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To Our Clients, Partners, and Friends –

What a difference a year makes. Our quarterly letter at the beginning of 2016 addressed concerns about volatility in the market, but with an anticipation of slow growth. China's economy, oil prices, the strong dollar, and interest rates were at the forefront of the conversation. Almost on cue, the S&P 500 had the worst start to a year in history—down 10.5% through February 11th before making a comeback[1]. The year finished with the three major U.S. stock indexes plus the Russell 2000 index (which measures small cap companies) hitting record highs in November[2]. It is typical for the market to do well in a presidential election year and, as expected, volatility was a major factor. But the story of 2016 and the outlook for 2017 are about the unexpected.

Populist pressures first came to fruition with the surprising outcome of the U.K. vote to leave the European Union. Not to be outdone, the United States voted to elect a decidedly anti-establishment candidate in Donald Trump. The initial jitters of both headlines rattled the markets before showing surprising resiliency. The 5% drop brought on by Brexit took the S&P 500 just eight trading days to erase[3]. Pre-market trading had Dow futures down close to 4% after Trump won Pennsylvania, only to close the next day on November 9th up just over 1%[4].

In the subsequent post-election weeks, the "Trump rally" helped equity markets achieve double-digit returns for the year. U.S. retailers reported that consumer spending this past holiday season is projected to top $1 trillion[5]. "The world was gloomy before I won," tweeted Donald Trump, and congratulated himself on these encouraging statistics.

We would expect nothing less from the braggadocious President-elect. However, the effects of the election are anything but expected. After years of offshoring, corporations are pledging their commitment to domestic manufacturing, jobs, and production. Abruptly, after the long battle of passing and integrating the Affordable Care Act, health care is poised for a seismic shift. Trump is also taking a hard line on taxes, immigration, and foreign policy.

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[1] David Randall, "What's Behind the Global Stock Market Selloff?", *Reuters*, February 12, 2016
[2] Liz Ann Sonders, "Will The Momentum Continue into 2017?", *Schwab Market Perspective*, December 9, 2016
[3] Dr. Andrei Nikiforov, "Brexit Economic Impact", *International Business Times*, August 4, 2016
[4] Rob Berger, "How Donald Trump's Presidency Will Affect the Stock Market", *Forbes*, November 10, 2016
[5] Rod Sides, "2016 Deloitte Holiday Survey", *Deloitte University Press*, October 25, 2016

We are in the midst of an ideological change, in many ways similar to the 1979-1982 shift of power in the U.K., U.S., and Germany. In her final year as prime minister, Margaret Thatcher famously shouted "No! No! No!" in protest of further integration with the European Economic Committee. Ronald Reagan slashed the top income tax rate by 42% while navigating the extreme foreign relations tension of the Cold War.

Trump has proven to be just as hard-nosed, but it's not likely that we will hear "tear down this wall" in the next 4 years. The question is whether or not this administration will be aggressive and thoughtful, or aggressive and reckless. Trump's cabinet appointees, much like him, are negotiators and dealmakers. Their viewpoints don't fit neatly into a political ideology, but there are many common threads.

This administration is heavy with corporate executives and military leaders. Combined, the top eight officials have 83 years of business experience and 55 years of government or military experience (mostly military)[6]. This is the most business experience ever for an incoming administration and second-lowest, only to Reagan's administration, in government experience.

Despite some differences in policy opinions, the most apparent shared value system in the Trump camp is from an economic perspective. Their dogma is straight from an Ayn Rand novel: people and policies should be judged and rewarded based on productivity. This administration will likely make strong "profit-makers" into heroes with significant power, not villains with limited power. This is a departure from the style and attitude of the current leadership. Such a stark contrast may incite some growing pains.

However, the Trump administration is inheriting an economy that is showing reason for optimism. Accelerating GDP growth around the globe should produce faster revenue and earnings growth. Aggressive fiscal policy is likely to revive the confidence of businesses and investors. This is already being seen in economic consumption data, with consumer confidence getting a boost in early December to its highest level since July 2007[7].

While Trump may want to take full credit, it is clear that consumer confidence is also being derived from the strength of the U.S. dollar. Paul Volcker, former Federal Reserve Chairman, once said that a nation's exchange rate is the single most important price in its economy. Known for his aggressive monetary policy tactics, Volcker fought, and ultimately defeated, the double-digit inflation of the late-1970s. His theory is that all economic activity is impacted by changes to currency strength—the stronger, the better.

Coming into 2017, the U.S. dollar shows no signs of slowing its ascent. The expectation of multiple interest rate hikes by the Federal Reserve will make dollar-denominated assets more attractive to foreign investors. Expectations of expansionary fiscal policy are also adding to the demand for the dollar. During a similar environment under Ronald Reagan, the ICE Dollar Index increased by over 80% from 1981-1985 as tax cuts and interest rate hikes were executed in tandem[8].

[6] Ray Dalio, "Reflections on the Trump Presidency", *Bridgewater Associates*, December 19, 2016
[7] Liz Ann Sonders, "Will the Momentum Continue into 2017?", *Schwab Market Perspective*, December 9, 2016
[8] Ira Iosebashvili, "Re-Energized Dollar Looms Over the Rest of the World", *Wall Street Journal*, January 1, 2017

Since the Volcker and Reagan era, the global economy has become exponentially more interconnected. Fiscal stimulus under George W. Bush failed to boost the dollar in the early 2000s, as equity markets were uncertain amid geopolitical strife. Today, the strong U.S. dollar is negatively impacting China. Capital outflows and tightening liquidity are causing stock prices and bank reserves to plummet. The other side of this coin is the potential for U.S. manufacturing and exports to suffer while China's thrive.

A major theme for 2017 will be how and if the dollar dependency of international markets will bleed back into the U.S. economy. The incoming administration is anything but predictable, and campaign promises are typically a far cry from what politicians actually enact. It is likely that widespread speculation on the Trump presidency will lead to volatility as the paradigm is shifting. However, strong fundamental economic data paired with a pro-business White House leaves reason for a very optimistic outlook.

Thank you for your continued confidence in Planning Capital Management. If you have any questions or comments, please do not hesitate to contact us. We welcome the opportunity to discuss our thoughts in greater detail.

Sincerely,

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