Investment Implications of the Trump Presidency

Trump really might succeed in creating a wonderful environment for value investors.

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Key Takeaways

- **We believe that the dual problems of tepid economic growth and income inequality were the key factors in Trump winning the presidency**. We offer an historical perspective to the economic conditions that ushered in the Trump era.
- **Trump's announced policies will likely have a limited effect on spurring economic growth and will likely exacerbate issues of income inequality.** We offer a clear-eyed look at Trump's policy proposals and their likely effect upon the national and international economy.
- **We see evidence that Trump's administration may bring heightened social and economic uncertainty, which in turn has the possibility of bringing about value-destructive investment outcomes.** We urge investors not to get caught up in the "Trump Rally," but consider a relatively more cautious investing stance that involves decreased leverage and increased cash.
- **Value investors love economic conditions that offer plenty of stocks trading at far below their intrinsic values.** Be careful what you wish for.

Introduction

Donald Trump stunned the pundit class with his long-shot candidacy and his upset presidential win. We believe that the conditions enabling the Trump presidency have been roiling for years, are structural in nature, and have their roots in two issues: tepid economic growth and income inequality.

Trump has explicitly pledged to correct the former issue through a series of stimulus and tax reductions, and implicitly suggested that success in boosting GDP will automatically cause reductions in inequality. We believe that his policies to spur economic growth may generate a tailwind in the short-term, but may cause damage in the longer term; they are also likely to exacerbate issues of income inequality.

The three elements that will determine the success or failure of Trump's economic stimulus proposals are 1) how they are designed and implemented, 2) their timing, and 3) the strength of political opposition to them.

In addition to the likely failure of Trump's policies to address the very real and important issues of income inequality and the social stress that such a failure may bring about, we believe that President-elect Trump's transition process (in addition to anecdotes from his business career) highlights some reasons to doubt the executive efficacy of the upcoming Trump administration. These issues may be serious enough to cause a substantial loss of confidence in the market and an attendant drop in market prices.

How to best prepare for the Trump presidency from an investment perspective? We believe the best approach is a cautious one and the best stance, one that lowers portfolio risk. While the world seems to be saying "Risk On," we are happy to take our foot off the gas pedal.

Two Long-Term Structural Problems

The US faces two structural economic problems – tepid economic growth and income inequality. We believe that the support for Trump's candidacy was mostly due to voters in less populous states (whose votes are worth proportionally more than votes from populous states) being the most negatively exposed to each of these trends, and seeing Trump's platform as being the one most advantageous to them.

This section investigates our contention that economic growth has been tepid and that income inequality has increased as well as drawing a causal link between these issues and Trump's presidential win.

Tepid Economic Growth

The following chart shows the nominal value of the US economy from 1947 – present, plotted on a logarithmic scale.

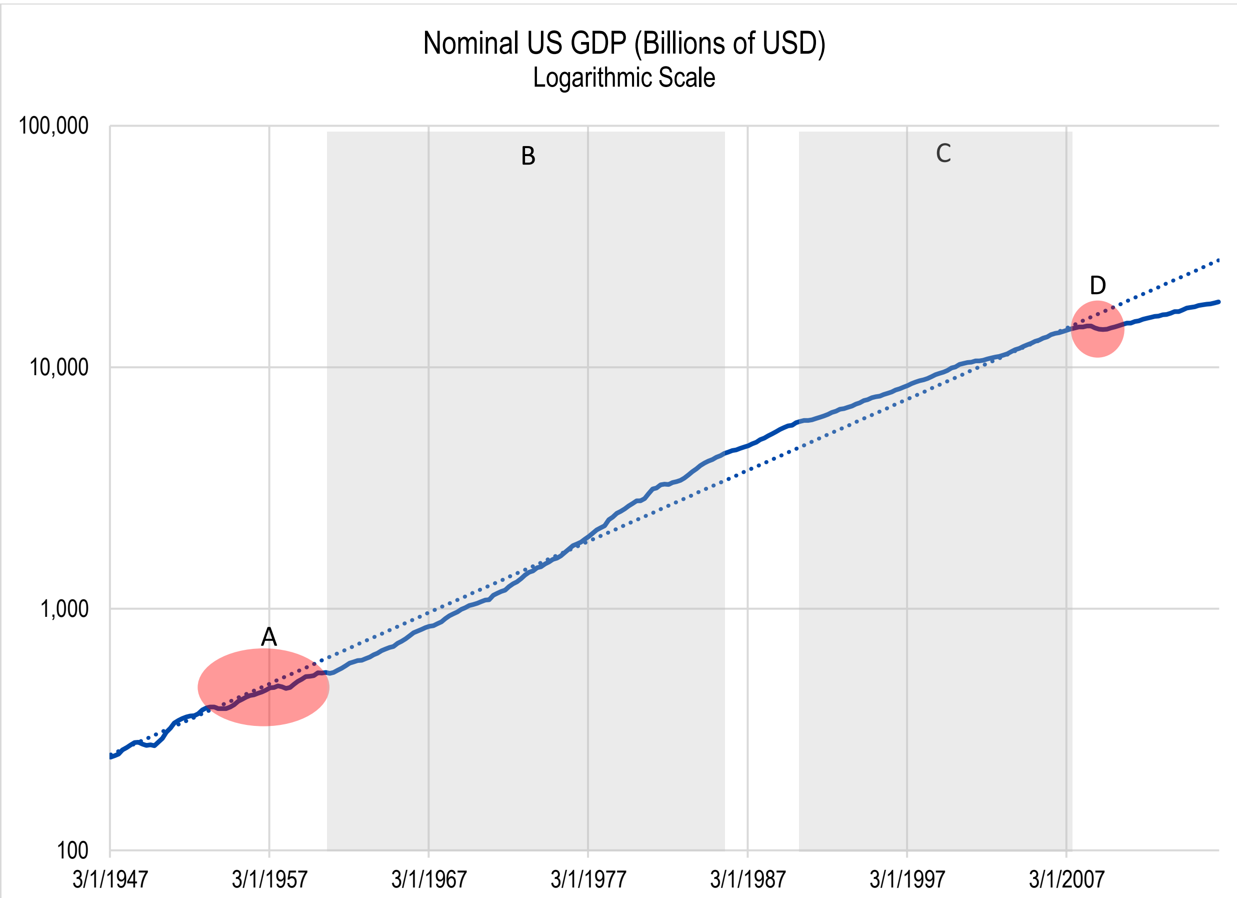

Figure 1. Source: Bureau of Economic Analysis, FWI Analysis

The dotted trendline shows the nominal growth of the economy at around 6.5% per year over this time, during which we have highlighted four periods.

Period A shows the 1954-1961 timeframe, during which there was a series of recessions that pulled GDP below the long-term trend. Period B highlights the long period during which the economy generally expanded at a rate at least as fast as the long-term trend, and considerably faster in many years. The interregnum between Periods B and C (roughly 1985-1990) see a flattening of growth paralleling at the trend rate. Period C follows and shows a general, gradual decline. Period D is the 2008-2009 Recession, and the unshaded region after that, the time until the present.

The sharp drop-off below trendline growth after 2009 and its continued movement away from that trendline is one of the reasons that many in the country believe we are still stuck in a recession. The economy has been growing, but at a sub-trend, tepid pace. For Americans whose income is tied to an increase in economic activity (i.e., wage-earners), this pace feels terrible, especially since prices for important categories like healthcare and education have been rising faster than the economy has been growing. (For Americans who generate income through investments (i.e., owners of capital), the post-Crisis environment has been very good – one look at an S&P 500 chart from March 2009 to present should be enough evidence of that.)

Partisans look at the sub-trend growth following the 2008-2009 crisis and talk about the Obama administration's failed economic policies. However, we believe that this drop-off was years in the making. Real wage growth for non-supervisory employees (discussed in the next section) has remained stagnant since the mid-1970s. To continue to enjoy better living standards even as wages held steady, Americans had begun taking on more debt in the late 1970s and 1980s.

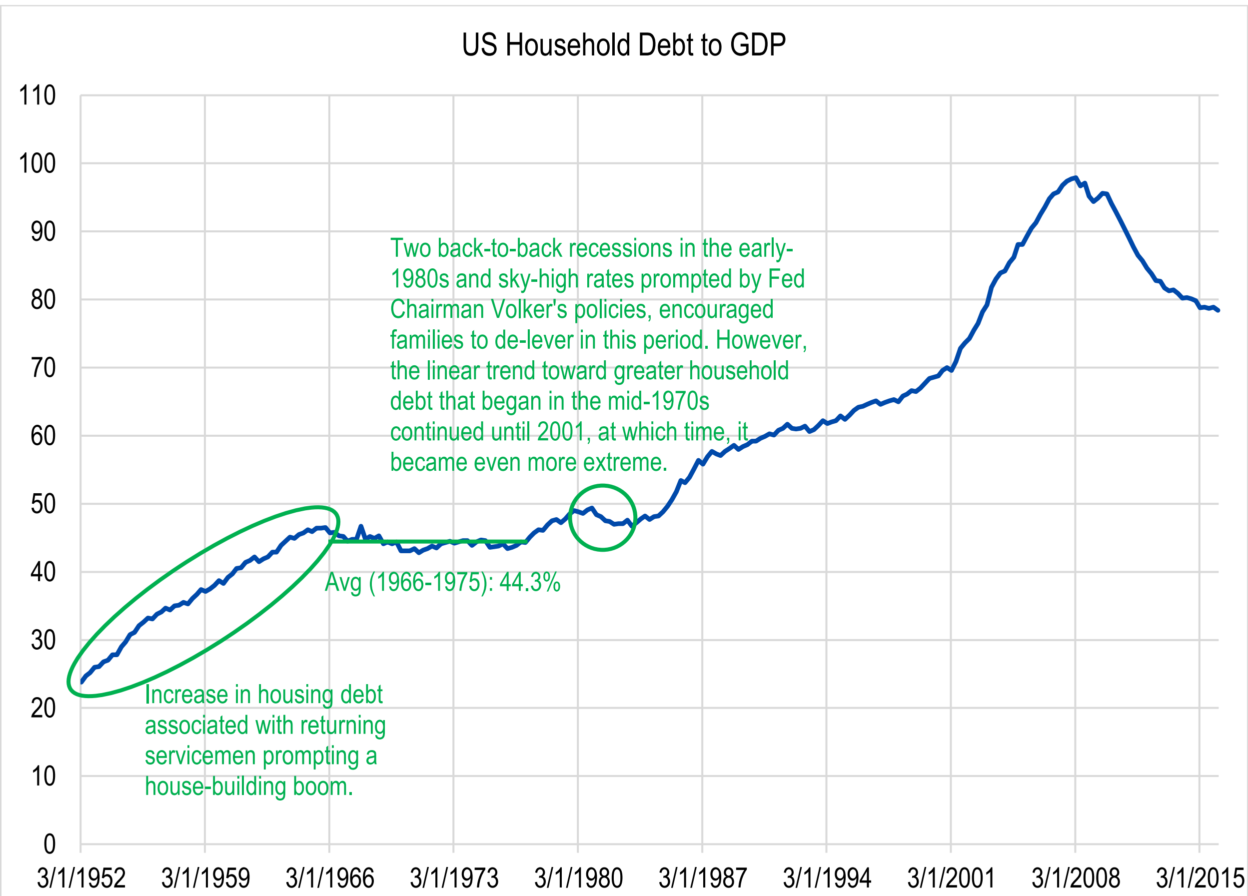

Figure 2. Source:Bank of International Settlements, FWI Analysis

As Bridgewater Associates' founder, Ray Dalio, points out in his article How the Economic Machine Works, purchasing on credit allows shoppers to boost consumption in the near-term, but forces them to consume less in a later period. If there is a severe income shock when consumers are heavily indebted, an economy heads into a period of deleveraging.

Blaming politicians for structural economic issues is the logical equivalent of ancient civilizations blaming droughts or floods on the local king.

In our opinion, Period C in Figure 1 represents the effects of slowing consumption as prior debts were paid off, Period D in Figure 1 represents an income shock, and the post-Crisis period, an economy facing a prolonged deleveraging event.

Blaming President Obama for a deleveraging event that had its roots in the mid-1970s is as irrational as blaming President George W. Bush for the 911 terrorist attacks in our opinion.

Income Inequality

Many academic observers have pointed out the trend of greater income inequality in the US over the past forty years. One driver of this trend has been wage stagnation.

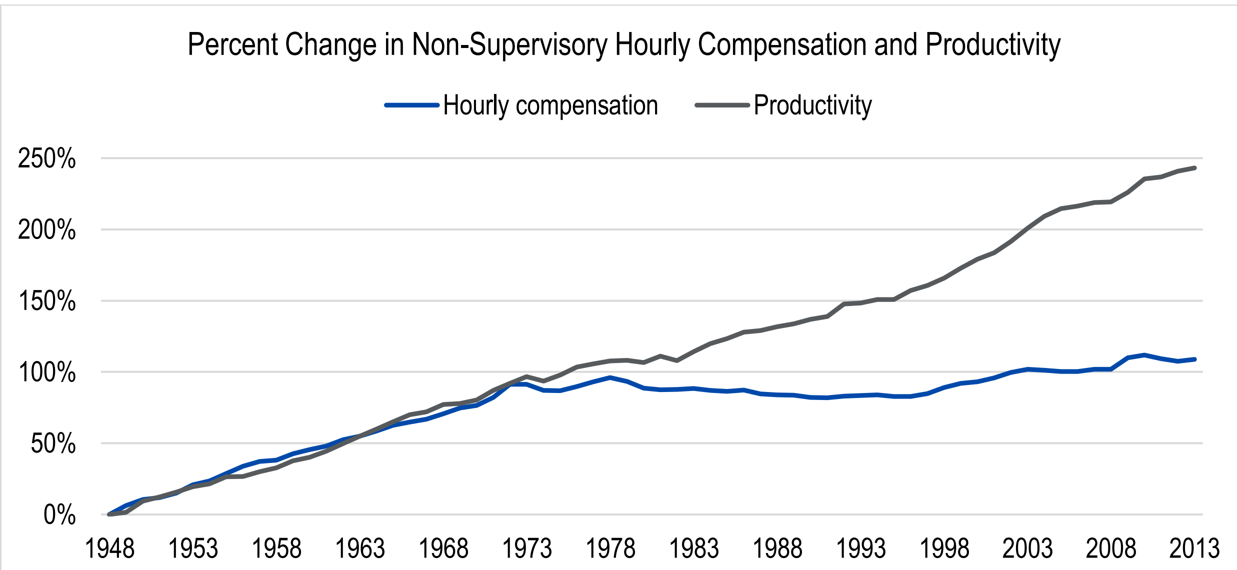

Figure 3. Source: BEA, BLS data via Economic Policy Institute

Increases in GDP are related to growth in worker productivity. The figure above shows that non-supervisory personnel's wages increased at roughly the same rate as productivity from 1948 through the early 1970s. At that time, wages essentially flattened, meaning that increasing national wealth brought about by productivity gains were routed away from non-supervisory personnel (i.e., working-class, both white- and blue-collar) and toward other groups.

The group most benefited by the rise in productivity and national wealth has been earners at the top of the US economic ladder. Note that in the figure below, the income of Top 5-1% of wage earners rose from 12.6% in 1972 to 16.9% in 2015. Similarly, the top 1% of wage earners saw strong growth in their incomes from the early-1980s through the present. GDP has continued to rise steadily during this period, so the figure below shows that the wealthiest strata of society was able to capture an increasing proportion of a growing pie.

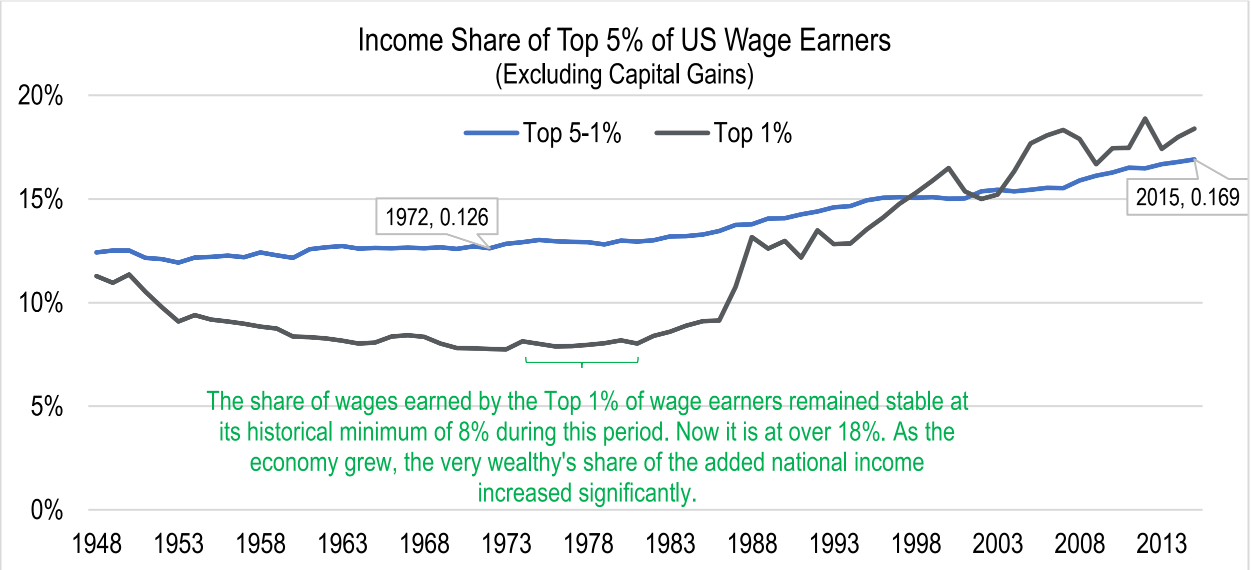

Figure 4. Source: Saez and Piketty, "Income Inequality in the United States, 1913-1998", Quarterly Journal of Economics, 118(1), 2003, (Tables and Figures Updated to 2015 in Excel format, June 2016)

While Figure 3 and Figure 4 look at wages from a slightly different data perspective, together, they tell a powerful story. Figure 3 shows that non-supervisory personnel's salaries stopped tracking growth in GDP in 1979 at the latest. Figure 4 shows that the top 5% of wage earners' wage growth not only kept up with GDP, but in fact surpassed it; the very wealthy captured an increasing piece of GDP as GDP grew.

Economic Factors' Effects on the Election

Our contention that tepid economic growth and income disparities were the driving forces of the election is difficult to prove conclusively, but we believe there is good anecdotal evidence for it.

The economy was consistently rated as the number one concern among likely voters.

A Gallup Poll whose results were published in mid-2015 showed the economy was the most important issue – 86% of respondents believing it was extremely or very important. In mid-2016, the Pew Research Center published the results of another poll showing similar results – the economy was considered very important by 84% of respondents – 10 percentage points higher than the response for healthcare. While these responses could be applied to either of the structural issues identified in this report, we believe it is more closely related to that of tepid economic growth.

For evidence regarding our contention that income inequality was a key determinant of the election results, we conducted a study comparing the personal income per capita to the vote results on a county-by-county basis.

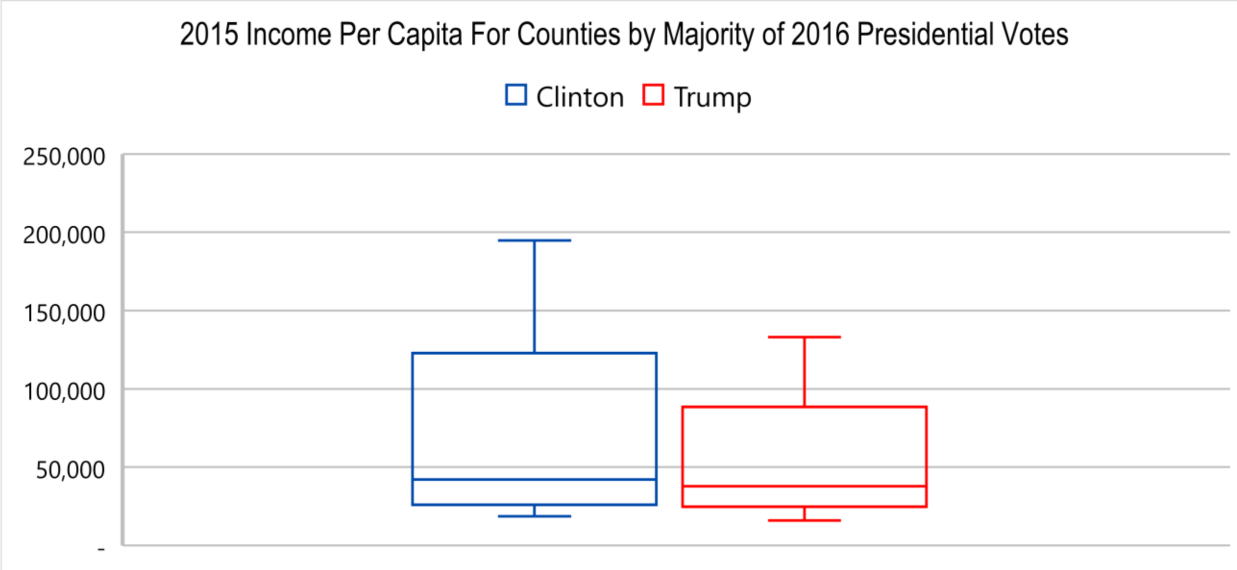

Figure 5. Source: Bureau of Economic Analysis (Income data, 2015), Kaggle (Voting data), FWI Analysis

These data show strong anecdotal evidence for our second contention. Counties voting for Trump had notably lower median incomes as well as a much smaller dispersion of incomes as can be seen in the figure above and the table below.

Table 1

	Clinton	Trump
Minimum	18,598	16,007
Q1	33,426	33,517
Median	42,075	37,775
Q3	50,848	43,942
Maximum	194,861	132,989

Also, the list of the top-earning counties for each candidate is also instructive.

Table 2

Clinton		Trump		
Location	2015 Income	Location	2015 Income	Difference
Teton, WY	194,861	Shackelford, TX	132,989	61,872
New York, NY	156,708	Wheeler, NE	125,171	31,537
Pitkin, CO	126,137	Kearney, NE	108,975	17,162
Marin, CA	109,076	McMullen, TX	107,627	1,449
Nantucket, MA	107,341	Midland, TX	106,588	753
Fairfield, CT	106,382	Williams, ND	101,645	4,737
San Francisco, CA	103,529	Billings, ND	92,463	11,066
Summit, UT	98,128	Union, SD	88,707	9,421
San Mateo, CA	97,553	Hemphill, TX	88,255	9,298
Westchester, NY	93,229	Williamson, TN	87,419	5,810
Blaine, ID	87,496	Lane, KS	86,725	771
Average	116,404		102,415	13,989

The high-income counties supporting Clinton in Wyoming, Utah, Colorado, and Idaho all represent counties in which ski resorts are located. The highest income counties supporting

Trump look to either be very sparsely populated (increasing the possibility that the income data has been thrown off by outliers) or associated with energy extraction economies.

The tendency for lower-income counties to vote for Trump is clear from these data, providing strong anecdotal evidence at least for a connection between income inequality and voting patterns.

It's ironic that economic growth just now appears to be picking up and wage growth has been strong for several quarters – suggesting that the economy is at last moving past the Post-Crisis extended deleveraging phase. Voters, if they were aware of recent improvements, mentally filed the data points under "too little too late" and bought into Trump's vision of a stimulus-led American Manufacturing Renaissance.

Also, note that while globalization certainly did contribute to domestic job losses as low oil prices allowed for manufacturing jobs to be moved overseas (starting with the lowest value-added manufacturing first), it also allowed Americans to enjoy a high standard of living at a cheaper price. If plastic storage boxes were selling at $50 per box rather than $8, not many people could afford them. If packs of men's underwear were selling at $65 per pack than $12, we would be a nation much more adept at repairing clothes.

With this understanding of the historical background to this election, let's turn now to President-elect Trump's specific policy proposals.

President-elect Trump's Economic Proposals

One issue that any economic or political analyst must face when making projections about the Trump presidency – one to which we will return in a later section – is that it is very hard to pin down President-elect Trump's level of interest in or commitment to any announced proposal. We have attempted to present the President-elect's positions accurately, and provide links to his statements or announcements as reference.

For each proposal, we analyze the President-elect's stated policies in the context of the two long-term structural problems detailed in the preceding section and use this framework to forecast the likely effect on equity investors.

Infrastructure Stimulus

The Plan

Trump's published America's Infrastructure First Plan site does not spell out any details, but on the campaign trail, Trump pledged $1 trillion of stimulus to improve highways, tunnels, bridges, and airports. A report written by Trump advisor and hedge fund manager Wilber Ross offers specific suggestions regarding tax incentives to help reduce the funding cost of the plan (though curiously dedicates a good bit of time discussing pipelines – assets in which he likely owns an investment stake – rather than highways, etc.), and this set of suggestions may have morphed into a suggestion to establish a state-funded Infrastructure Bank that would be supervised by the Executive branch and that would perhaps involve public-private partnerships.

FWI Analysis

Trump's infrastructure stimulus plan aims at closing the gap in Figure 1 between present GDP and trend GDP by boosting government spending and encouraging companies to invest in capital goods to provide the tools and services to improve infrastructure.

The American Society of Civil Engineers has given US infrastructure a close-to-failing grade for years and suggests that the cost to remedy this issue is $3.6 trillion. Spending $3.6 trillion (or even a *mere* $1 trillion) would provide a terrific boost to the US economy, thanks to the "multiplier effect" of roughly 3x (over 20 years) and to greater improvements in the speed and efficiency of transportation and commerce.

We like the emphasis on infrastructure spending and believe that such spending is necessary. The biggest issues with the plan include 1) potential political pushback, 2) timing, and 3) how the stimulus plan is structured.

It is unclear to us whether prior political opposition to infrastructure spending was mainly due to fiscal concerns or partisan ones.

In terms of political pushback, various iterations of a very similar plan have been suggested over the last eight years by the Obama administration, including the establishment of an Infrastructure Bank, but all of these proposals were batted down in Congress save for two – the 2009 Economic Recovery Package and last year's transportation bill.

While the Republican party is playing nice with the incoming administration now, note that Mitch McConnell, Senate Majority Leader, distanced himself from Trump during the presidential campaign and recently told NPR that infrastructure spending was "not top priority." Even within Trump's own administration, Vice President-elect Pence, part of the Tea Party Caucus while a congressman, was a fiscal hawk and resistant to infrastructure spending. While supporting Trump's plan publicly now, as Indiana congressman, he voted no on the Economic Recovery Package (which appears to be very close to what Trump is presently recommending) and was slow to address infrastructure issues as Governor of Indiana.

Considering these issues, we think it may be difficult to bank on the Trump administration unleashing a wave of infrastructure spending any time soon.

Regarding timing, if infrastructure stimulus does pass through the political gauntlet, it's worth noting that the present environment is very different than the one we were in in 2008-2009, when the Obama administration was coming into office. GDP shows signs of picking up a bit, unemployment has dropped to the 5% mark – a fairly low level historically – and wages are rising.

Additional government spending may add fuel to a fire that is already starting to heat up.

Adding fiscal stimulus to an economy that is already in the process of heating up is liable to drive up prices – especially the price of labor, "wage inflation." Even the suggestion that a Trump infrastructure spending boost was in the cards has led to rapidly rising 10-year Treasury rates and a 100% chance expectation of a Fed funds rate hike in December of this year.

In addition, as the Obama administration found out, infrastructure projects take time to plan and carry out. Any Trump infrastructure stimulus is likely to take several years to really start providing an economic boost.

Last, we believe the structure of the stimulus may work against the interests of many rural Trump supporters for two reasons. Logistically, not all infrastructure projects will be in the areas that most need assistance. Fixing up the disaster that is LaGuardia airport is a worthy goal, but it's not going to do much to better the economic prospects in Greenville, Maine. Workers can move to areas with more jobs, but this also has a wasting effect on rural economies.

Structuring the stimulus in a way that benefits mainly investors and the wealthiest strata of society is dangerous from the standpoint of social stability in the medium- and long-term.

Additionally, we fear that the political opposition to infrastructure spending programs mentioned above may lead the Trump administration to structuring the stimulus in the form of tax cuts to corporations working on infrastructure projects. This would likely bring about a situation in which rather than starting new projects, companies will simply receive tax breaks for projects already taking place. This kind of stimulus would be good for investors (see the Taxation section below), but the betterment of investors in itself would likely further exacerbate the income inequality issue, in that the wealth of the highest-income earners would likely be boosted to a greater extent than that of lower-income earners.

In the short-term, an increase in income inequality is not likely to have negative effects on social stability, especially if lower-income wages are rising at a faster clip than they have been, but longer term, we believe this situation does not bode well for the American democracy and the economy it sustains.

Investment Implications

Financial Sector: We believe the biggest near-term stock price boost will be to firms in the financial sector. Rising rates makes it much easier for banks and other financial companies to make money on the spread between the rates at which they lend and the ones at which the borrow.

If inflation expectations durably rise again to their historical norms, Trump's infrastructure stimulus would likely have a positive effect on the *value* of financial firms as well as on their market prices, since spread income would be reset at a higher level into the future.

In addition to the infrastructure spending boost, there have been rumors that the Dodd-Frank financial reform law will be repealed. This law, passed in the wake of the 2008-2009 financial crisis, increased regulatory control of banks and reduced banks' ability to take on leverage. If this law were repealed, banks would likely be more profitable, but would also likely start taking larger market risks. At least in the short-term, the lowered regulatory burden would provide a boost to financial stocks' prices, though the increased potential for a future fall makes us cautious about assuming that financial firms' values will also be boosted.

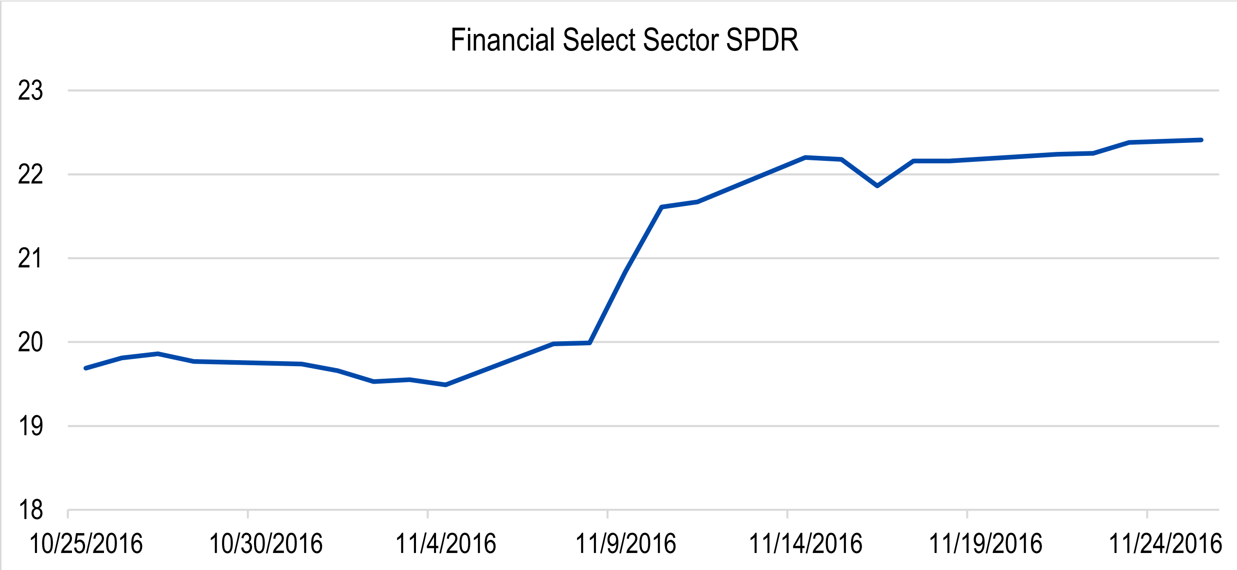

Figure 6. Price of the Financial Sector Tracking ETF (XLF). Source: YCharts

Industrials and Basic Materials Sectors: We believe the effects on industrials and basic materials firms is likely to be less positive than many investors are assuming based on stock price movements in these sector tracking ETFs.

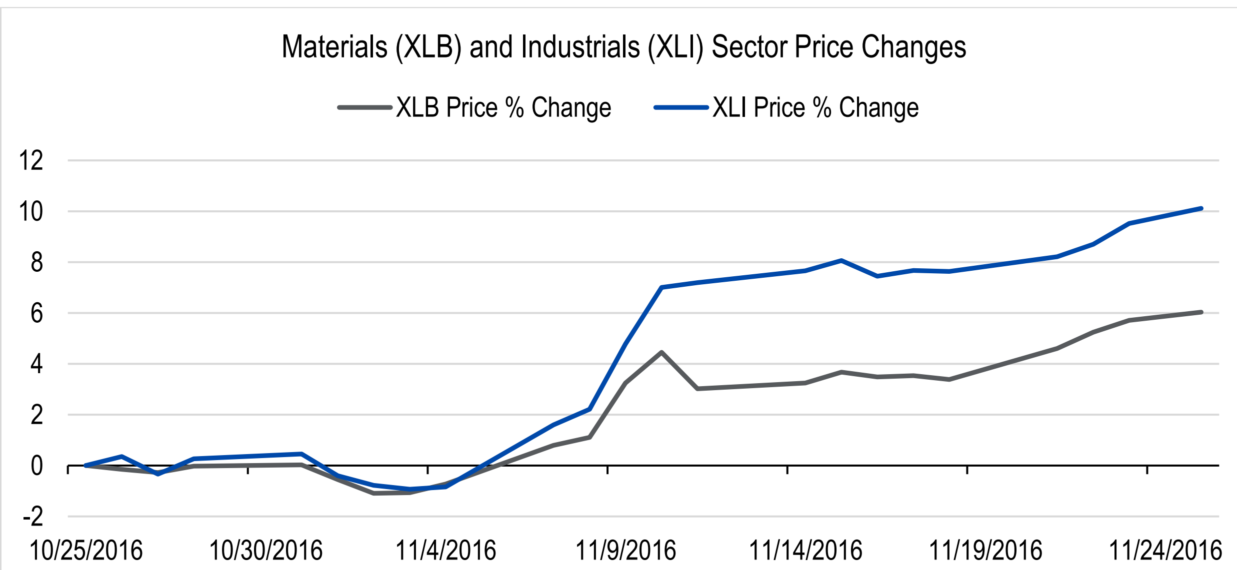

Figure 7. Price of the Materials and Industrials Tracking ETFs (XLB, XLI). Source: YCharts

We believe that the political roadblocks to infrastructure spending are likely to be difficult for the Trump administration to overcome, especially if Vice President-elect Pence is leading the effort (due to his likely mixed loyalties to this spending program). Also, the timing for any stimulus is likely to be slower than what the market looks to be anticipating presently, and this would also suggest the market's expectations regarding stimulus are too high.

On the other hand, if infrastructure stimulus is structured mainly in the form of tax credits, there will be a real benefit to these companies' values. We discuss this more in the tax section below.

Other sectors: Considering the uncertainties regarding passage and timing, we are unwilling to assume a boost to any other sectors at present. It is worth noting, however, that the rise in long-term rates has also pushed up the value of the US dollar. This will depress the revenues and earnings of companies doing business overseas in the short-term. Investors are likely to see sell-side analysts begin to drop their quarterly EPS estimates in 1Q2017 if this trend toward dollar strength continues.

International Trade

In this section, we look at both trade in labor and in goods.

The Plan

President-elect Trump has pledged to build a wall on our southern border "on day one," and it is clear that his priorities lie in controlling the flow of goods and labor across borders. The manifestation of this priority includes possible restrictions on H-1B Visa applicants (foreign skilled workers), possible increases in punitive tariffs, and a plan to renegotiate or cancel multilateral trade agreements like NAFTA and TPP.

FWI Analysis

Setting aside the Mexican Wall plan for a moment, Trump's aim for international trade is to increase the slope of the hourly compensation line in Figure 3 above, by attracting manufacturing jobs back to the US and increasing the supply of high-wage jobs for American workers.

In our opinion, the best-case outcome of this plan will be to boost input costs and greatly increase uncertainty in the short-term. The worst-case outcome would be to lower the availability and raise the prices of consumer goods in the US, decrease the competitiveness of US products overseas in the short-term, and damage the standing of the US as a world economic power in the long-term.

Labor is now a global market. Tariffs and trade restrictions are a government's attempt to create an artificial local market for certain tasks – in this case manufacturing.

In our opinion, rather than creating protections for a form of labor that is among the least expensive in the world (finished product assembly), it would be better long-term to create a more highly-skilled labor force that can command a higher rate on the world market.

It is very true that globalism is one of the primary factors driving both the flattening of the non-supervisory worker wage line in Figure 3 and the upward-sloping income lines for the top 5% of earners shown in Figure 4.

However, as mentioned above, one of the things that has made the flattening wage line tolerable has been the fact that consumer goods are cheap and readily available, and this is also partly the result of globalization. The US economy has benefited from trade deals even as some workers have been displaced.

Globalization is a genie that cannot be put back in the bottle. S&P 500 companies derive a significant proportion of their revenues overseas and it would be hard to find many that did not have a significant exposure to overseas supply chain relationships. Renegotiating multilateral trade agreements is time consuming, not guaranteed to achieve better results than the original deal, and disruptive to the respective countries during the process.

Tariffs too would meet with enormous resistance from business groups in the US, considering the degree to which large companies rely upon global supply chains and access to other markets. The US imposition of tariffs on imports would likely cause a response in kind with regards to our exports – the result being lowered trade volumes and values worldwide.

Regarding the construction of a physical wall, we can think of no worse way to spend $25 billion. Granted, the wall will provide incomes to construction workers for several years, but after the point of completion will not facilitate commerce or otherwise boost the overall economy nearly to the extent that improvements to a port or a highway might. The kind of expansion of the Immigrations and Customs Enforcement Agency necessitated by Trump's enforcement plans would provide work to tens of thousands of Americans, but would also expand governmental budgets and would likely result in far fewer marketable innovations than if those people were employed in technology or engineering, for example.

In general, we believe that Trump's attempts to return the US to a center of low value-added manufacturing (as opposed to high-value manufacturing like that done by companies like

General Electric, for instance) fails to recognize a structural shift in our economy. Robotic assembly lines, self-check-out lines at the grocery store, and kiosk ordering at fast food restaurants are just the beginning. Within the next 10 years, we will certainly see:

- Robotic truck and taxi drivers
- Call centers "manned" by Artificial Intelligence programs
- A larger proportion of news stories written using AI technology
- A greater use of AI applied to investment management.

Boosting tariffs on molded plastic boxes or spending billions of dollars attempting to build and maintain a border wall, and staffing a hugely expanded ICE police force is a reactive and unproductive approach to these enormous structural changes, in our opinion.

Investment Implications

In our opinion, if Trump's campaign promises regarding international trade are implemented, it will end up being a negative for all US firms, even those with no overseas exposure. Increased costs will hurt shareholders of international companies and all consumers. The ripple effects on companies with only domestic exposure would also be negative.

If immigration policies are enacted sooner rather than later, note that The Western Union (WU) derives a significant proportion of its revenues and profits from cross-border remittances, and would likely fall heavily. The fact that its stock price has risen since the election suggests that market participants are discounting the possibility of Trump's anti-immigration policies being implemented.

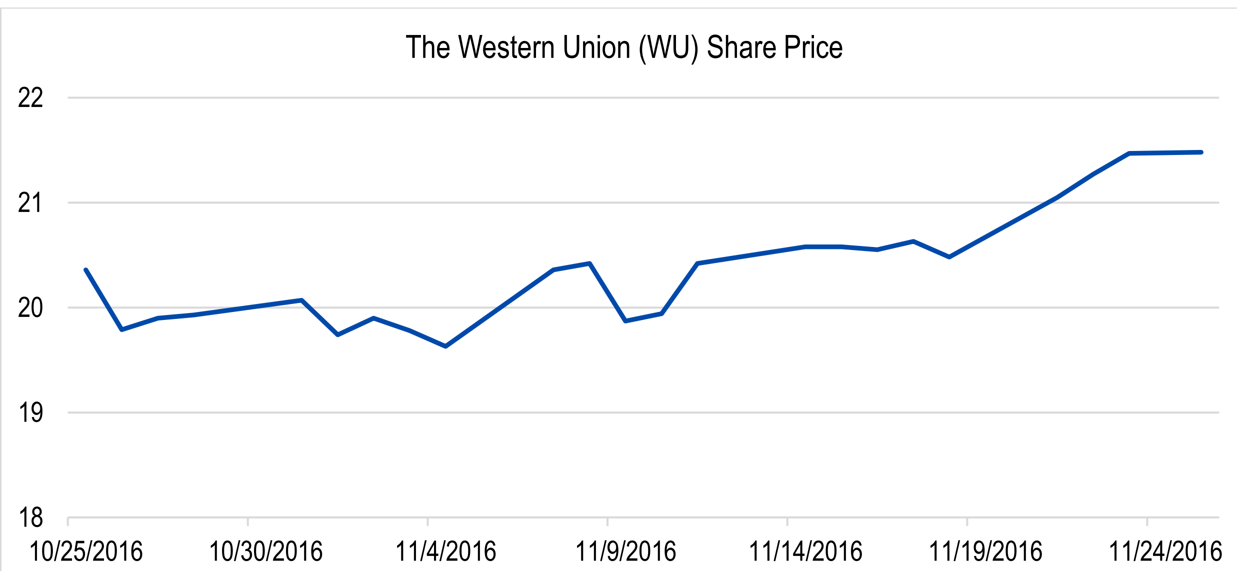

Figure 8. Source: YCharts

Longer-term, US renunciation of international trade deals leaves a vacuum in the world economy that is likely to be filled by China. If this were to happen, there is the possibility that longer-term structural growth rates for US companies would also fade, significantly lowering the value of US companies. Also, making it harder for H-1B visas to be issued would likely make the US less attractive to the same highly-skilled immigrants who have powered 20 years of technological innovation and wealth creation. This is a bad idea!

Note that the largest proportion of any firm's value is based on the assumption the firm will continue to operate as a going concern. The growth rate of cash flows in the medium- and long-term is a critical driver of value. If US companies are restricted from fully participating in the global market or if the costs of doing so are raised, the value of the firms will necessarily fall.

Taxation

The Plan

Trump's tax plan represents a substantial reduction to individual and business taxes The statutory corporate tax rate will be reduced from 35% to 15% and the government will offer companies with profits held overseas a tax holiday rate of 10% to repatriate those funds.

Individual tax rates will also be reduced and standard deductions increased, such that the overall tax burden to individuals and families will decrease [*N.B.* a new report has suggested that some families would indeed pay more under the Trump proposal as it is structured now].

FWI Analysis

Trump's tax plan aims at closing the gap in Figure 1 between present GDP and trend GDP and, through individual tax cuts, increase the slope of the hourly wage line in Figure 3.

The effect on GDP is an indirect one, rather than a direct one such as that provided through infrastructure spending. Taxation is invisible to GDP – the aggregate output of a country's economy. In essence, taxation represents a fee exacted by the government for providing the legal and infrastructure framework that enables the generation of GDP. As such, lowering taxes does not affect GDP, just reduces the fee taken from GDP.

That said, lowering taxes does provide indirect support for GDP by passing more cash through to companies and individuals. If those individuals spend the excess cash to buy additional goods and services, those purchases boost GDP (as long as the additional goods and services are provided by domestic firms; buying imports reduces GDP). If individuals save the excess cash, banks can loan the money out to companies, which theoretically would make purchases to boost capital stock.

Tax cuts for individuals is largely a feel-good measure designed to boost individual consumption.

The tax plan would also temporarily help individuals *feel* that GDP was increasing, at least when the tax drop was initially implemented.

We believe that, all things held equal, decreases in taxes will boost Free Cash Flow to Owners (FCFO) of US companies and will, over several years, boost US GDP.

However, all things are not held equal, and we believe that, short-term, a drop in taxes has the potential to be inflationary, especially when added to the possibility for wage inflation mentioned in the infrastructure stimulus section, and the possibility for reduced and/or higher priced goods mentioned in the trade sanctions section. If inflation occurs simultaneous to lowered economic output due to trade disputes and disruptions, stagflation could result – which will likely be damaging to company values.

Longer-term, deficits tend to retard growth and fiscal flexibility.

Longer-term, we are concerned for the implications of reduced taxes to the fiscal health of the US. The Trump tax plan seems like a reheated version of Regan-era supply-side economics. This school of thought, whose primary contention – that reducing taxes for corporations and the wealthy reduces tax receipts in the short term, but brings faster economic growth and higher tax receipts long term – has been studied extensively over the past 30 years. A recent study by academics at Brookings and Dartmouth concluded that:

> *Tax rate cuts may encourage individuals to work, save, and invest, but if the tax cuts are not financed by immediate spending cuts, they will likely also result in an increased federal budget deficit, which in the long-term will reduce national saving and raise interest rates. The net impact on growth is uncertain, but many estimates suggest it is either small or negative.*

Short-term, people feel better, but longer term, the benefits are small or negative and, since Trump is planning to pair tax cuts with increased spending, in the future, we can look forward to reduced national savings and higher interest rates – both of which are detrimental to long-term growth.

Trump's proposal suggests that infrastructure spending will be subsidized by windfalls from taxing repatriated profits. This presupposes that corporations find an advantage in repatriation.

In terms of the tax holiday on foreign-held profits, President Obama forwarded a similar plan in early 2015, but this plan met with stiff Congressional resistance. Some part of the political resistance to the plan was reportedly based on dissatisfaction that the tax holiday proposal was not included with a more comprehensive revamp of the tax system. However, at least part of the resistance seems to have been related to the tax rate proposed by Obama (14%). Trump's plan is for a limited time 10% rate on repatriation followed by statutory rate of 15% on an ongoing basis. In contrast, the rate proposed by the chairman of the powerful Ways and Means Committee when President Obama made his proposal was only 1.25%. Perhaps Trump's tax reform proposals will be enough to convince congressmen to vote for his tax repatriation proposal, but this may also be a contentious political issue.

In addition to these issues, we believe that this tax plan runs the risk of exacerbating the structural issue of income inequality mentioned in the previous section. The Tax Foundation's analysis breaks down the tax cut benefits expected to accrue to different income levels:

Table 4. Distributional Analysis for Donald Trump's Tax Reform Plan

Effect of Tax Reform on After-Tax Income Compared to Current Law

All Returns by Decile	Static Distributional Analysis	Dynamic Distributional Analysis
0% to 10%	1.4%	10.7%
10% to 20%	0.6%	10.6%
20% to 30%	1.2%	11.5%
30% to 40%	3.0%	14.3%
40% to 50%	5.3%	17.7%
50% to 60%	7.2%	19.5%
60% to 70%	8.0%	19.7%
70% to 80%	8.3%	19.4%
80% to 90%	8.9%	19.5%
90% to 100%	14.6%	22.6%
99% to 100%	21.6%	27.0%
TOTAL FOR ALL	10.2%	20.0%

Source: Tax Foundation Taxes and Growth Model, Sept. 2015.

Figure 9. Source: The Tax Foundation

The column "Dynamic Distributional Analysis" includes the effects of Tax Foundation analyst's assumptions for GDP growth, and I have ignored these data. They show the same trend as the "Static Distributional Analysis" column, which shows the straightforward numeric effects.

Ignoring the GDP effects – which I believe to be smaller and much less certain than the Tax Foundation analyst seems to – you can see that the beneficial effect of the tax cuts falls disproportionately to the top 10% of wage earners, further exacerbating the society's income inequality.

In 2009, we wrote a report suggesting that lowered tax revenues might lead to a two-tiered system of public infrastructure – wealthy receiving First World services and poor receiving Third World ones. We believe that with the Flint, Michigan water crisis, this prediction has come true. In the future, we believe this issue will become yet more pronounced.

Long-term, wealth inequalities are damaging to social stability; in the case of the United States – which funds education mainly through property taxes – inequality breeds lower educational levels, which has a negative effect on innovation and economic vitality.

The ability for developed economies to take advantage of opportunities in the twenty first century depends upon workforces that are well-educated and have access to the resources needed to compete against workers of all other countries. We worry that tax reforms that explicitly favor wealthier groups makes it harder for the US to do this.

Investment Implications

In our opinion, the post-election "Trump Rally" demonstrates the market's belief that tax cuts will be a positive factor to corporate values, and we agree this appears true in the short-term. The firms most likely to benefit are small capitalization stocks. Large companies with international subsidiaries can often use "transfer pricing" and other loopholes to manage their US tax liabilities. However, small cap companies are usually unable to do so. As such, the boost to small cap stocks upon a tax cut are proportionally larger than those to a large firm operating globally.

However, longer term, we believe that the case for negative outcomes from these tax cuts, especially when combined with other elements of Trump's economic plan, is possible considering the likely deepening of the budget deficit and the deficit's probable effects on future national savings and productivity. The greater the debt burden, the higher the proportion of future output that will need to be channeled toward the "non-productive" goal of paying for prior spending. This suggests a lowering of growth rates, which in turn suggests the depression of values.

Given that there is at least the chance for lowered corporate values that the market seems to be discounting (judging by the VIX, which is trading at a modest 12.4), we believe an increased allocation to bearish investments in overvalued stocks and / or to protective puts on indices is an appropriate investment strategy.

Energy

The Plan

Trump's policy statement regarding Energy contains only generalities, but on the campaign trail, candidate Trump spoke of revitalizing the coal industry and unleashing the nation's shale and liquid energy reserves.

FWI Analysis

Trump's energy plan mainly aims at closing the gap in Figure 1 between present GDP and trend GDP band through the reduction of energy imports.

Regarding coal, we must differentiate between metallurgical coal and the coal used in steam generation of electricity ("thermal coal"). Metallurgical coal is used in integrated steel mills, of which roughly 30% of the steel in the US is produced. Metallurgical coal is immune to competition from natural gas (but exposed to competition from Chinese and Australian producers as well as to fluctuations in the value of the US dollar), whereas thermal coal is not. This discussion relates to thermal coal, which we believe forms the centerpiece of Trump's policy on coal.

Governments are less powerful than commodity markets.

The economics behind any extractive commodity is bound to two factors: market pricing and production costs. Recent trends in both factors suggest that no matter what President-elect Trump's energy proposals are, they will have very little impact on actual economic conditions.

The combination of improved fracking technology and lowered equipment rental rates as a result of oil oversupply has significantly lowered the break-even price for North American tight oil and gas production. The nation is awash with oil and gas, to the extent that storage capacity has been close to maxed out for much of 2016. In this environment, coal simply cannot compete with natural gas in terms of price, and no one is rushing to produce more oil and natural gas at present prices either.

Tech businesses like Alphabet, Amazon, and Facebook are increasingly looking toward renewables to power data centers.

Electric utilities plan to continue moving more generation capacity to natural gas and renewables for reasons entirely related to economics. Apparently, many in the coal industry are skeptical about Trump's statements related to a coal Renaissance. We are too. For natural gas, the US and the world alike are in the midst of a glut of the commodity. Liquefied Natural Gas (LNG) exports began in March of this year, but prices have remained in the doldrums. Opening up natural lands to drilling will do little if drillers cannot produce profitably from their present fields. Our views on oil also follow the same logic.

Investment Implications

We do not believe the Trump energy proposals will have any impact on coal, oil, and gas production. We are working on a valuation of First Solar (FSLR) and will take that opportunity to provide more carefully considered comments on the investment implications on the renewables sector. Considering what we have read so far, though, we are inclined to think that the negative valuation effects on the group will be less than what the market's initial reaction to Trump's election suggested.

Looking at a chart of the S&P/TSX Renewable Energy & Clean Technology Index, we think the market too has realized that the sky is not falling (pun intended).

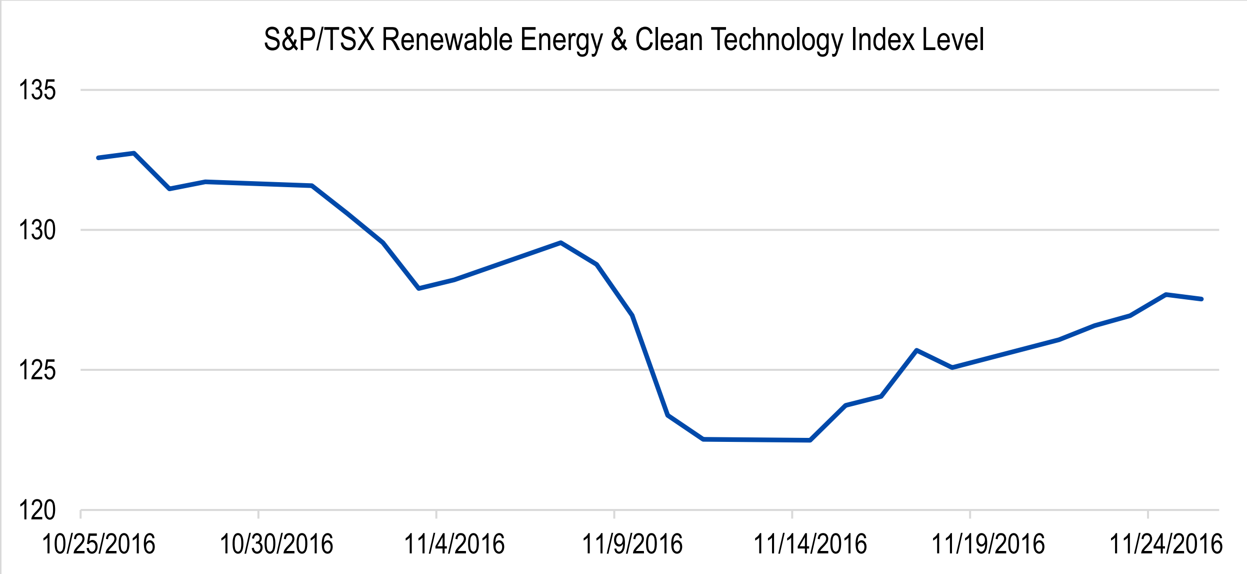

Figure 10. Source: YCharts

Defense

The Plan

President-elect Trump's military spending proposal revolves around increasing the size of the Army and Marines, increase the number of ships in the Navy, and the number of airplanes in the Air Force.

FWI Analysis

Trump's military spending plan mainly aims at closing the gap in Figure 1 between present GDP and trend GDP band by boosting the production of military equipment.

According to the Peter G. Peterson Foundation, military spending by the United States exceeds that of the next seven countries combined.

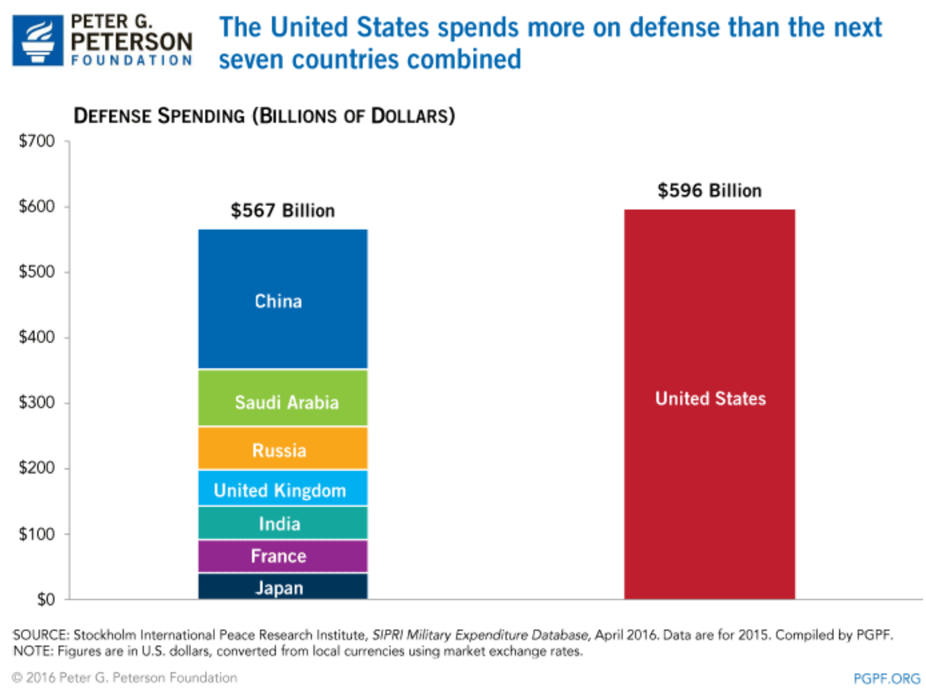

Figure 11. Source: Peter G. Peterson Foundation

In our opinion, military spending in the US is much more a system of transfer payments to defense contractors than a military necessity – especially considering the President-elect's isolationist tendencies. Trump's "America First" stance would necessitate much lower military spending – our nation has formidable natural borders on three sides (the Atlantic, Pacific, and the Sonoran Desert), so if we made the decision to rethink our position of world military hegemon, we would be able to lower spending significantly.

To the extent that an increase in military spending would help boost GDP and would have a multiplier effect as well, the proposal would meet the main thrust of Trump's goal. However, it is unlikely to have any great effect on the second main structural issue – boosting working-class salaries.

Military spending represents an "easy" choice for politicians of virtually all persuasions.

Even still, politicians seem to have great difficulty saying no to military expenditures, and the aerospace / defense industry maintains a very effective and active lobby, so it is likely that military spending will pick up under the Trump administration. For those of us with a tendency toward fiscal conservatism, it is a good sign that President-elect Trump has reportedly been speaking with retired Marine Corps General James Mattis, who has expressed skepticism in the past regarding gratuitous military spending.

Investment Implications

The market has already figured out that aerospace / defense companies have a tailwind from the incoming Trump administration (see figure below).

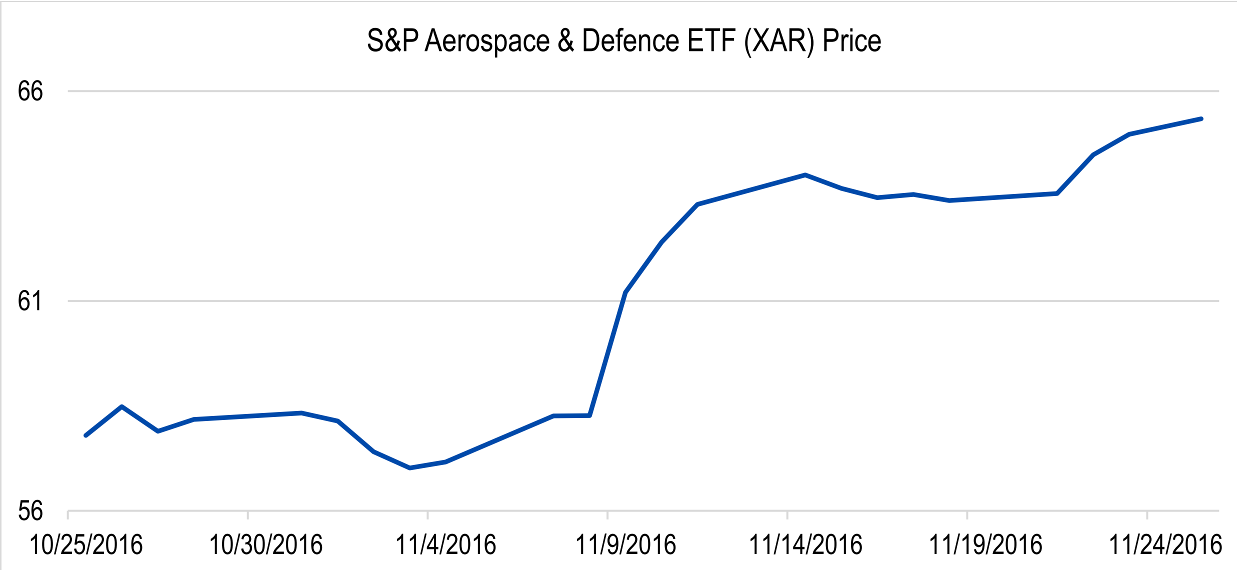

Figure 12. Source: YCharts

There may be additional opportunities in this industry, but taking a quick look at Owners' Cash Profit (OCP) margin for three prominent defense contractors – Lockheed Martin (LMT), Northrop Grumman (NOC), and General Dynamics (GD) – two of them look to be generating close to their historical level of peak profits.

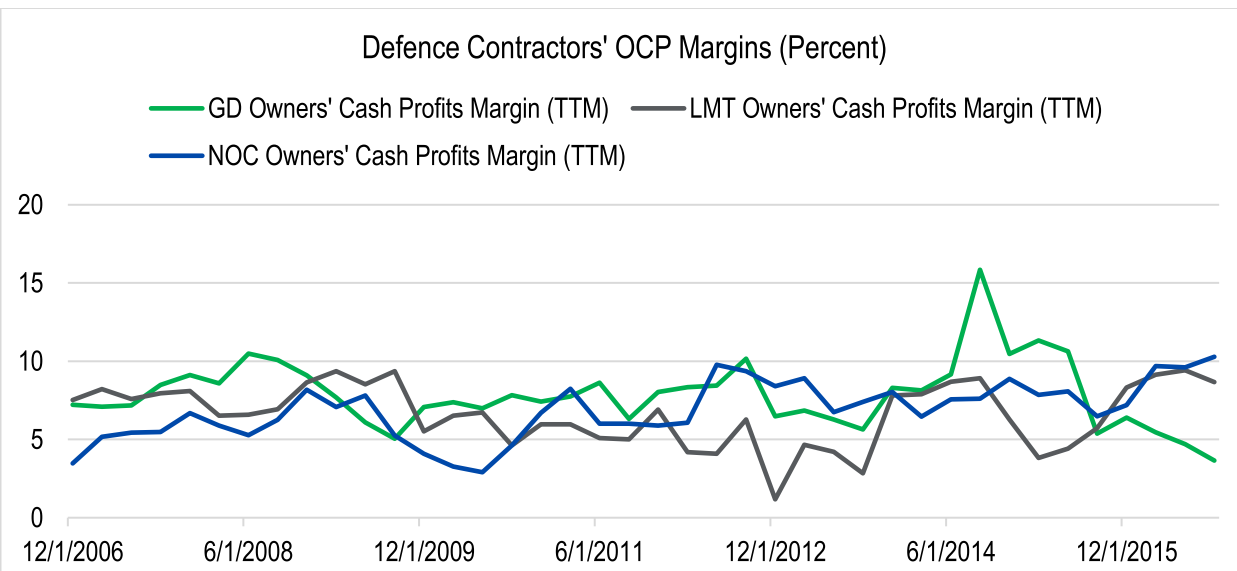

Figure 13. Source: YCharts

Summing up our analysis of President-elect Trump's policy proposals gives us the following table.

Proposal	Effects on GDP	Effects on Wages	Company Valuations	Notes
Infrastructure Stimulus	**Short-Term** Neutral or slightly positive, depending on degree to which new infrastructure projects can be found, funded, and started.	**Short-Term** Potentially positive on a nominal basis, but negative if wage inflation heats up faster than productivity.	**Short-Term** Banking sector likely to be largest beneficiary if inflationary expectations contribute to rise in rates.	Some infrastructure projects are more attractive to private investors than others. A new toll road is relatively easy to monetize; a modernized sewage system is not. Reliance on public-private partnerships is likely to exacerbate differences in infrastructure quality between affluent and poor neighborhoods.
	Long-Term Large deficits could be offset by strong, durable growth in GDP, but the chance for this Goldilocks scenario is low.	**Long-Term** Infrastructure needs are highest in developed areas, so increased spending will likely bring less benefits to rural Trump voters.	**Long-Term** If deficits are high, long-term growth will be lower, depressing the value of companies overall.	
International Trade	**Short-Term** Negative if disrupted trade relations bring about goods shortages, higher prices, or weakened competitiveness of US exports.	**Short-Term** Neutral or negative, depending on inflationary trends. We doubt real wages will rise.	**Short-Term** Increased trade frictions will be negative for virtually all firms. Domestic firms negatively affected from the drop in general economic activity.	Globalization is a genie that can't be stuffed back into the bottle. Labor is a global commodity, so imposing controls on goods to boost domestic wage rates will simply force firms to find a more efficient way to manufacture products.
	Long-Term Negative if US firms are less able to compete in global marketplace.	**Long-Term** Onshoring low value-added manufacturing is likely to speed the shift to automation and would probably exacerbate income inequality.	**Long-Term** Negative if US firms are less able to compete in global marketplace.	
Taxation	**Short-Term** May get a short-term boost if consumers believe tax cuts are permanent and decide to spend windfall.	**Short-Term** Consumers are likely to feel as though their wages are going up when tax cuts are initially implemented.	**Short-Term** Positive for all companies, especially smaller capitalization ones.	To us, the Trump proposal sounds like a warmed-up version of supply-side economics – a policy that has been shown to have negative or neutral outcomes.
	Long-Term Deficits will likely damage future growth.	**Long-Term** Structure of tax cuts will likely increase income inequality since benefits are proportionally greater for wealthier tax payers.	**Long-Term** Positive for all companies as long as tax receipts allow the government to provide necessary services.	
Energy	**Short-Term** No effect.	**Short-Term** No effect.	**Short-Term** Clean energy stock prices may be hurt by negative perceptions and loss of subsidies.	Commodity markets, not the government, will be the final arbiter of what energy gets produced and by what means.
	Long-Term No effect.	**Long-Term** No effect.	**Long-Term** If government regulations actively discriminate against clean energy R&D, long-term competitiveness of US clean energy firms will be hurt.	
Defense	**Short-Term** Slightly positive.	**Short-Term** Neutral	**Short-Term** Provides tailwind to aerospace / defense firms.	Trump's isolationist tendencies do not mesh with high military spending, but this kind of "welfare" is easy for politicians to vote for.
	Long-Term Only positive if military allows for increased global stability that US firms can take advantage of with int'l trade.	**Long-Term** Corporate welfare for defense firms will likely benefit the wealthy and exacerbate income inequality.	**Long-Term** Positive for aerospace / defense firms.	

President-elect Trump's Executive Efficacy

During a Charlie Rose interview, Bridgewater Associates' founder Ray Dalio made the comment that he didn't get paid for taking sides, but for having a clear-eyed view of reality and acting on his insights for the benefit his investors.

The author of this report gets paid somewhat less than Dalio (over $1 billion in 2015 per the NY Times), but admires Dalio's approach and attempts to do the same. It is in this spirit of callin' 'em like I sees 'em that we look at issues separate from policy that we believe have the potential to affect investments during the Trump administration.

As we see it, the first role of the president is to establish the framework by which the legislative agenda and political discourse during the administration is organized. President Carter was an intelligent, earnest leader, but did a poor job of setting and articulating his agenda, and is thus considered a failure. President Reagan was likely not as intelligent as Carter, but was a master of articulating his political agenda and is thus considered a success.

After setting and articulating an agenda, the president is responsible for pushing it forward by gaining acceptance of his proposals among members of his own party, opposition parties, and the public at larger. President Clinton was a brilliant communicator who set and articulated his agenda for a major change to the healthcare system as the centerpiece of his first administration. However, his inability to garner acceptance of his proposal within even his own party doomed it to failure and allowed Republicans to take control of the House in 1994.

Considering these presidential goals, we believe the key skills of a president are as follows[1]:

1. Clearly articulate a vision for the country
2. Craft a strategy for implementing proposals consistent with that vision (strategic planning)
3. Create consensus within his own party regarding his vision and strategies (tactical execution)
4. Create consensus among politicians from opposing parties that supporting his vision will create more good for them than it will create damage (tactical execution)
5. Engineer support for his policies within the populace at large, at least to the extent not to lose seats in the mid-term elections (charisma)

The successful administration is one that creates an environment in which individuals and businesses understand and buy into the president's vision and are given the fair opportunity to prosper by supporting it. In this socioeconomic environment, businesses thrive, individuals prosper, and the wealth of the nation increases.

In contrast, the most damaging things a president can do is to create a chaotic and uncertain environment through confused or contradictory messaging, to fail to take the strategic and / or tactical steps needed to make his chosen agenda succeed, and to apportion rewards in an inequitable manner. In this socioeconomic environment, resources are wasted and opportunities missed, the level of enmity in the society increases, and people come to believe that the system has failed them.

During the campaign and in this transitionary period, President-elect Trump has, in our opinion, exhibited evidence that his administration is likely to be a chaotic, divisive, and unproductive influence on the society, and this quality represents risk that we believe an investor must recognize and manage.

In this section, we outline current examples of President-elect Trump failing in each of the presidential skills articulated above and attempt to assess whether his history as a businessman supports or refutes this evidence. We conclude by offering a best- and worst-case scenario for the socioeconomic environment under a Trump Administration.

[1] There is one more essential skill, which we will only touch on in this report: "Manage relationships with other nation-states skillfully and minimize the impact of or head off threats (military or economic) from foreign powers." It is very had to assess the ability of president Trump to do this, though, in our opinion, his reluctance to attend intelligence briefings as well as his potential conflicts of interest (Russia, China, Germany, US Banks) do not bode well in this area.

Articulate a Vision

"Make America Great Again" is a simple, bold vision statement. However, when pressed on details, President-elect Trump's vision becomes cloudy, and he tends to go back on statements and promises he has previously made. This backtracking blunts the vision and creates uncertainty regarding what the real goals of the administration are.

#MAGA is great advertising copy, but Trump's history of backtracking on his promises lowers his ability to successfully articulate his vision.

Examples

- Repeal Obamacare on day one is the stated policy on Trump's website, but a few days after the election, the Wall Street Journal reported that he may keep some key provisions.
- Climate change is a hoax perpetrated by the Chinese was Trump's stated position (perhaps to curry votes among carbon-based energy producers), but has recently said that climate change is real and may be caused by humans.
- Trump promised to build a big, beautiful, powerful wall along the Mexican border, but recently has said parts of the wall may have to just be fencing.
- During the campaign, one of the main rally cries of Trump supporters was to "Lock her up!" with the 'her' being, of course, Hillary Clinton. However, after the election, Trump has described the Clintons as 'good people' and has dropped his call for a special prosecutor.

Historical Examples

While not related to a political vision, there are ample examples of businessman Trump going back on business agreements and stiffing his contractors. In a sense, Trump was articulating a vision to contractors ("You'll make a lot of money on this deal") and then did not follow through in executing that vision.

We believe Trump's historical actions supports a view that Trump's vision is changeable according to circumstance and expediency, see this as a negative trait in terms of executive efficacy, and believes that it will add to uncertainty in the investing world.

Craft a Strategy

It may be too early to tell how skillfully President-elect Trump is doing at crafting his strategy. In researching this report, the author spent a good bit of time reading through the policy proposals on Trump's website, but many times found that the policies were either light on detail (so could not be assessed), or the details seemed flawed and unworkable.

Recent Examples

- A report was published in August of this year that Trump's family essentially offered Ohio governor John Kasich the formal powers of the presidency while serving as Vice President. The implication was that Trump himself would work as a sort of figurehead and promotor while Kasich would craft the strategy and be responsible for carrying it out. This leads us to believe that Trump may have little interest in strategy, but wants instead to "outsource" strategic duties.
- Influential professional economists have been saying much the same thing as this author regarding the lack of detail or unworkability of Trump's policy proposals. Even Larry Kudlow – a prominent conservative economist – finds President-elect Trump's proposals regarding immigration and trade to be unworkable.
- Before the election, 370 academic economists and a few Nobel Prize winners wrote an open letter decrying Trump's policies as ill-advised and potentially harmful to the country's economy.

Historical Examples

Trump's business strategies lacked the introspection required to accurately assess actual conditions, in our opinion.

Trump as a businessman crafted business strategies that were often ill-advised and out-of-touch with the desires of the consumer. His strategy for the Trump Shuttle, his airline that defaulted on its loans in 1990, was to create a no-expense-spared experience with luxury appointments to his short-haul 727 fleet. This strategy was at odds with consumer demand for convenience at a reasonable price. Similarly, the strategy behind the Trump Taj Mahal was to build the largest casinos in the world in Atlantic City. However, that strategy too failed to meet the reality of the economic environment – it was far too large and opulent for the small-dollar casino market on the Jersey shore. After several business failures and a reported six bankruptcies, Trump has at last hit upon what seems to be a winning business strategy – licensing the Trump name to other businesspeople and allowing them to make strategic decisions about a property.

We believe Trump's historical actions supports a view that Trump is weak in the area of crafting strategy, see this as a negative trait in terms of executive efficacy, and believe it creates potential uncertainty for the market.

Create Consensus

This is one area in which recent evidence points to President-elect Trump being extremely weak – the number of politicians publicly repudiating Trump's statements and policies, from both sides of the aisle, is too voluminous to list. Weakness in this area is dangerous for a politician – no matter how good the strategy is, if you cannot create buy-in among the members of your own party and win over members of other parties, the strategy will not be implemented. Full stop.

Recent Examples

- Paul Ryan, Speaker of the House, has called Trump's comments regarding a federal judge as racist.
- Ryan refused to campaign with Trump after an audio tape of the latter's admission to sexual assault were broadcast on air.
- Senate Majority Leader, Mitch McConnell, has said that infrastructure spending – one of Trump's centerpiece issues – was not a top priority.
- Mike Pence, Vice President-elect, also cancelled planned campaign events after the Access Hollywood tapes became public and was reportedly livid about the incident.
- Trump reportedly disliked (dislikes?) Pence and had second thoughts about announcing Pence as a running mate the night before the announcement was made.
- During the primaries, there were numerous reports of infighting and poor morale within the Trump campaign after losing several states.
- Trump has publicly disagreed with Pence's policy pronouncements
- Pence has voted against measures very similar to Trump's present policy pronouncements.

Historical Examples

While Trump's style is not one you would think of when hearing the words "create consensus" his business track record and selection of Reince Priebus as Chief of Staff suggests he may surprise us by his tactical ability.

This is one area in which history provides a more nuanced view. Certainly, in the process of negotiating deals as a businessman, Trump was successful in getting his way many times, such as when he bought the Plaza hotel and also when he avoided personal bankruptcy when he could no longer pay for it. We believe this displays a keen sense of tactical awareness and the ability to build a sort of consensus.

We also note that Trump named Chairman of the Republican National Convention, Reince Priebus, as White House Chief of Staff. This also reflects the ability of the President-elect to forge coalitions with "establishment" Republicans, as does the fact that Mike Pence has supported the President-elect even through some very trying times and now publicly endorses Trump's proposed infrastructure program.

On the other hand, in a recent PBS Frontline documentary about Trump and Clinton, several of Trump's long-term business associates such as his accountant, an executive at Trump's company, and a banker to whom Trump owned money, commented that Trump the businessman was never very interested in details. The banker commented that he had always thought of Trump not as a CEO, but as a professional pitch man.

We believe that a combination of Trump's recent and historical actions supports an assumption that Trump is relatively weak in the area of working tactically to create consensus. Our concerns are tempered by recent and historical counter-examples.

Engineer Support Among the People

Many of Trump's supporters are fervent, as testified to by his political rallies and by his dark horse win in both the primaries and in the general election. Clearly, Trump's brand of swaggering, tough-guy confidence is charismatic to some portion of the electorate.

We note, however, that at least a portion of his supporters are woefully misinformed through misleading and salacious "fake news" websites, one of which, Breitbart.com, is associated with Steve Bannon, a senior member of Trump's executive team.

Who would support a candidate like Hillary Clinton, who has fallen ill because of her practice of cannibalism, for instance? How could voting for the Democratic party not be unethical if the chairman of the Democratic National Convention is the mastermind behind a child prostitution ring? This is the level to which the American political discourse has sunk. (The gentle reader is encouraged to skim through the transcripts of the Lincoln-Douglas debates to confirm that the level of discourse in the US was much higher in the past).

The US has no compelling, immediate foreign rivals capable of successfully attacking the US. On the other hand, its populace is well-armed and seemingly becoming more divisive as time goes on. The racially-charged rhetoric of Trump's campaign makes us wary about the possibility for increased social instability and violent confrontations.

While these fake news websites have energized certain members of the polity, it has horrified others, especially considering the similarity to some of the ugly and dangerous propaganda of the 1930s for instance.

The Southern Poverty Law Center reports 867 incidents of racially- or gender-motivated attacks (many of which, it points out cannot be proven, so are anecdotal) as well as 23 incidents of politically-motivated violence against Trump supporters. White supremacists have spoken in glowing terms of Trump's election, and his own cabinet choices (e.g., Bannon, Sessions) have well-documented histories of making racially biased comments.

In addition, Trump himself has made numerous statements that indicate a lack of sensitivity to the perspective of people in minority groups and of women. In addition, his understanding of and appreciation for Amendments not related to the right to bear arms (First Amendment, Fourth Amendment) should be concerning to everyone in the polity.

Trump's positions and statements meant that his candidacy had very high unfavorability ratings and he lost the popular vote by more than 2 million votes.

While it is clear that Trump's message resonates strongly with one segment of the population, it is equally clear that it concerns an even larger segment. Trump may sway some portion of the electorate, but it is hard for this author to imagine him mending fences or meeting those with differing opinions halfway. We believe his divisiveness is likely to limit his executive efficacy and, taken to an extreme, may negatively affect social stability.

Representative Best- and Worst-Case Scenarios

Best-Case

The best-case scenario appears to be what the market is pricing in post-election: President Trump will walk back populist campaign promises and become a business-friendly, low-tax, high-military spend Republican in the model of Reagan. Uncertainty due to the nature of Trump's administration and style would be limited by a division of labor between the President and the Vice President: President Trump serving as the pitchman and Vice President Pence carrying out day-to-day responsibilities. Pence would resist his natural inclination to oppose Trump's Keynesian policies directly, but would work with Congressional Republicans to restrict infrastructure spending even while approving spending for the military.

Were this to come true, businesses would likely have a tailwind at least in the short-run (an inflationary reaction might take some time to pick up speed), but benefits would more likely accrue disproportionately to the very wealthy. With little spending directed at commercially unattractive infrastructure spending (e.g., new sewer and water lines), over time, public safety disasters like the Flint, Michigan water crisis will continue to crop up in neighborhoods populated by the poor and working class. These crises would eventually strengthen the populist outcry and may lead to increased political upheaval in years to come.

In the best-case scenario, it is better to be exposed to equity markets over the next several years, but the longer-term prospects would be worse (because increased political strife and decreased national savings rates are not a recipe for strong growth over time).

Worst-Case

The worst-case scenario appears to be what the futures markets were pricing in during the election night. President Trump, inexperienced in managing complex organizations and fundamentally disinterested in the duties of commander-in-chief, attempts to retain the support of his populist base by an aggressive attempt to push through campaign trail policy proposals in opposition to his own Vice President and most Congressional Republicans. Cabinet members, frustrated by being sidelined and undermined by the president's children, resign and a quick pace and it becomes increasingly difficult to find qualified replacements.

The most symbolic and inexpensive of Trump's campaign promises (e.g., special prosecutor for Hillary Clinton, Mexican border wall) are pushed through even as the scrapping of trade agreements and a slowdown in Europe and Asia cause the US economy to falter. A foreign military action or a domestic terrorism surprise creates additional stress within the government, and more qualified professional bureaucrats and soldiers resign. Social tensions increase, leading to large, disruptive protests that tend toward violence.

In the worst-case scenario, clearly it is better to reduce exposure to equities in the short-term. Longer-term investment opportunities will depend on the political and social response.

With respect to our own portfolio, we have delevered considerably and have also increased our cash reserves. We believe the economy is fundamentally strong and improving, but for the reasons discussed here, believe that the chance for downside volatility is high.

Our considerations discussed in this final section lead us to believe the Trump administration to be rather brittle, and are circumspect about its ability to thrive during a crisis.

We would not be surprised to see Russia take aggressive military action in Europe or more aggressive military action in Syria near President-elect Trump's inauguration. From what we can tell, Islamic State in the Levant (ISIL), al Qaeda, and other related terrorist groups' capacity has been degraded following military actions in the Levant, but we would also not be surprised if a terrorist attack were directed at American soil, or at Trump-branded properties on or about the President-elect's inauguration.

Were such an event to occur, we question the administration's ability to absorb the shock, deal with it appropriately, and keep pushing forward with its domestic policy proposals. In our mind, unexpected global events could precipitate a rapid transition from a "best-case Trump" administration to a worst-case one.