Are these Issues in Washington Having an Impact the Stock Market?

By Bob Deitrick, ChFC, CEO
May 23rd, 2017

The news out of Washington over the last two weeks has been tumultuous; therefore, we thought it appropriate to follow up on our newsletter published in April. Last month we wrote:

"We are cautious but optimistic about 2017. The concern we have is whether the new administration in the White House can get beyond the tweets, hyperbole and day-to-day rancor and focus on what they need to do: Lead us - which means they need to govern. To the extent that the Trump folks can become organized this could be a very good year for the equity markets. We are watching these issues very carefully, that is our assurance to you."

Steven and I thought it would be of value to discuss the issues and our concerns over what is taking place in Washington. We want you to know where we stand and our game plan to the extent things deteriorate. We are closely monitoring two key metrics of our economy, both of which indicate the current prospect of White House policy implementation: the U.S. dollar and bond yields. Both metrics have been under pressure of late. This may reflect a reduced probability that the Trump policy agenda will be advanced. It is too early to tell, but the spread between the yields on the two and 10-year notes, which surged post-election, have done an about-face. The steeper the spread, the more the market is betting on economic growth and inflation.

Bond yields have continued to weaken surprising many economists who thought that the reverse would take place and that growth and inflation would tick up. Our concern is that the

political distraction in Washington may impede or drown the prospects for tax reform, deregulation, and an infrastructure bill which the equity markets are counting on. The dollar has suffered a similar reversal since the Comey firing of May9th.

The case for a strong dollar has centered on tough trade policies from the White House. But since the president took office, he has stated that China is not a currency manipulator and his threats to scrap NAFTA have dissipated as well.

The stock market had shown resilience given this recent drama until dropping 373 points last Wednesday as the political risk intensified. The DOW recovered late last week making back more than half of the decline. The other good news is the volatility index called the VIX has been at record lows over the past few weeks, unemployment is improving, oil has been stable and consumer confidence continues to improve as well.

Our concern is that to the extent tax reform, deregulation, and infrastructure are delayed or abrogated, this may have a negative impact on the market since the market has been counting on these policies for six months. However, a strong counterpoint comes from our friend Larry Kudlow, who was an economist for President Reagan in the 1980's. Larry remarked last week:

"If the smart-money folks on Wall Street think a special counsel to oversee the Russian probes spells defeat for business tax cuts, they're leaning well over their skis. The market sold off over 300 points on Wednesday, but it may have come back to its senses with a 140-point gain on Friday. And while there's never 100 percent probability in forecasting political risk, it seems the likelihood of health-care reform by the summer and tax reform by year end (or early 2018), is quite high. Paradoxically, special counsel Robert Mueller will provide cover for President Trump as it will take him many months to complete his investigations. The leaks are going to dry up. By law, information on the probe must be protected. So, Trump will have months without the attack headlines in which to sell his tax-cut plan. Meanwhile, amid all the controversies, the GOP Congress knows it could get whacked in next year's midterms if it doesn't govern. A big incentive" per Kudlow.

We hope Larry is accurate. However, note that most of the leaks over the past two weeks have been coming from within the White House. We are watching these political events for you closely as they unfold in Washington. We are not being political as we have said on numerous occasions that <u>we want to see our President succeed.</u> Having said that, the trajectory and speed of events in Washington at this moment is surreal. John McCain said last week,"we've seen this movie before. It's reaching Watergate size and scale," he remarked at a dinner for a Republican group. "This is not good for the country," McCain said.

Having grown up in Northern Virginia as a student at Cooper Junior High in 1973, I have a unique perspective one could only invoke having grown up in DC. During the Watergate era, that topic was the only one discussed for months and during this time the market was pummeled -by 45% - from peak to trough. That was then, this is now. Today the news cycle moves at lightning speed with Twitter, Facebook, 24/7 news and hundreds of news outlets today compared to 4 networks in the '70's. Any bad news can impact the market decisively.

We want you to know that we have decided to establish certain benchmarks or triggers over the next few weeks to the extent certain events materialize. They are as follows:

- *Any event that causes concerns about The White House having been involved in any type of obstruction of justice, collusion or undue influence will become a trigger.*
- *James Comey is testifying before the Senate Intelligence Committee next month. Any disparaging comments that Former Director Comey makes under oath, that place the White House in peril, will become another trigger.*
- *Deputy Attorney General, Rod Rosenstein - a Trump appointee, has named former FBI Director – a Republican Robert Mueller, to be the special prosecutor who will investigate the White house and any connections to Russia et al. If the President decides to fire Mueller, that will become another trigger.*

We are watching these events with great scrutiny for you. We hope the ol' adage <u>this too shall pass</u> becomes a reality. However, if matters collapse, we are prepared to move to more defensive havens. Those safe havens include, but are not limited to,dividend producing stocks, the FANG stocks,high-quality bonds, gold, utilities, preferred stock, and real estate.

Finally, on ahousekeeping note, due to regulatory changes, certain share classes are being eliminated from fee-based accounts. As a result, you may be receiving trade confirmations over the next month as these share classes are removed. <u>These transactions will be processed at no cost to you.</u> Also, if any transactions occur within a non-qualified account, please be aware that they will not incur a taxable event. Any cost basis information will be transferred.

<u>And on an exciting note: Steven and Marie had the birth of their first son last Friday evening at 9:29 p.m. His name is William Scott Morgan and he came into the world weighing 7 pounds/11 ounces. I'm happy to report mother and son are both doing exceptionally well!</u>