

J E R E M Y
S I E G E L
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“TrumpQuake;” Rose-colored Glasses; December Hike a “slam dunk”

Friday, 10:35 a.m. EDT

If you would have told me that 2 days after an upset Trump victory the Dow Jones Industrial Average would sit at an all-time high, I would have asked: “What are you smoking?” But that is indeed the case. Is it rational? Yes, if you put on your rose-colored glasses and believe that Trump will be a much different president than he was on the campaign trail. Is that possible? Yes, at least in part. He was never a “dyed-in-the-wool” Republican who lived or died for a fixed set of ideals. His strong point was making deals. And if he wants to move his agenda through Congress, deals he must make. Remember that despite the GOP sweep, the Republicans actually have a smaller majority in both the House and Senate than they did under Obama. And the Republicans are far from united behind many of Trump’s proposals (especially on NAFTA, immigration, etc.). Unless he shows flexibility, he will get little done.

The focus of the markets now is that Trump will succeed in pushing forward large increases in infrastructure spending, because this was one of the few areas where the Democrats and Republicans agreed. The surge in industrial and material stocks is that understandable. What is surprising is not that long-term yields rose, but how much they rose, with the ten year jumping 30 basis points since his election, sending yields to an 11-month high of 2.15%. Yields on ten year TIPS also jumped, but only half as much, indicating that a good part of the rise in yields was due to an increase in inflationary expectations. Indeed the break-even ten-year rate of inflation jumped from 1.73% to 1.89% (and the 5 year –year forward breakeven, which the Fed closely monitors, jumped 16 basis points.). This alone virtually seals the deal for a rate hike next month. Low inflation and moderate inflationary expectations have the main reason the Fed has held back raising rates this year. A rise in these measures guarantees a rate hike in December – and likely one in March if yields continue to firm.

We are entering a period where the government bond market – more than the incoming economic data – will dictate future Fed moves. On the equity side, investors would love for Trump to adopt the “Ryan agenda,” and his initial outreach to the House leader and other Republicans was interpreted as a favorable sign. In truth, no one can be certain of how a Trump presidency will evolve. If Trump moves towards the Republican agenda and away from radical action, this is extremely positive for the equity market. If instead he first tries to slash and destroy NAFTA, impose tariffs, and restrict legal (and especially high-skilled) immigration, this honeymoon will be over. The fact that VIX rests at 15 – instead of the usual 11 or 12 when markets are at all-time highs, shows that Trump’s direction is by no means certain.

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