Investment Insights

The U.S. Economy's "First 100 Days"

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Highlights

- In the first 100 days of Trump's presidency, the U.S. economy has continued its modest growth trend, while stocks and business/consumer confidence have surged
- Regulatory, tax, and trade policy will be critical in driving growth trends from here
- Deregulatory actions and a softening of Trump's trade stance have contributed to investor optimism; we continue to expect some level of tax reform this year, though progress will be bumpy

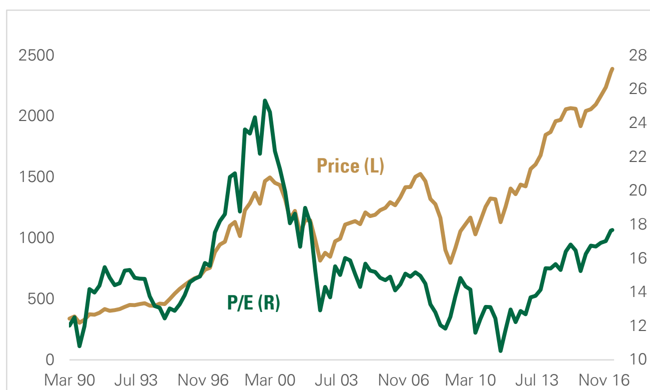
The original "first 100 days" represented President Franklin D. Roosevelt's flurry of legislation in 1933 designed to bring an end to the Great Depression. Since then, the first 100 days of a president's administration have become a symbolic checkpoint of sorts. What progress has the new administration made, and where is it headed? Policy is always one factor of many driving financial market performance, and it has been especially important for markets so far this year. In this *Investment Insights*, we look at the first 100 days of the Trump administration through an economic lens. In our view, U.S. economic growth is improving, but the trajectory remains shallow, and much-anticipated tax and regulatory reform will be critical in providing the domestic economy with the ammunition needed to further extend the recovery.

Progress Report for the U.S. Economy

To be clear, the time frame of the first 100 days of any U.S. president's term is by and large inconsequential to the state of the economy during that period, no matter how many executive orders are signed or laws are passed by Congress in the initial days of a new administration. However, periodic progress reports can be a useful tool for grading the performance of the U.S. economy, much in the same way parents use them to monitor the improvement of grade-school children.

Consumer and business confidence accelerated following the November 2016 U.S. election, taking U.S. stock prices to all-time highs and valuations to the highest levels since the tech bubble (Exhibit 1).

Exhibit 1: S&P 500 Price and Valuations Climb to Lofty Levels

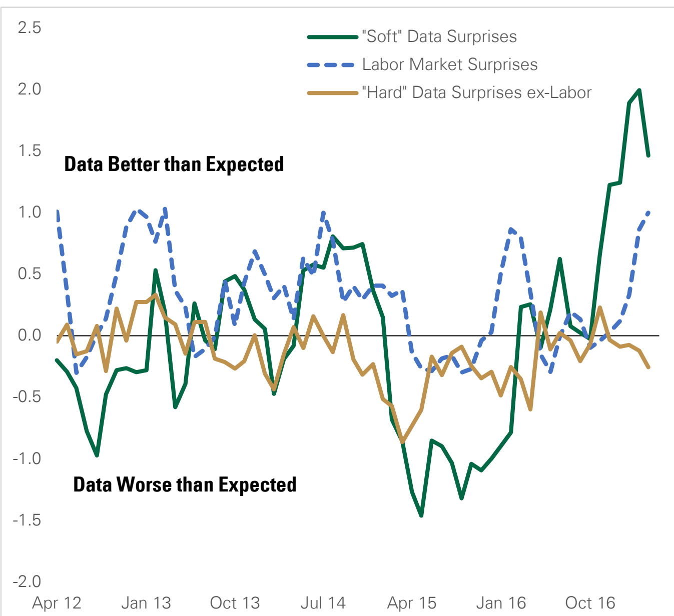


As of April 27, 2017. P/E represents price-to-earnings ratio based on next-12-month earnings.
Source: Bloomberg, Standard & Poor's

Surging confidence has been based on hope for policy change rather than anything material happening right away in the economy. In fact, with the exception of the labor market, other measures of "hard data," like retail sales or housing activity, have disappointed, while leading indicators of sentiment, or "soft" data, have moderated in the last month (Exhibit 2).

Recent data led us to expect the soft first-quarter U.S. GDP report released Friday, and we believe at least part of the weakness can be attributed to seasonality and higher inflation eating into real spending, both of which we anticipate will be transitory. We would look for growth in the second quarter to rebound, similar to the past three years. Policy will be an important factor in determining whether the U.S. economy can switch to a higher gear, both near term and over the year and years ahead.

Exhibit 2: Sentiment and Labor Market Robust, but Other Activity Lackluster



As of April 27, 2017. "Soft" data represents surveys and sentiment. "Hard" data represents an average of industrial, housing, personal & household, and retail activity. A positive number indicates better-than-expected data versus consensus estimates.
Source: Bloomberg

Policy Drivers of Growth

Three key policy initiatives have played an important role in the Trump administration's first 100 days and stand to be critical in driving the next phase of growth in this economic cycle.

Taxes

Bottom line: Tax cuts and/or reform are likely to pass into law in 2017 or early 2018, but the road to get there will be bumpy. It is still too early to have a clear sense of what corporate or personal income tax reform could end up looking like because any initial plans can change significantly in the legislative process. President Trump's initial campaign promises for tax reform were, in our view, much too ambitious both in scope and timing. However, his latest plan includes aspects that should prove to be growth positive, if passed. The personal income tax system should see a reduction of complexity, but we expect the biggest economic impact to come from corporate tax reform. Specifically, we would note corporate tax reform that includes one-time repatriation and a move to a territorial tax system, high-teens or low-20s tax rates for C-corporations, and similar rates for pass-through entities (which represent small businesses that employ nearly half of the workforce). Unfortunately, the longer it takes to answer key questions (e.g., will tax reform be budget neutral and, therefore, permanent? To get there, will Republicans push through some form of a border tax? Will there be enough revenue offsets to allow for 100% immediate capital expense depreciation?), the longer companies will remain in limbo, hesitant to invest or make any major business decisions. In other words, stronger business-led growth first needs action on taxes and tax clarity.

Deregulation

Bottom line: Deregulation has arguably been the most successful policy initiative of the Trump administration's first 100 days and could end up

having a significant economic impact. Efforts began in earnest with President Trump's executive order on January 30 calling for the removal of two existing regulations for each new regulatory rule issued. Since then, several regulations touching the financial, environmental, and other industries have been repealed through legislation or the Congressional Review Act. Going forward, deregulation could be very growth positive, particularly for financials and small businesses. The challenges will be twofold, including accurately measuring the economic impact and insuring that the future regulatory environment does not foster undue risk.

Trade

Bottom line: It is positive, in our view, for markets and the economy that Trump has not delivered on his trade-related 100-day threats, which is supportive for emerging markets in particular, and investor sentiment in general. Trade has been among the most dramatic about-faces that we have seen from Trump between his campaign and today, and we are not complaining. Deciding not to name China a currency manipulator, as well as agreeing to renegotiate but not withdraw from NAFTA, reflects a decidedly softer tone regarding trade and protectionism. Going forward we expect trade issues to remain very visible —the tariffs levied on Canadian lumber last week are one such example. However, we anticipate future trade disputes to involve specific goods from individual countries, with an eye toward reciprocal treatments rather than a broad-brush tariff against an entire industry or country.

Looking Ahead

Regulatory, tax, and trade policy will be critical in driving growth trends. Specifically, regulatory relief and tax cuts could support profit margins, which declined for about two years, though have recently stabilized. Data suggests that corporate CEOs are anxious to spend on capital expenditures, and we believe that tax reform could be the catalyst for actual spending. While we think some expectations of legislative action in the first 100 days of the Trump administration have been too optimistic, we believe progress on key growth policies will provide businesses with much-needed clarity to support further investment.

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