777 Third Avenue | New York, NY 10017 | USA | tel. +1.212.355.1234 | fax +1.212.355.8873

## Stock Market Development in Q 3

After a short-lived sell-off, the equity markets, which were up on the prospect of a Clinton win, quickly turned positive again on renewed expectations for an even stronger U.S. economic growth under Trump. The S&P 500 TRA Index closed on 11/30 up 9.8% for the year. The treasury market corrected severely on the notion that Trump's increase in government spending, together with unfunded tax cuts, would increase the deficit, inflation and interest rates. The yield on 10-year Treasury bonds has increased from 2% to 2.32% since the election.

Trump's victory was supported by an under-current of anti-globalization and anti-establishment sentiment, which is not exclusive to the U.S. Eurosceptic; nationalistic parties feed on the same sentiment in Europe. The key risk is that this trend could strengthen fringe parties in Europe and threaten the European project with elections in 2017 in 3 of 5 leading European countries.

During the Obama presidency, ultra-easy monetary policy was compensating for tight fiscal policy, tight regulation, and lack of reform. Trump's plan could mark the first shift toward much overdue support from fiscal policy, which could add 2-3% to GDP, and spark an improved cycle of consumption, price inflation, corporate profits, investment and wage inflation.

The cornerstone of Trump's plan is significant fiscal stimulus with aggressive tax cuts and increased spending on infrastructure and defense (est. $ 1 trillion). His campaign promises included: tax reform, reduced income tax rates for corporations and for the middle class, a one-time 10% tax to enable corporations to repatriate an estimated $1-3 trillion in profits held abroad, a reduction of business regulation, a program to improve the infrastructure, a repeal of the estate tax, fewer regulatory restrictions for banks to lend money by partially repealing Dodd-Frank, and a revision of the "Affordable Care Act" to alleviate pressure on pharmaceutical and health care companies to reduce prices. He also intends to finance this higher government spending plan through higher economic growth, forming public-private partnerships, and increasing public debt by taking advantage of the historically low interest rate environment.

All these initiatives, if properly fulfilled, are likely to attract more business activity to the U.S., be dollar positive and supportive for the broad equity market.

A key concern is, however, to what extent the Trump administration's policies will be approved by congress, and uncertainty remains, therefore, high. His tax proposals, which are even aggressive by Republican standards, are unlikely to be implemented in full. Furthermore, it remains to be seen how his protectionist stance, especially towards China, his plan to renegotiate NAFTA, his rejection of TPP, his isolationistic stance, and tough stance on immigration will unfold. The choice of his cabinet will, therefore, send an important signal on the kind of policies we can expect.

## Federal Reserve Bank Policy Outlook

The Federal Reserve Bank will likely raise the Fed Funds rate by 0.25% in December, as it reaches its goal of 2% inflation and the level of maximum sustainable employment. Future interest rate increases are likely to be gradual because it takes only an increase to 1% for the Fed Funds rate to be neutral meaning a level that neither spurs nor slows the economy.

## U.S. Economy

The economy is doing well. Q3 GDP growth was revised up from 2.9% to 3.2% supported by a solid- labor market progress and steady consumer spending. Unemployment fell to a low of 4.9%, wages, consumer prices and residential investments are rising. The momentum in household spending is likely to continue through Q 4 with consumer confidence at the highest in 9 years. Growth will remain heavily reliant on the consumer, while business investment remains a weak spot.

777 Third Avenue | New York, NY 10017 | USA | tel. +1.212.355.1234 | fax +1.212.355.8873

## TN-Outlook

Consensus expectations for 10-year Treasury yields in 2017 are 2.675% up from 2.35% to reflect the risks of rising inflation and potential increases in Treasury supply. The focus in 2017 should be on short duration corporate bonds with higher spreads relative to their durations to cushion losses incurred by interest rates rise. High grade technology and materials have the highest spread premiums.

High-yield corporate bonds should also fare relatively well in an rising interest rate environment, as their high yields are a cushion against rising government yields. Years of declining borrowing costs have supported a record-high median interest coverage for consumer discretionary and materials companies. Credit spreads are still high and bonds look attractive. This may change if further wage gains support consumer spending and improving industrial metals demand boosts materials production. Furthermore, credit risk has not increased, new issuance of high-yield debt remains solid, and an improving economy should stabilize if not further improve credit risk.

The stock market is likely to remain fairly valued if economic growth rates of 3% plus, expected under Trump, can be achieved. Stock prices are likely to be driven by higher corporate earnings and investor flows. Foreign investors have been net sellers of U.S. stocks for 4 years. Since the election $ 28 billion were invested into U.S. stocks and $ 18 billion were rotated out of global bond funds. This trend is likely to continue. Furthermore, with improved fiscal spending the Federal Reserve Bank will be able to raise interest rates to a normal level which will make investors feel more confident about the pricing of assets which had become increasingly difficult during the years of accommodative monetary policy (QE). Sectors with the highest correlation to growth, such as finance, brokerage and insurance companies, banks, and consumer finance will benefit from rising interest rates. Consumer lenders, payment networks and card-issuers are likely to benefit from lesser regulation, improving credit-loss rates and wider margins. Mobile payments are increasing and online loan platforms are being launched. Smaller domestic companies, which pay relatively higher taxes than global companies, in particular, are likely to benefit from a lower corporate tax which enables them to increase their investments in growth. Financials and Health Care are our most preferred sectors for 2017. The ability for large pharma and biotech companies to repatriate cash trapped overseas without paying full U.S. taxes may fuel the potential for large cash returns to shareholders, and could result in M&A with smaller U.S. biotech firms. We expect in-line market gains in technology, consumer discretionary, as well as attractive yields in utilities and REITs. We would underweight consumer staples, materials & energy based on valuations and a strengthening dollar, and be selective in industrials. Defense companies are likely to benefit most from an increase in defense spending under Trump. Ships and aircraft remain a focus, as these industries are a boost to manufacturing. As a result of better profits, cash flow will continue to be deployed for share buybacks and support dividends. Furthermore, we expect infrastructure investments to be focused on electric transmission/efficiency, green power, and water purification systems. Companies involved in these industries should therefore benefit from this trend. In summary, we expect a corporate tax cut to add $ 10 to the earnings in the S&P 500 which should provide room for the Index to reach 2400 in 2017 with an average PE of 18.

Active investing is likely to trump passive investing in 2017 because of the performance dispersion among the sectors versus the index. Stock picking, ample risk diversification and patience remain key.

Happy New Year!
Your Terra Nova Team!

777 Third Avenue | New York, NY 10017 | USA | tel. +1.212.355.1234 | fax +1.212.355.8873

***Terra Nova Asset Management, its principals, employees, or customer accounts may or may not be holding a position in the company that is being analyzed.***

**Investors should be cautious about any and all stock recommendations and should consider the source of any advice on stock selection. Various factors, including personal or corporate ownership, may influence or factor into an expert's stock analysis or opinion.**

**All investors are advised to conduct their own independent research into individual stocks before making a purchase decision. In addition, investors are advised that past stock performance is no guarantee of future price appreciation.**

**Privacy Statement**

**For a copy of our privacy statement, kindly click this link – PRIVACY STATEMENT**

**http://www.terranovausa.com/privacy-e.pdf**