INVESTING
without a crystal ball

With the end of 2016, and a spectacular post-election run-up in the stock market, it is critical to evaluate how best to invest in a U.S. equity market confronted by both positive and negative cross currents.

Long-term wealth creation demands careful navigation of these choppy waters. Powerful tailwinds are in place (or potentially will be put into place). Despite the Federal Reserve's "tapering" of QE purchases, and its recent quarter-point increase in the fed funds rate, the ECB and BOJ remain in QE mode.

As a result, global financial markets continue to benefit from historically-loose monetary policy. In addition, the Trump administration has articulated several "pro-business" policy intentions, among them, deregulation, tax reduction, and cash repatriation.

These measures could provide a powerful boost to consumer spending, corporate profits and GDP growth.

President Trump has promised to eliminate unnecessary regulations, "massively cut taxes for the middle class," cut the corporate tax rate from 35% to 15% and permit a one-time repatriation of cash held offshore by U.S. companies, to be taxed at 10%.

In addition, the new administration intends to invest a $1 trillion in infrastructure, which, if successful, could provide a boost to the economy.

Yet significant headwinds remain in place potentially blunting the impact of these new policies.

Weak GDP growth persists with the U.S. forecast at +2.3% and global at +3.2% in 2017 (well below the +4.2% average during 10 years prior to the financial crisis). Potential rising trade barriers (tariffs, border taxes) could further constrain growth.

A second major headwind is the overhang of excessive global debt. Non-financial debt in the U.S. has reached a new high of $47 trillion resulting in an all-time-high debt-to-GDP of 252%.

"These measures could provide a powerful boost to consumer spending, corporate profits and GDP growth"

According to the IMF, global debt has reached $152 trillion (2015) for debt-to-GDP of 225%, also an all-time high.

Excessive debt acts as a constraint on growth and hampers the efficacy of monetary and fiscal policy.

The upward trajectory of interest rates and rising wages put additional pressure on corporate margins.

Lastly, stock valuations themselves are quite extended with trailing 12-month P/E on the S&P 500 having grown to 21x from 12x in 2009.

While the U.S. equity market has experienced an unprecedented 8-year run, returning +290% from the market low in 2009, the above-mentioned tailwinds could propel it even higher.

Nonetheless, the headwinds remain formidable and cannot be ignored.

Given the difficulty of predicting how these head and tailwinds will resolve and with the prospect of continued market volatility, it is more critical than ever to seek a solution that allows for participation in the continued upside momentum in the market, but in a way that will protect on the downside if a dislocation were to occur.

Written by
Edward N. Cooper
Senior Research Analyst

Article supplied by Stralem & Company