POINT OF VIEW SERIES

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Trump in Charge

What Janus Investment Professionals Expect as Trump Takes Office

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Janus recently spoke with Ron Fournier to discuss expectations, opportunities and pitfalls for the Trump presidency that begins on January 20. Mr. Fournier is the publisher of Crain's Detroit Business, formerly senior political columnist and editorial director of National Journal, and Washington bureau chief of The Associated Press. (Mr. Fournier's biography is below).

Mr. Fournier sees the current climate as a once-in-a-century convergence of revolutions in technology, economics and warfare. The inability of our institutions to keep up with these changes led to a momentous loss of trust in the establishment, resulting in a global rise in populism reflected in June's Brexit vote and Donald Trump's election in November. The time is ripe for disruption.

Post-Election Trump Bump in Equities and Trump Tantrum in Bonds

The U.S. equity market ran up on expectations that a Trump presidency will deliver growth as a result of tax cuts, infrastructure spending and regulatory changes. In U.S. fixed income markets, rates sold off abruptly after the election, while risk assets, such as corporate credit, remained in favor during the "Trump Tantrum."

The problem is that no one knows for certain what Mr. Trump will do once he takes the oath of office, which has significant implications for future growth and market returns. Two very different forces are pulling on the president-elect. The first is the populist movement that elected him. The second is the conservative orthodoxy of the Republican Party that now claims him. Ideally, given his unique background, Trump could find a middle ground and forge a new coalition that brings about change. But that scenario faces plenty of obstacles.

KEY TAKEAWAYS

- Populism and conservative orthodoxy are pulling on the president-elect. Given his unique background, Mr. Trump could find a middle ground and forge a new coalition that brings about change. But that outcome faces plenty of obstacles.
- Cooler heads may prevail on trade policy. Look for tax cuts and infrastructure spending if Mr. Trump works with Democrats to pass legislation. Bipartisan cooperation will be critical in reforming the Affordable Care Act.
- Uncertainty lies ahead for the country and the financial markets. Mr. Trump is his own worst enemy. This may be a climate that favors active investment management.

No Ideological Compass and No Self-Discipline

Mr. Fournier points out that Mr. Trump won the 2016 presidential Republican primary battle and general election absent an ideological compass, or governing experience to provide any clues about how he will govern in the White House. He is the rare president who owes few, if any, political favors in Washington — possibly the first such president since Theodore Roosevelt, another disruptor.

His impulsive personality adds uncertainty to his political opacity. Mr. Trump is easily slighted *and* easily flattered. In his recurrent Twitter storms he picks fights with the press, Democrats, Republicans, foreign governments, corporations and even Hollywood actresses, while lauding those who support him and his movement.

Yet through this unprecedented behavior, he has avoided paying any price, reinforcing Mr. Fournier's point that the current political and social climate favors leaders who disrupt what is widely seen as a failed status quo. As a result, there is plenty of uncertainty ahead for the country — and the financial markets. Disconcerting? Yes, but this may be an opportunity for active investment management to excel given its ability to focus on individual company fundamentals and, when appropriate, flex with policy decisions. Here is what we're watching and how we're thinking as the Trump era begins:

Taxes

Tax reform will be a priority for the new administration, Mr. Fournier says. Both Mr. Trump and the GOP support sweeping tax changes, including reducing the number of federal income tax brackets for individuals from seven to three and trimming the top tax rate from 39.6% to 33%.

Even bigger changes are slated for business taxes. A GOP proposal calls for effectively eliminating the corporate income tax rate – today as high as 35% – and replacing it with a 20% "border-adjusted tax," which would be imposed on imports, while exempting exports. In doing so, the U.S. would shift to a system that taxes goods based on where they are consumed rather than produced, a policy employed by most other countries. Both Republicans and Mr. Trump have also talked about creating a "tax holiday" for cash that businesses repatriate from overseas. But the complexity of corporate and personal tax reform may drag these initiatives well past the first 100 days of the new administration.

What Janus Thinks:

Judging by the stock market's rally, investors assume that pro-business measures, including tax reform, will be passed quickly, says Portfolio Manager Marc Pinto, CFA. "A lot of expectations are already baked in," he says. Mr. Pinto and other Janus investment professionals believe a tax holiday for repatriation is likely and would be especially beneficial to technology, biotech and pharmaceutical companies, which have ample cash reserves abroad.

But overhauling the corporate tax system is complicated and the process could lead to short-term volatility in the market. Higher taxes on imports, for example, would drive up the price of some goods (offset, in part, by a stronger dollar) and potentially anger Trump's populist base. In addition, companies that rely heavily on imports, particularly retailers and refiners, would see their earnings fall significantly. "Would the senators from Arkansas [where Walmart is headquartered] vote for it?" says Director of Research Carmel Wellso. "I don't know." But if corporate tax reform fails, it could signal that the political gridlock that has gripped Congress for the past eight years will continue, says Darrell Watters, Head of U.S. Fundamental Fixed Income. Such a perception would be bad for markets, particularly risk assets, and is something that the markets are overlooking today.

China & Trade

The list of how Mr. Trump could upend global trade is long, from imposing tariffs and scrapping trade agreements to labeling China a currency manipulator. The early days of Trump's presidency will help shed light on what's bluster and what's real, Mr. Fournier says. Mr. Trump, for example, is expected to exit the Trans-Pacific Partnership (TPP), a 12-country trade agreement, and begin renegotiating the North American Free Trade Agreement (NAFTA) shortly after taking office. But tariffs could be a harder sell with GOP members who favor tax reform as a way to advance U.S. economic interests, rather than tariffs and trade wars.

What Janus Thinks:

Although cooler heads may prevail, uncertainty still exists, says Portfolio Manager George Maris, CFA. He notes that while many Republicans subscribe to free-trade principles, some party members have started to adopt protectionist thinking. Then, there's Twitter. Trump already has used social media to criticize Boeing, Lockheed Martin and Toyota. Future tweets could roil other companies – and their stocks.

As for China, it's clear that Trump is going on the offensive. Less clear is whether his proposals will pack much punch. "Abandoning the TPP just means the trade agreement will include every other player but us," says Ms. Wellso. What about labeling China a currency manipulator? So far, the country does not meet criteria set forth by the Treasury to earn the designation. That may not stop Trump (who could direct the Treasury to change the criteria), but the move would be largely symbolic and consequences, such as tariffs imposed on Chinese exports, would be subject to World Trade Organization (WTO) rules. Head of Global Fundamental Fixed Income Chris Diaz, CFA, also points out that China is the second-largest holder of U.S. Treasury debt and a significant trading partner for the U.S. A trade war with China would be significantly more detrimental to the U.S. economy than helpful.

Health Care

It's no secret that repealing and replacing the Affordable Care Act (ACA) is also a priority, Mr. Fournier says, and change is already in motion. Earlier this month, Trump announced that Congress would act on a replacement plan for the ACA during the first 100 days of office. At the same time, the House and Senate approved budget resolutions that will strip away parts of the ACA. That doesn't mean the 20 million or so people insured through the ACA will lose their coverage overnight. "The Republicans don't want to repeal so much of Obamacare [another term for the ACA] that it hurts a lot of people," Fournier says. But other parts of the law will likely be revoked immediately, such as the individual and employer mandate and taxes on health insurers and drug manufacturers, among other things.

Drug pricing is shaping up to be another Trump target. In a press conference this month, the president-elect criticized rising pharmaceutical costs and hinted at new ways the government will negotiate with drug makers, saying, "We have to … create new bidding procedures for the drug industry because they're getting away with murder." Stocks of biotech companies plunged the same day.

What Janus Thinks:

Ethan Lovell, portfolio manager of the Janus Global Life Sciences strategy, argues that bipartisan support for a replacement of the ACA is possible, so long as the GOP maintains the spirit of the legislation and leaves other programs, such as Medicaid, largely untouched. "The odds of Democrats working with the GOP are less than 50% – but it's there," he says. He also believes that Republicans will want to pass a replacement before Congress turns to 2018 election campaigns in the fall. Mr. Lovell thinks a new plan will favor a managed-care system that embraces free-market mechanisms to help control costs and provide individuals with more choice. Andy Acker, CFA, who also manages the Global Life Sciences strategy, says under such a scenario, HMOs stand to benefit, as well as companies that are involved with Medicare Advantage. "That's one program that Republicans have been big believers in," Mr. Acker says.

Fiscal Policy: Tax Cuts with No Prospects for Entitlement Reform

Overall, the investment professionals at Janus believe the Trump administration could help accelerate U.S. economic growth and inflation in 2017, which would be a net benefit for stocks. A more accommodative regulatory environment and increased infrastructure spending will also help. But longer term, the administration's policies could have a deleterious impact on the country's deficit and debt burden if other actions are not taken.

For one, Mr. Trump's tax plan calls for significant tax cuts for the wealthy and middle classes. However, it's unclear whether his tax cut plan will pay for itself through higher economic growth or whether tax cuts will lead to wider annual budget deficits and increased borrowing. According to the U.S. Treasury, during the Obama administration, the federal debt mushroomed from nearly $10.6 trillion to just under $20 trillion today. Entitlement spending is the primary factor behind that surge, yet neither party is willing to take serious action to dig out from this deepening hole, and Mr. Trump has made clear his opposition to entitlement reform. It is a dangerous recipe for the country's financial health, and could have one of the biggest impacts on the country's long-term prosperity.

What Janus Thinks:

Proposed tax cuts and infrastructure spending may be additive to growth but insufficient to prevent the national debt from expanding further. The country's aging population and persistently low productivity could be significant headwinds, says Mr. Watters. If new policies fail to generate sufficient growth, we may be forced to regress to the accommodative monetary policy that the Federal Reserve used to prop up the economy for the last few years. Mr. Diaz explains what we really need are long-term, productivity-enhancing initiatives, and given his business background, Mr. Trump may realize what is at stake and take necessary steps to mitigate the risk.

Accomplishment or Self-Destruction – Stock and Issuer Selection is Vital

Mr. Fournier suggests that the early days of the new administration will foreshadow just how successful the Trump presidency will be. Mr. Trump's ability to craft a third way in American politics should not be underestimated. His business career defines him as an astute negotiator and dealmaker, with an unorthodox style by Washington standards. But the time is ripe for disruption and given the weakness of both mainstream political parties, Mr. Trump could carve out enough votes from Democrats and Republican to pass legislation on a number of issues. As Mr. Fournier pointed out, Mr. Trump owes few political favors in Washington, which affords him a freedom that no president has had in more than a century. If managed properly, he can use that independence productively to tackle long-standing issues such as infrastructure, tax reform and perhaps even entitlement spending.

But Donald Trump is also his own worst enemy. That leads us to believe that investing in the Trump era will be an exercise in disciplined stock and issuer selection, favoring active management.

About Ron Fournier

Ron Fournier is the publisher of Crain's Detroit Business and an award-winning and nationally acclaimed political contributor to *National Journal* and *The Atlantic*. He formerly served as senior political columnist and editorial director of National Journal. Prior to joining Atlantic Media, he was the Washington bureau chief and a 20-year veteran of *The Associated Press*. Covering the Bush presidency on 9/11, Fournier was the last civilian evacuated from the White House, filing award-winning dispatches while a Secret Service agent urged him to leave. In 2006, he left the AP briefly to run a social networking startup but returned a year later in the roles of columnist and Washington bureau chief. In 2010, Fournier moved to *National Journal* as editor-in-chief; he stepped down in 2012, wanting to return to column writing. Fournier has won numerous awards, including the Society of Professional Journalists' Sigma Delta Chi Award and the prestigious White House Correspondents' Association Merriman Smith Memorial Award (a record four times). Also succeeding at the heights of academia, Fournier served in 2005 as a Harvard fellow at the Kennedy School's Institute of Politics, where he currently serves on the Senior Advisory Board.

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