LEGACY WEALTH ADVISORS

Eye of the Beholder

August 2018

A little over a year and a half ago we offered the following caution in our January 2017 newsletter.

We suggest our readers put their seat backs in the full and upright position, fasten their seat belts low and tight, and prepare for takeoff. We are quite certain it's going to be a bumpy first 100 days.

What we ultimately saw was that; and more. The "never-ending chaos" of the Trump administration has been trumpeted by the President's detractors on a continual basis, and yet many of the key issues Trump campaigned on have been accomplished. His supporters are largely pleased overall with his "accomplishments", while his detractors were alternately revulsed and horrified by the same. Indeed, his approval rating with his base is higher than any Republican in history — including Reagan.

This month we take a non-partisan, market-focused look at our 2017 post-election prognostications about all things Trump (in *italics* below). We review areas where we were correct, where we missed the call, how it may effect the 2018 mid-terms, and the economic and market outlook for 2019. We will leave it to our readers to utilize their own political filters to assess the broader impacts of those policies and changes.

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Blitzkrieg: An Appropriate Term

By tightly scheduling multiple events with overlapping timelines, offering more limited press access to White House policy makers, delegating significant power to his Cabinet members and speaking directly to the public through social media, we expect Trump will deliver a tsunami of actions on his campaign promises in a very short timeframe. (January 2017 [1])

One of the biggest areas of disagreement among pundits (and voters) before inauguration day was whether Trump actually meant many (or any) of the things he campaigned on and whether he was in any way, shape or form 'conservative'. Most of our assumptions about Trump's operating style have been proven correct, especially his propensity to delegate significant authority to his cabinet officers and military leaders to act as they see fit within their authority.

If anything, we underestimated the speed with which Trump would move on those items that were directly within his control; by either wielding his own Executive Orders or by pushing for administrative rules changes (or reversals) by his cabinet officers. However, as we'll see below, areas that required Congressional action were largely

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"Fake News": Change in Ownership

The main stream media (MSM) will find their ability to influence the political narrative to be diminished in many respects, and has recently found itself an unexpected recurring target of the "fake news" accusations that emerged after the election. ([1])

As a result of several high profile missteps in rolling out early policy changes (like the "travel ban") and Kellyanne Conway's "alternative facts" imbroglio, the main stream media attempted to brand Trump's pronouncements and assertions as "fake news". In one of the more ironic outcomes of his administration, Trump has quite successfully turned that epithet back on the MSM, much to their frustration. He frequently uses it in rallying his base at his roving red-state rallies, with one result being a continued decline in the overall public's perception of the media's honesty and integrity.

In fact, a recent Gallup poll found that "*Americans are much more likely to say the media supports our democracy "very poorly" or "poorly" (43%) as to say it supports democracy "very well" or "well" (28%). Less than half of Americans (44%) say they can name an objective news source. And only 27% feel very confident in their ability to distinguish factual news from opinion.*"

A Pen: With Disappearing Ink

President Obama famously said "I've got a pen, and I've got a phone … And I can use that pen to sign executive orders and take executive actions and administrative actions ..." We feel one of the most visible and stunning effects of Trump's approach will be the immediate reversal of many of Obama's 240 executive orders (gun control, refugees, Cuba, environmental and employment policies, Title IX, Obamacare, etc.) with Trump wielding his own pen and phone, with a vengeance. [In addition the] *Congressional Review Act … it appears that thousands of final agency rules … will be subject to revocation by majority vote for the first 60 "session days" of 2017.([1])*

Trump (and Congress, in mostly partisan votes) have acted in virtually every area listed above, rolling back thousands of regulations and administrative rulings put in place by the Obama, Bush and Clinton administrations. The obvious risk (to Trump, and in hindsight to Obama) of using Executive Orders (EO's) to change policy is that it is easily undone by the next administration.

Competing Priorities: Mixed Results

In the table below we handicap the most likely priorities of Trump and the Republican majority in Congress. As indicated earlier, we fully expect the Trump administration to be moving on many, if not all of these, simultaneously and aggressively.([1])

Legislation	Trump	Congress	Action
ACA Repeal & Replace	High	High	Fail
Tax Code Changes	High	High	Pass
Supreme Court	Medium	Medium	Pass
Energy Policy	Medium	Medium	Pass
Trade Reform	High	Low	Ongoing
Immigration Reform	High	Low	Fail

Trump has succeeded in 4 out of 6 of the key areas shown in the table above. Trump's two biggest campaign promises, repealing Obamacare and "Building the Wall" have gone nowhere, despite several half-hearted attempts by establishment Republicans.

Our key failure was in actually believing a broad swath of Republican campaign promises to help Trump achieve those key objectives was sincere and achievable. When push came to shove, actually moving legislation to make those changes was far more difficult, and potentially more costly in the mid-terms than Republican leadership could stomach.

Repeal and Replace: Bait and Switch?

Based on Trump's legendary ego, we don't see that modifying Obamacare has any possibility of success. Absent a significant weakening of popular provisions of the ACA we expect a quick repeal, followed by a reasonably quick passage of an acceptable replacement. ([1])

While Trump was successful in rolling back the individual mandate, we misjudged the sincerity and fortitude of Republican leadership, and to a lesser extent the rank and file, in acting on their campaign promises. Despite several bites at the apple, and with limited cooperation on "compromise legislation" put forth, every attempt to offer an alternative has failed. The ultimate outcome on this issue will hinge on the mid-terms.

If Democrats are successful in taking control of the House (possible, given historical precedent) and the Senate (unlikely) both sides may find a bi-partisan solution. If Republicans merely hold both chambers a continued stalemate is most likely, with minor tweaks around the edges. If however, R's add seats in either chamber repeal and replace may yet occur.

Tax Reform: Better Late Than Never

Tax reform may find common cause between establishment D's and R's, with significant opposition from the Conservative wing of the latter. In the end, we expect the top tax rates to fall to between 20-25%.([1])

We overestimated the ability of Establishment D's and R's to come together to compromise on a final bill. Democrats were far more resistant to any Republican "compromises" than even the conservative Freedom Caucus in the House. Indeed, the final vote was 51-49, with no Democrats voting for the reforms, which may have a slightly negative effect in the mid-terms.

The final package included significant reductions in individual tax rates, increased standard deductions, reductions in mortgage interest deductions, a doubling of estate tax deductions, and corporate taxes rates at the lower end of our expected range, at 21%. One consequence (intended or not) of the reduction in State/Local tax deductions is to place blue states, which have historically had a higher tax burden, under pressure from their constituents in the mid-terms.

As with Obamacare, the future of tax reform is heavily dependent on the mid-terms. Democrat leadership have spoken openly about rolling back many of the cuts, especially for businesses and higher income individuals. Republicans would likely push to make the recent changes permanent, and given a solid majority would likely argue for further reductions.

Supreme Court: Scalia's Twin(s)

Trump has announced he intends to send his nominee to Congress sometime in the first two weeks after the inauguration … has also signaled that his pick will be in the mold of Justice Anthony Scalia, a reliably staunch conservative. … We expect the nominee to be readily approved, with some degree of crossover votes from more moderate Democrats facing tough elections …([1])

As expected, Trump nominated a reliably conservative jurist, taken from the preferred list put together by the Federalist Society, of judges with an affinity for an "originalist" interpretation of the U. S. Constitution. Despite a fair amount of pushback, and leftover animosity based on the Republican treatment of Obama's last nominee, Merrick Garland, Neil Gorsuch was readily approved by a 54-45 margin, with the expected Democrat crossover votes guaranteeing the approval.

With the announced retirement of Justice Anthony Kennedy, Trump will have another opportunity to further reshape the Supreme Court. Trump has nominated another reliably conservative jurist in Brett Kavanaugh to the position. We expect a similar process and outcome, with confirmation completed by early October in time for the next Supreme Court session.

Of perhaps greater importance, by the end of his first term Trump may have had a chance to fill an extraordinary number of district and appellate court vacancies, perhaps totaling as much as 20 percent of the overall authorized number of judges. These appointments will likely have a far more practical and far reaching impact than the Supreme Court fight.

Energy Policies: In Process

We expect to see an immediate reversal of many of Obama's energy related executive orders, specifically as they relate to coal utilization and oil fracking, as well as an early policy reversal and subsequent approval on the construction of the Keystone Pipeline.([1])

As expected, the administration withdrew from the Paris Climate Accords, loosened drilling restrictions in some sensitive areas and dropped all opposition to Keystone. Construction is expected to begin in early 2019 despite a recent court-ordered environmental impact update. Trump has also announced key reversals on other Obama "anti-coal" policies and administrative rules, including delaying retirement of aging coal and nuclear plants. Officials alluded to national security concerns over the price stability of base electricity generation in light of the higher price volatility of natural gas, with stiff rebuttal from industry officials.

Trade Policies: In Process

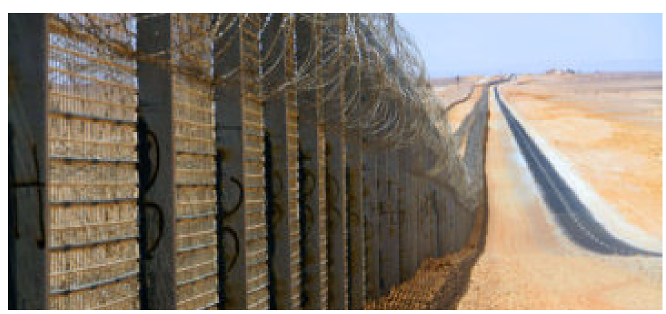
Speaker Ryan has indicated that the House will prevent Trump from unilaterally imposing tariffs due to Constitutional limitations. Further, pushback from China and our other major trade partners is all but assured to be vigorous, and perhaps retaliatory.([1])

Trump's signature approach to trade is to shun multilateral deals and to renegotiate deals with individual countries. Initial NAFTA renegotiations have ground to a halt and we expect it to be replaced with individual deals with Canada and Mexico, with the latter being put in place first. Despite Ryan's announced opposition, Trump has begun a series of targeted tariffs, primarily against "dumping" of steel and aluminum.

While some foresee a global trade war, we are much more confident that the U.S will prevail in a matter of months, with only a limited back-and-forth retaliation cycle. The U.S is too large and important a trade partner for all concerned to suffer a protracted, and deepening battle, especially for China who is heavily dependent on exports over the foreseeable future.

Immigration Reform: At a Stalemate

In reality, the border will likely be secured by a combination of fencing in places where a wall is not feasible, electronic and areal monitoring, and a significant increase in border patrol agents with new orders to interdict illegal entry into the U.S. ... Immigration reform will likely be a secondary issue, to be pursued separately, beginning immediately with fiscal penalties on so-called "sanctuary cities" in the form of reduced, or eliminated, Federal funding, coupled with a possible mandatory requirement for the largely voluntary E-Verify System (created in 1996). ([1])



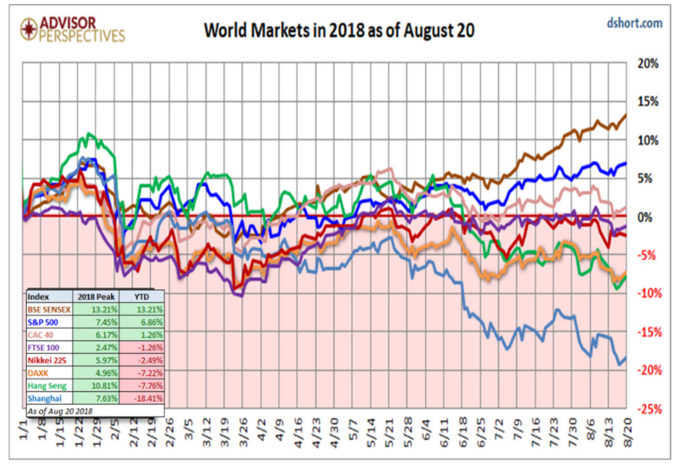
Because the immigration issue is among the most divisive in modern politics, and with the possibility of a turnover in the House in the mid-term elections there has been little to no progress on the issue. Despite their tough talk in the 2018 election cycle, Republicans made only tepid attempts at tinkering with, much less overhauling, current policies, and Democrats remain firmly against accepting any R changes.

Market Impact: Surprisingly Positive

We acknowledge that this enthusiasm, combined with an aggressive push by the Trump administration to jump-start the U.S economy through changes in trade, taxes, energy policy, immigration reforms and perhaps even new stimulus for infrastructure (less likely in our opinion) could result in economic growth and earnings above our forecast.([1])

The business, economic and trade results have been much more positive than we initially expected, even with the absence of a new infrastructure plan. The recent announcement of 4.1% GDP growth is a direct reflection of the underlying metrics. Unemployment rates for Black, Asian and Hispanic workers are at all-time lows, while the rate for women is at a 65 year low, and for teenagers is at a 50 year low. Consumer Confidence continues at a 17 year high along with similar measure for business confidence.

We have witnessed a significant number of new jobs created since inauguration day, many as a result of manufacturers and businesses moving jobs back to the U.S. We believe this has been the biggest driver of the economy. As a result we have seen a significant tightening in the labor market, with some specialty jobs remaining unfilled due to a lack of qualified workers. We have begun to see the rise in wages and income that we have been waiting for, even as it raises the possibility of higher inflation over the next year. The key will be the Fed's reaction to such increases.



DShort/world-markets-update

That said, we expect that U.S. markets will likely outperform global markets given a likelihood of a stronger U.S. fiscal, economic and regulatory environment.([1])

This has been, by far, the biggest confirmation of our thoughts 18 months ago. Since January 2017 the U.S stock market is up over 25%, whereas global equities have lagged significantly with Europe up 17%, Emerging Markets up 19%, and China down 15% over the same period. Finally, as of this writing the current bull market has captured the title of the longest on record and we see no compelling evidence that a recession or bear market is imminent. We remain cautiously optimistic that the Fed remains vigilant, and that market excesses are being dealt with on a rotational basis, allowing the bull to run a bit further.

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Now What?

Domestic market performance continues to diverge, with the Dow, S&P and Small Cap stocks testing the highs while the NASDAQ plays catch up. At the same time Emerging and European markets are bouncing off their lows for the year. We maintain our bias towards domestic stocks over international. We maintain our positions in high quality, medium duration bonds, but would continue to lower weights for longer duration high yield bonds and interest rate sensitive securities as the Fed tightening mode continues.

We now have six quarters in the rear-view mirror and are comfortable in saying that the true impacts of Trump's policies are being seen in the actual data, as opposed to mere expectations and measures of confidence early in his term. We feel that U.S equities and bonds will provide a better return than overseas markets, for now, but we are mindful that we are in the later stages of the economic cycle. If you would like more information please contact us at (954) 809-6363.