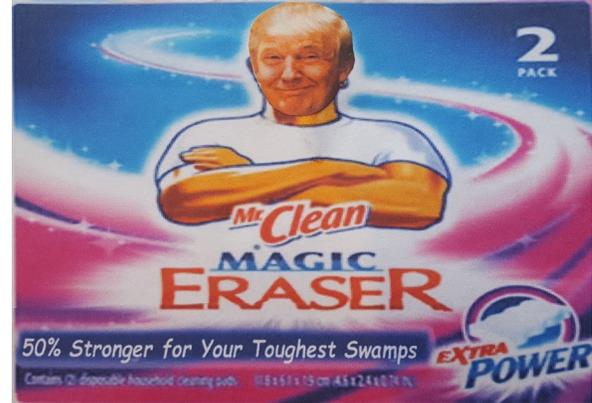


Shock and Awe

Volume II - 2017

In the aftermath of the recent election many establishment politicians on both the left and the right have been struggling to come to grips with the new political realities they now face. Every day reveals the sharp divergence from the political dynamics that have existed for the last 35 years or so. And not since Ronald Reagan have the media found themselves in such an antagonistic relationship.

President-elect Trump's first news conference should be viewed as a taste of coming attractions for his administration, and it's new relationship with the press, Congress and the public. The genteel, often timid (although some would say diplomatic) responses of recent Republican administrations to criticism from the opposition, or the media, will in all likelihood become a relic of the past.



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.

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Ready, Set ...

We suggest that President-elect Trump (PE Trump) plans to overwhelm the opposition, both Democrats and Republicans, in standing up his new administration with lightning speed, by implementing simultaneous battles on multiple fronts, on key policy proposals, and using a variety of methods. 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; a matter of days and weeks, rather than months and years, as many observers have come to expect.

The Encyclopedia Britannica defines a blitzkrieg as: “a military tactic calculated to create psychological shock and resultant disorganization in enemy forces through the employment of surprise, speed, and superiority in matériel or firepower”. Regardless of what it's called we feel that's exactly the condition that will prevail over the next 100 days, a condition last seen when General Norman Schwarzkopf introduced the term “Shock and Awe” to Iraq, and the rest of the world, in 2003.

With the emergence of widely expected resistance to Trump's policies, both parties will be subjected to a degree of public pressure and criticism through social media previously unknown. Trump has a social media following of 45 million users (18 million of which are on Twitter alone); during primetime Fox News, CNN, and MSNBC have a combined audience of 4.7 million. 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. We expect the practical result will be an acceleration in the adoption and implementation of the Trump's policies. We have already witnessed the phenomenon in the recent Senate hearings on Trump's cabinet appointments.

Despite expectations of fierce opposition from the Democrat leadership, and a threat to “slow-walk” the nominees with each hearing taking up to two weeks, the result has been anti-climactic, with the Senate scheduling as many as four hearings a day. With the threat of a filibuster removed by Harry Reid in the prior Congress, there appears to be little to prevent the approval of his appointees.

A Pen and a Phone Redux

In response to Republican obstruction of his policies in his second term, 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 ...”. As our opening graphic indicates, 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.

Another tool will be the little-used *Congressional Review Act*, which allows Congress to pass a *Resolution of Disapproval* of any final regulatory rules passed within a specific time period, with a simple majority vote, with no possibility of a filibuster by Democrats. While the calculation is slightly more complicated, it appears that thousands of final agency rules submitted to Congress on or after June 13, 2016, will be subject to revocation by majority vote for the first 60 “session days” of 2017, according to terms of the Act.

Competing Priorities

Trump’s transition team now includes over 500 people (200 staff and 300+ volunteers) working across multiple fronts. Their first priority is to prep Trump’s cabinet nominees for their Senate confirmation hearings so that key players will be approved by Inauguration Day. Eighty-five people are involved in the confirmation process, with specific designees playing their roles in “murder boards” used to prepare the nominees for tough questioning, and guiding their prospective responses. Based upon what we’ve witnessed so far, they have done an excellent job of preparing them.

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.

Legislation	Trump	Congress
ACA Repeal & Replace	high	high
Tax Code Changes	high	high
Supreme Court	medium	medium
Energy Policy	medium	medium
Trade Reform	high	low
Immigration Reform	high	low

Repeal and Replace

The House and Senate have already approved a spending resolution which will be used as a vehicle to repeal Obamacare, similar to the budget reconciliation maneuver the Democrats used to originally pass it. Democrats will be unable to prevent its repeal because a reconciliation bill is not subject to a filibuster, and should easily pass with the simple majority vote required.

Trump has already publicly contradicted Speaker Ryan, and the prevailing narrative in the press, that while *Repeal* may take place relatively soon, the *Replace* part of the Obamacare repeal effort may take several years. Trump has publicly stated that the administration will send a specific healthcare proposal “within days, and possibly hours” of his cabinet head taking office. Any resistance from establishment Republicans (GOPe) to moving aggressively on R&R will undoubtedly be greeted by a Trump Twitter storm of epic proportions, possibly calling out resisters by name, with the intent of igniting their congressional office switchboards.

While initial resistance to R&R by the GOPe and the Healthcare and Pharma lobbies will likely be significant, polls reveal that public support for R&R is strong enough to force Congress to take action. 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 plan.

It’s Only Money

One of the key factors behind Trump’s main stated goal of creating more, and better jobs, is reform of the tax code. The immediate goal is to stimulate innovation, jumpstart hiring and attract foreign investment by significantly reducing the number of tax brackets, as well as the highest tax rates, for both businesses and individuals. Critics will charge that this is just a recycling of Reagan’s “trickle down economics”, yet the record speaks for itself in nations like Ireland who have taken just such an approach. The result has been a significantly higher level of technological innovation, higher capital spending, business formation and the creation of better jobs. Ironically, these same policies have led many U.S. manufacturers and pharmaceutical companies to shift production to Ireland.

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%.

Status Quo Ante

Trump has announced he intends to send his nominee to Congress sometime in the first two weeks after the inauguration, to be picked from his pre-existing list of 20 potential nominees, who have won broad approval among conservative observers. He has also signaled that his pick will be in the mold of Justice Anthony Scalia, a reliably staunch conservative, who passed away nearly a year ago leaving the current vacancy. Because such a nominee would not significantly change the makeup of the Court, we expect that opposition will be less than is widely expected. The real opposition would come should Trump have the opportunity to replace another Justice over the next four years; which would actually tilt the Court to the right.

Prior to the election, and expecting a Clinton victory, Senator Harry Reid announced (as the incoming Majority Leader) he would do away with the 60 vote majority requirement for Supreme Court nominee approvals if Republicans attempted to stonewall the nomination made by President Clinton. The tables have turned.

While Democrats have promised a vigorous opposition to any nominee, Republicans have not ruled out the “nuclear option” of reducing the number of votes required to a simple majority, eliminating the possibility of a Democrat filibuster. The Republican Senate Majority Leader, Mitch McConnell, has indicated he will not tolerate Democrat obstruction for its own sake. We expect the nominee to be readily approved, with some degree of crossover votes from more moderate Democrats facing tough elections in 2018.

Energy and Trade Policies

Energy independence is a key component of Trump’s vision for America, while trade reform will help drive a shift in American manufacturing, domestic job creation, and an expected improvement in the U.S. trade deficit. 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.

Trump has already seen a substantial number of symbolic “wins” where global companies have agreed to return off-shored jobs or create new factories and jobs in the U.S. as a result of Trump’s aggressive use of the Presidential “bully pulpit”. Trump has made no secret of his intent to favor those companies who respond, and to penalize those who resist. We expect some unlucky firm to be made an example of in short order.

While corporations have a right to do business wherever it makes the most economic sense for them to succeed, there is nothing that prevents the U.S. from responding to perceived trade abuses by imposing tariffs and targeted taxes. Whether or not Congress will go along with Trump’s approach remains to be seen, and in fact 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 insured to be vigorous, and perhaps retaliatory.

Note that every job shifted to America by global corporations under threat of potential tariffs, renegotiated trade deals, and Twitter “shaming” is one less job (and the related reduction in income and spending) for the country that lost it; and an additional unplanned headwind for investors in foreign securities.

Good Fences Make Good Neighbors

Trump has publicly stated in no uncertain terms that he will be sending proposals to Congress to begin immediate construction of a wall along our southern border, to be paid for up front by taxpayers if necessary, with the costs to be borne by Mexico over the next several years. 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.



Trade negotiations with Mexico, NAFTA reform, potential taxes (or even prohibitions) on money remittances to Mexico from workers in the U.S, and tighter restrictions on work visas will all provide a large incentive for Mexico to ultimately cooperate, and yes perhaps even “pay” for the wall, directly or indirectly.

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). We expect immediate action on these issues.

Impact on the Markets

We have previously identified many significant global crosswinds impacting Europe, China, Latin America and the Middle East that fly in the face of the newfound confidence and excitement revealed by recent domestic business and consumer sentiment surveys. 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. However, many of Trump's policies will not bear significant fruit until 2018 at the earliest, which may be a long time for markets to maintain what we believe to be current elevated valuations.

We are firm believers that markets are fairly efficient **(over a full market cycle)** in determining the appropriate value of differing types of financial assets across a wide variety of economic, monetary, regulatory, cultural and political conditions.

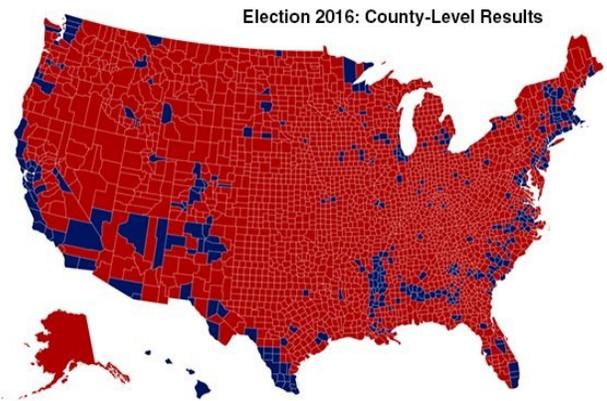
However, markets can be very inefficient, sometimes even manic or depressive during shorter periods of such uncertainty. U.S. market expectations, either positive or negative, may significantly differ from actual outcomes, given global conditions. The current market environment may be one of those times.

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Now What?

We have remained mildly cautious on equities as the modest summer rally faded throughout the fall, and even through the post-election bounce. Our perception of market risks remain elevated and we maintain our underweight positions in small caps, international and emerging market equities, for now. We also maintain positions in high quality, medium duration bonds, but would begin to lower weightings to longer duration high yield bonds and interest rate sensitive securities on any additional rally in prices from recent levels.

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U.S. equities have largely remained in a trading range since mid-December, perhaps having moved too far, too fast, post-election. Our most likely scenario is perhaps to see a global market letdown in the months following the inauguration, as investors begin to realize the global challenges ahead are significant. 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.

When thinking about PE Trump's expected approach we are reminded of the following quote by General George Patton: "A good plan violently executed now is better than a perfect plan executed next week." We feel both his supporters and detractors should get ready for a blitzkrieg of "Trumpian" proportions.

It could be several quarters before the true impact of Trump's policies are felt in the actual data, as opposed to recent expectations and measures of confidence. even so, we feel the U.S equities and bonds will provide a better return than overseas markets, for now.

If you would like more information please contact us at 954 809-6363.

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