part of the problem. At this point since both parties recognize the need for improving our infrastructure, we should see some progress, but I expect it to be plodding, and its impact on the economy to be minor.

Perhaps the most challenging matter on the new president's agenda will be trade. During the campaign, he argued that the United States was the victim in virtually all of our international agreements. He talked about scrapping NAFTA and called China a currency manipulator. I don't think Donald Trump wants to start a trade war with the major countries that export to us by putting in place very high tariffs on imported goods. I do think he wants to show that he can put a set of policies in place that can bring some manufacturing back to the United States. One plan being discussed is not to tax the profits on goods exported by American manufacturers. If Boeing builds a plane in the state of Washington and ships it to Japan, the profit on that plane would not be subject to U.S. income taxes. Alternatively, if Walmart imports a coat from Vietnam and sells it in the U.S., the cost basis for the coat would be treated as zero and the company would be taxed on the entire selling price less store operating expenses. This proposal was incorporated in Paul Ryan's "Better Way" agenda and there is no question that a major effort will be made to bring some manufacturing back. Many American companies are manufacturing parts in Mexico and China for final assembly in the U.S. These companies will try to influence the Trump administration to be careful not to create tariffs that disadvantage them. The labor cost differential American manufacturers have by locating their factories in Latin America and Asia is huge. Making major progress in restoring manufacturing will be difficult, but Trump is determined to demonstrate some success in this area because it was such an important theme in the campaign. It will require negotiating skill, imagination and sensitivity to accomplish this goal.

The same can be said for international security agreements. While having members of NATO to pay their agreed-upon share of the cost of operating the organization is clearly a good idea, we don't want to scrap the alliance which has done so much to provide stability in Europe. Donald Trump has made a number of isolationist statements during the campaign but he has also recognized the importance of U.S. military strength in maintaining world order. There is probably no international agreement that cannot be improved, but withdrawing from our commitments unilaterally could make the world a less stable place. We should make every effort to ensure that Iran is complying with its nuclear pact. Donald Trump has

declared this one of the worst deals the United States has ever entered into. This agreement involves countries other than the United States and once again, modification would be a better path than abandonment. While the Iran agreement has many critics, including most countries in the Middle East (among them, Israel and Saudi Arabia), there are nuclear experts who believe Iran's production of weapons-grade material has been restrained. I hope the new Secretary of State will tackle this one with both firmness and pragmatism. Before Trump takes over, a number of private sector companies will be encouraged by the lame duck administration to sign deals with Iran. The hope is that these companies will ask the Trump team to move slowly on pulling out of the agreement. While such tactics are unlikely to soften his resolve, perhaps Trump's relationship with Putin will. With so many major issues to be confronted it is easy to see how education and the environment will be low priority items in the new administration.

In looking over the whole panoply of issues facing the president-elect, I wonder if he knew what he was getting into. He clearly wanted to win the election and he did it using tools very effectively that nobody had ever used before in quite the same way. Now he has to do the job and that doesn't look like so much fun. There are no crowds cheering in the Situation Room. All the problems are gray, not black and white. His adversaries are tough and not always reasonable and they, unlike the president-elect, have been in the public arena their whole lives. I can understand why he would want to spend half his time in New York.

My interpretation of the early signs is favorable. I have a mixed view of certain people chosen for key jobs so far, but the process seems deliberate. One of the aspects of being overwhelmed by the challenges facing you is that you become subdued, but so far we have only seen limited evidence of that.

As for the financial markets, Trump will vigorously pursue a pro-growth agenda. The Fed will tighten, inflation and interest rates will rise somewhat and profits will improve. I am optimistic for equities for the near term. My hope is that Donald Trump's desire to be loved by the people overcomes his drive to shake up the establishment and he continues to back away from his more extreme positions. Several years from now, when inflation, interest rates and the budget deficit may rise sharply, the environment for common stocks may be more difficult. Let's hope growth softens the negative effects of those risks.

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