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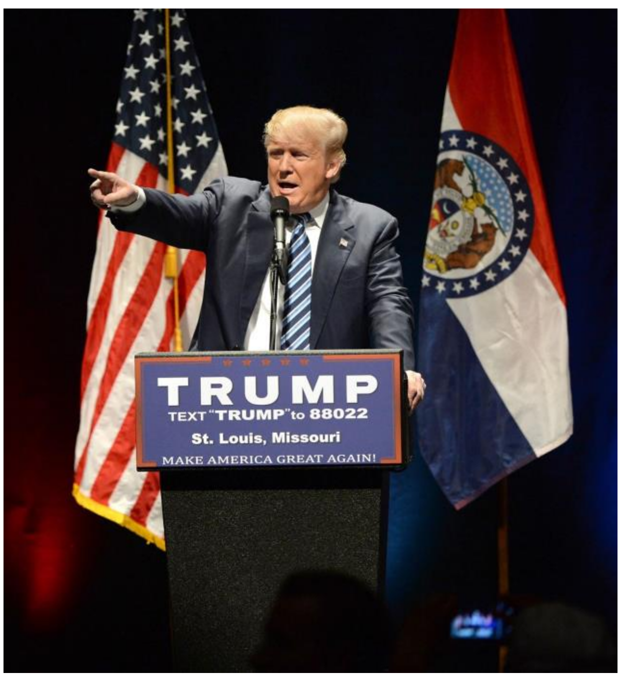
MANCHESTER
CAPITAL MANAGEMENT, LLC

Insight

With this New Year, Manchester Capital Management will continue production of our newsletter, Insight, now on a monthly basis. We hope that you find this valuable and informative.



"After an angry, contentious campaign, an unexpected outcome has seen the stock market advance dramatically and this has left investors questioning…believe it or doubt it?"

The "Trump" Market Rally: Believe it or Doubt It?

-Manchester Capital Management Strategy Team

BELIEVE IT? If I told you we would be entering an environment of lower corporate and personal taxes, reduced regulations and much-needed infrastructure spending, would you be bullish or bearish?

To put some numbers on Trump's plans, Wall Street's consensus estimate for S&P 500 earnings in 2017 is about $131[1]. According to J.P. Morgan's economists, full implementation of Trump's agenda would be worth an additional $20. If we assume half of that agenda is passed (consistent with past success rates), earnings would be $141 and the forward P/E could drop to a reasonable 16.5x from 18x.

Ray Dalio, founder of hedge fund Bridgewater Associates, suggests reading the works of Ayn Rand to capture Trump's economic mindset. He suggests that the new administration will likely favor "strong, can-do profit makers."[2] A pro-business U.S. could offer an attractive environment for those with capital to invest. If able to fire-up investors to move out of cash into risk-on investments, this regime change can have a bigger impact on the economy than simply new tax and spending policies.[3]

Post-election we have witnessed a seismic shift from monetary policy being the only game in town to having fiscal policy and capital investment at our disposal as well. At least until the Fed comments issued on 12/14[4], there had been a positive correlation between short interest rates and equity markets; stock and bond prices have both responded to faster growth expectations.

Higher interest rates have been more than offset by a drop in the equity risk premium and an expectation of higher future earnings. Historically when the Fed Funds rate increases, rates rise across the board, spreads contract and high beta stocks outperform – this has been happening in spades since the December 14 rate hike.

Prices follow money flows. In the first month after the election, $50 billion flowed into equity ETFs and funds and $30 billion came out of bond ETFs and funds. The last time we witnessed this phenomenon was during the 2013 "Taper Tantrum." It was also the last time investors looked at their brokerage statement and realized you can lose money in bonds.

DOUBT IT? Wall Street appears overly complacent. Sentiment indicators are registering multi-year highs. The University of Michigan Consumer Sentiment Index[5] jumped to 98.0 in December (second highest reading in this economic cycle) from 87.2 in October, yet spending intentions on autos and housing both fell, illustrating a disconnect between perception and reality.

Since the market's moves post-Election Day have been swift, a decline in yields and stock prices could be imminent. The 2.1% dividend yield on the S&P 500 has not been above the 10-Year Treasury yield of 2.5%, signaling that equities are no longer the bargain relative to sovereigns that they were two months ago.

Federal Reserve Chair Yellen's 12/14 comments[6] were more hawkish than the market expected. Her belief is that the economy does not require increased stimulus because full employment has been achieved. She pushed back against the notion that the Fed is allowing the economy to run hot and suggested that aggressive fiscal stimulus would be met with more rate increases. The immediate response to her comments were that the dollar spiked, rates moved higher, and stocks prices fell.

Presidents usually keep about 60% of their campaign promises according to multiple studies over the last 50 years[7]. Remember President Obama's intention to renegotiate NAFTA, cut taxes for low and middle incomes, institute an $830 billion infrastructure plan, and create 5 million green energy jobs? Likewise with Trump, it is risky to pin one's investment outlook on expectations for government policy.

The fact is that since 2008, the economy is still muddling along at a 2% clip and a president isn't likely to be able to reverse the effects of excessive debt, aging demographics, globalization and technology advances on slow growth and declining productivity.

New to the Firm

Manchester Capital Management would like to welcome Craig Lewis to its ranks. Craig is filling the new role of Chief Investment Strategist and will be working out of our Charlottesville, VA office. Craig comes to us with nearly three decades of experience in the investment industry and was a Lieutenant in the United States Army before that. Most recently, he served for eleven years as Chief Investment Officer and Equity Portfolio Manager with Franklin Street Partners, a $2.2B RIA based in Chapel Hill, NC. He and his wife, Erica, have four very active children. When not spectating at their sporting events, he enjoys biking, swimming and golf.

We can say with some confidence that consensus opinion is often wrong. For example, a year ago, the market expected four rate hikes and an improving economy in 2016. We should also expect a much wider range of outcomes under a Trump regime versus the "known, status quo" from a Clinton win, arguing for more tactical allocation changes in response to what we perceive to be any market moves not justified by the fundamental backdrop.

ENDNOTES

1. S&P Dow Jones Indices. December 30, 2016.
2. Dalio, Ray. December 19, 2016.Reflections on the Trump Presidency, One Month after the Election.
3. Ibid
4. https://www.federalreserve.gov/newsevents/press/monetary/20161214a.htm
5. Data published December 2016. http://www.sca.isr.umich.edu/reports.html
6. The transcript of Janet Yellen's press conference can be found here: https://www.federalreserve.gov/mediacenter/files/FOMCpresconf20161214.pdf
7. http://fivethirtyeight.com/features/trust-us-politicians-keep-most-of-their-promises/

DISCLOSURES