# "Santa Trump"

## Market Commentary – December 2016

By Frank C. Fontana, CFA
President, Banyan Asset Management, Inc.
*Written November 30, 2016 – www.banyan-asset.com*

**The second estimate of Gross Domestic Product (GDP) shows that the output of goods and services produced by labor and property located in the U.S. grew at an annual rate of 3.2% in the third quarter of 2016.** This is the higher than the advance estimate of 2.9%. The following is a comparison of the GDP components' contribution to the Q3 reading (advance estimate percentage points, second estimate percentage points): consumer spending (+1.47, +1.89), investment (+0.52, +0.34), net exports (+0.83, +0.87), and government spending (+0.09, +0.05). The sum total of the first set of numbers equals +2.91% and the second set equals +3.15%. Historically, consumer spending is about 70% of GDP. With this assumption, +1.89 for consumer spending implies +2.7% overall GDP growth (mediocre, but not terrible). Investment is still disappointing, with the building of inventories accounting for more than 100% of overall investment. In November, the dollar has continued to strengthen, so the net exports value will likely decline in Q4. GDP readings are, by definition, historical. The results of the election on November 8 may spark what this economy truly needs to grow.

**All eyes are on the Federal Open Market Committee (FOMC) and its upcoming decisions regarding the target range for the federal funds rate.** The FOMC decided against raising the federal funds rate during its monetary policy announcement on November 2 (pre-election). Since then, financial markets have built in the expectation of a 25 basis point hike to be announced on December 14. Beyond that, federal funds futures see the federal funds rate at 0.75% by June 2017, 1.0% by December 2017, and 1.5% by January 2019. Futures markets have essentially priced in two 25 basis point rate hikes during 2017, compared with only one hike seen during 2017 as of one month ago.

**Sure enough, a Trump upset was in the cards for the 2016 election.** On election night, as it was becoming apparent that Donald Trump was likely going to win the U.S. Presidency, stock market futures sold off aggressively. What was surprising, however, was the speed at which the selloff reversed. We were expecting weakness in the stock market to last for days to weeks, but it instead lasted hours. Moreover, it has been fascinating to observe that the rising tide has not lifted all boats, as evidenced by the returns for some major stock market indexes from November 8 to November 30 (excluding dividends): S&P 600 Small Cap Value +12.6%, S&P 600 Small Cap Growth +11.1%, S&P 400 Mid Cap Value +9.4%, Dow Jones Transportation +7.8%, S&P 400 Mid Cap Growth +5.5%, Dow Jones Industrial +4.3%, S&P 500 Large Cap +2.8%, Nasdaq Composite +2.5%, Nasdaq 100 +0.1%, and Dow Jones Utility -5.4%. Market participants are betting that a Trump economy will be better for smaller and more traditional "value" companies, rather than fashionable "growth" companies (especially technology).

**Technical factors of the market are bullish (more demand than supply), while fundamentals are attractively priced – therefore, we are mildly bullish on the market.** The Standard & Poor's forecast for S&P 500 operating earnings per share (EPS) over the next 12 months is $130.94, which implies a price-to-earnings (P/E) ratio of 16.8 with the S&P 500 at 2,199. The earnings yield (E/P) of 5.96% represents attractive value relative to the 10-year U.S. Treasury note yield of 2.37%, although this gap has narrowed significantly over the past month.

**The S&P 500 muscled through resistance at 2,185 and is positioned to push to new highs, although a mild consolidation to test old resistance as support would be healthy.** Investors should be increasingly concerned about higher bond yields making stocks relatively less attractive. This issue becomes somewhat less important if economic growth ignites, which would drive corporate earnings higher. The uncertainty of the election reveals the wisdom of a balanced position between stocks and cash. It would have been easy to be spooked before the election, sell one's stocks, and decide to "wait and see". However, those investors were left behind by a market that roared higher very quickly. Santa Trump has come to town!