Financial markets often hate unexpected change, particularly when it could have far reaching economic effects. As a result, investors emotionally favor the status quo, especially when it comes to politics. The voters clearly rejected the status quo, yet the initial financial response to the Trump election was perhaps as surprising as the election itself. That may not be the final word from the financial markets, however. Until investors become more comfortable with what the election means for the future of their holdings, financial markets could still experience some significant price volatility.

After the short-term price reactions to the surprising outcome washes through the financial markets, prices will eventually need to reflect the impact that the new administration has on the economy and earnings. It will take time for the new administration to make policy changes and assess the impact of those changes. As that occurs, that impact should be reflected in a disciplined analysis of the indicators that most reliably tend to determine long-term investment results.

During uncertain times, it is important that investors stay focused on the longer-term outlook and simply use short-term price volatility to enhance long-term positions. We currently see relatively little risk of a recession, which limits the risk of major losses in an equity bear market. That outlook could improve if the new administration adopts policies that encourage more business activity, and would deteriorate if new policies cause activity to slow or decline. Until we see more evidence of a deteriorating long-term outlook, we will continue to be biased toward equity exposure.

Nonetheless, this has been an exceptionally weak growth cycle, and growth becomes even more challenging at this stage of the cycle. We have reduced equity exposure as the cycle has aged, and will likely remain more cautious about risk exposure until the cycle resets. The characteristics of the economic cycle inform our analysis of the potential impact of the new president. We are comfortable with moderate levels of risk, but would avoid taking aggressive levels of risk for reasons that go beyond the uncertainties of a new presidency.

Unfortunately, too, many of the traditional low-risk investment strategies have become expensive over the course of this cycle. As a result, bonds and high dividend equities are much more expensive than they have been in the past. Those investments still merit a continuing position in most portfolios, but that exposure needs to be evaluated in terms of investor needs and the risk of elevated valuations.

Bottom line, the surprising election of a very nontraditional candidate means that investors will endure elevated uncertainty about government policy for some time. That policy certainly has an important impact on the economy and on the financial markets, but there are many other critical determinants as well. Investors will want to carefully monitor the implications of changing government policy. At the same time, that cannot be allowed to overshadow the other critical factors that will also play a role in the long-term trend of market prices.

For questions, please contact your Key Private Bank Portfolio Manager.