



DAVIDSON
INVESTMENT ADVISORS

Investment Outlook: Trump's First 100 days

Paul Condrat, CFA - Portfolio Manager

Estate Planning Council of SW Washington - April 18, 2017



Paul G. Condrat, CFA
Portfolio Manager

Paul Condrat is co-portfolio manager of the Davidson Multi-Cap Equity strategy. He has 13 years of investment experience, having previously served as a Senior Research Analyst supporting D.A. Davidson's equity strategies. Prior to joining the firm, he worked with Bainbridge Capital, a private equity firm, in San Diego as a Business Analyst.

Paul serves on the Board of Directors and is the Board Chairman, for InvestED, a public nonprofit organization serving over 23,000 secondary school students in 650 schools across Washington State. He is a member of the CFA Society of Seattle. Paul holds a BBA in finance and marketing from Gonzaga University.



Firm Overview

- SEC-registered investment advisory firm, providing professional investment management services since 1975
- A D.A. Davidson Company, privately held, 100% employee-owned
- Claims compliance with the Global Investment Performance Standards (GIPS®)
- One team, multiple strategies
- A culture of risk awareness, shared responsibility, but explicit accountability

Investment Philosophy



Long-Term Approach to Investing

We consider ourselves to be investors, not traders, as demonstrated by our low turnover across strategies.



Truly Active Portfolio Management

We strive to add value for our clients beyond returns that can be achieved through passive, index-based investing. Our high Active Share and focused portfolios illustrate the conviction we place in our research-based approach.



Delivering on Risk

We seek to achieve favorable risk-adjusted returns through disciplined portfolio management. Integrated throughout our investment process are checks and balances, risk awareness and accountability to the highest levels of the firm.

Overview

Review of Market Post-Election

Big Three Policies

Risks

Current State & Positioning

Review of Market Post-Election



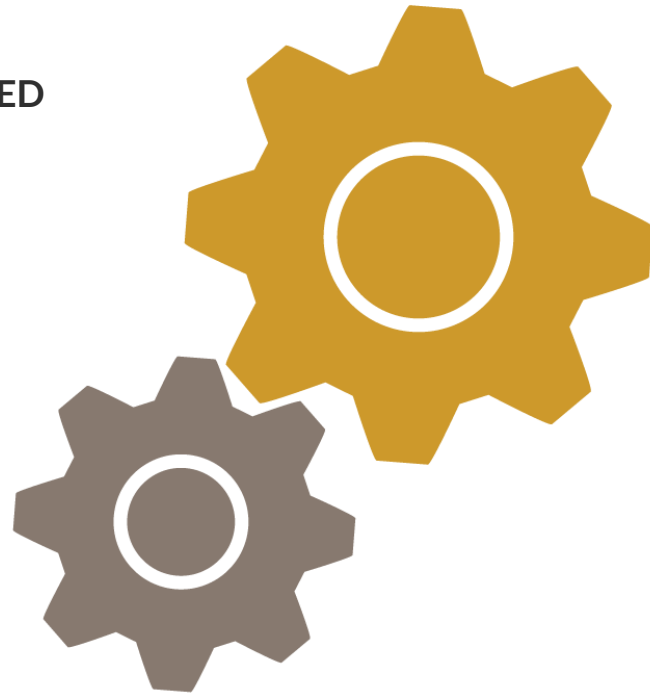
WHAT HAS WORKED/ WHAT HASN'T WORKED

- Sectors and Industry groups across the market

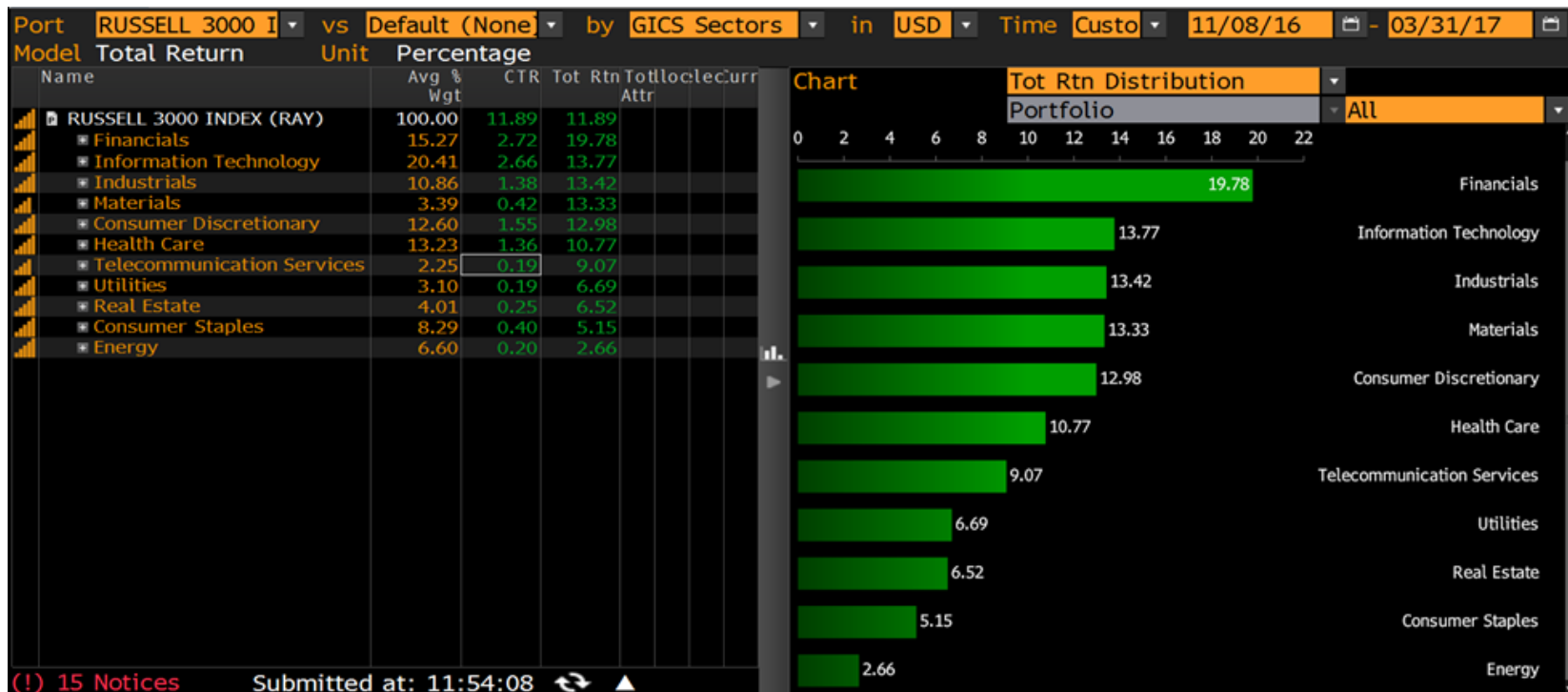


REFLATION TRADE THEME

- Lower for Longer
- Passing from Monetary Policy to Fiscal Policy

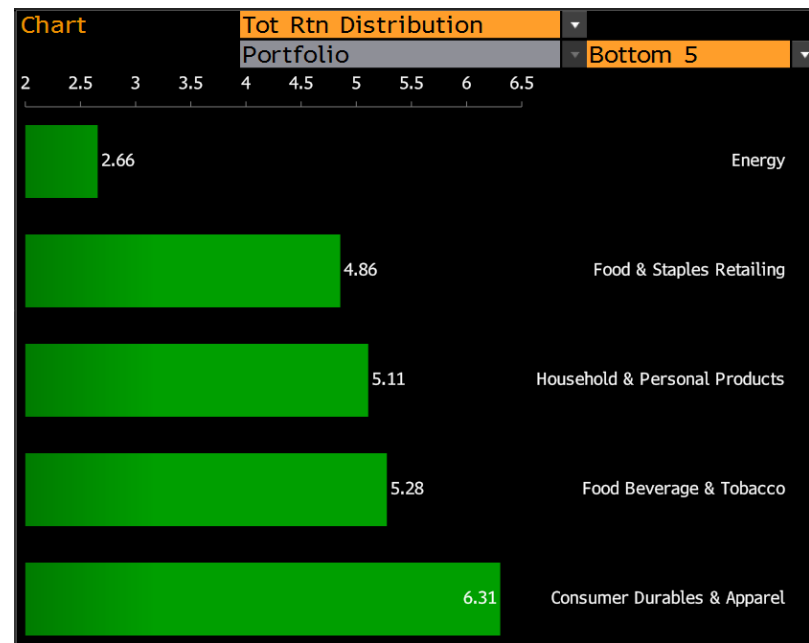
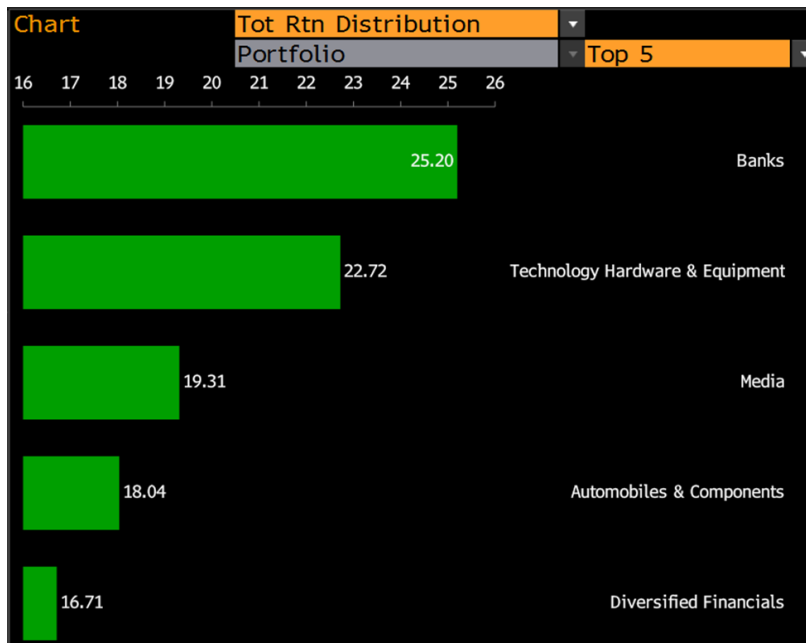


What has worked Post-Election



Source: Bloomberg

Top/Bottom Industry Groups



Source: Bloomberg

Lower for Longer or Reflation

Pre-Election

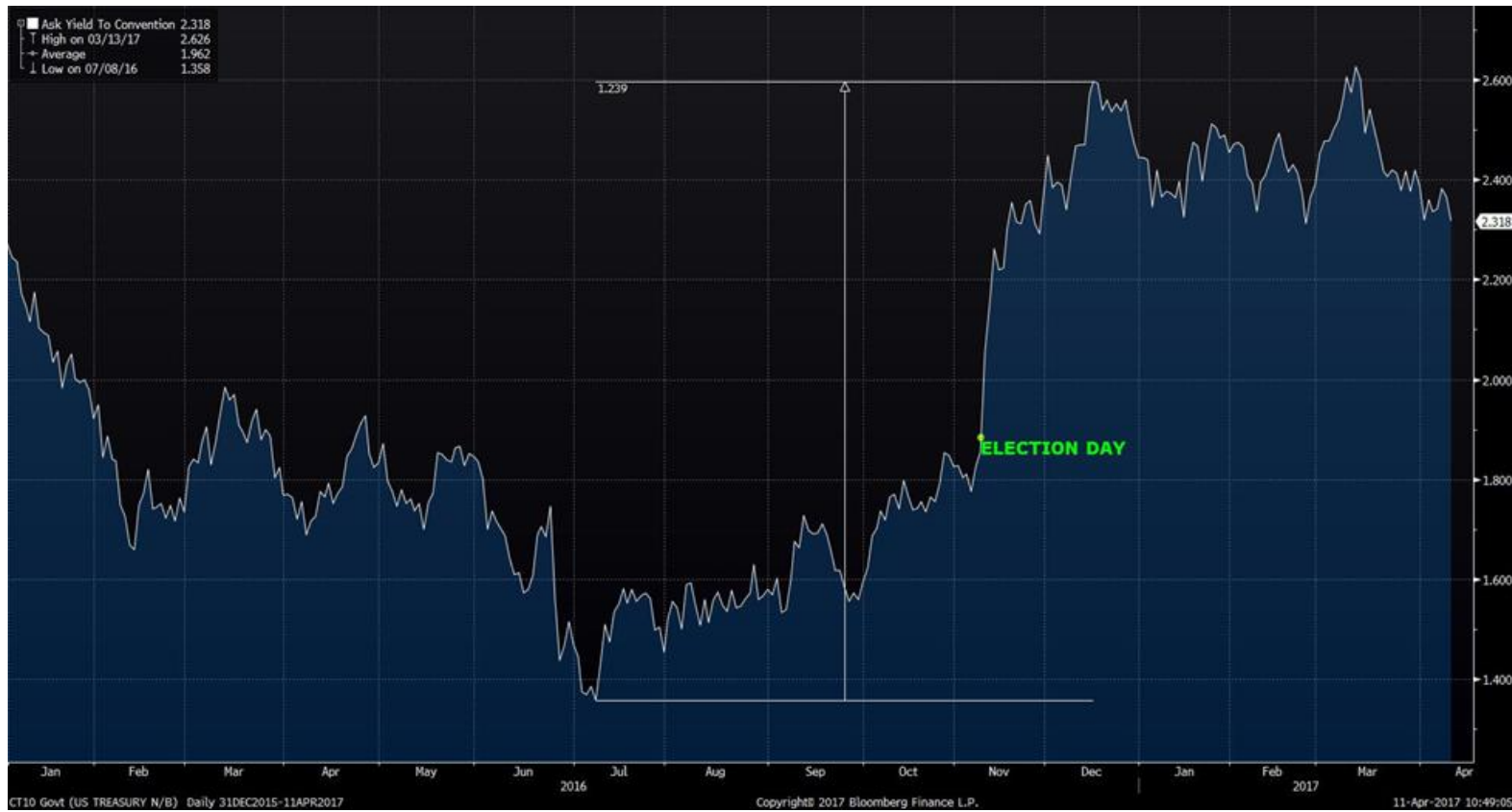
- Too Much Debt Globally
- Demographic Headwinds
- Slow to No Growth
- Deflation Risk > Inflation Risk

Post-Election

- Accelerating Growth
- Surge in Consumer and Business Confidence
- Animal Spirits kicking in
- Inflation Risk > Deflation Risk



“Lower for Longer” to “Reflation” – US 10 Yr Treasury Yield



Source: Bloomberg

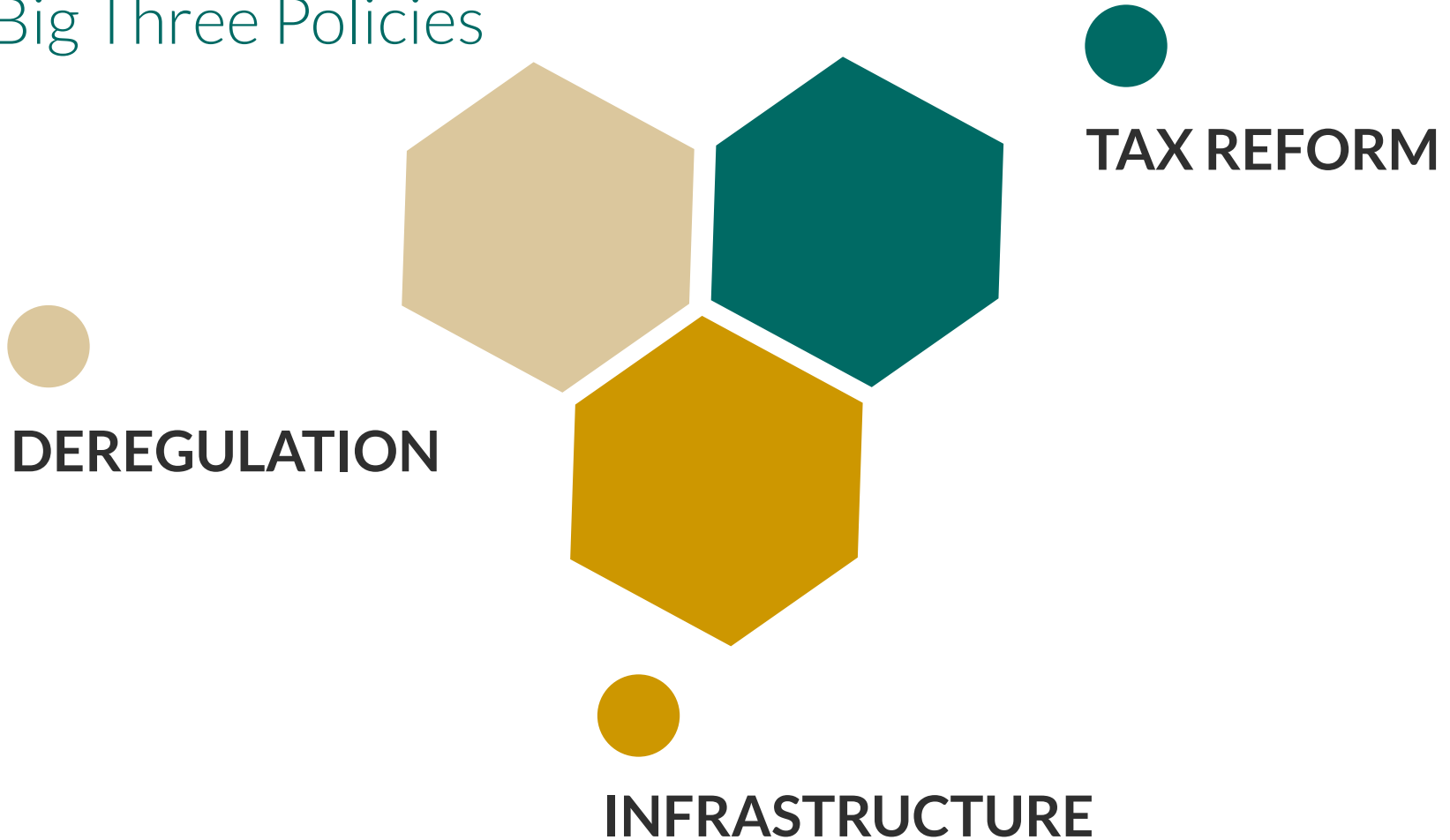
Monetary Policy to Fiscal Policy

Passing the baton / Not the only game in town anymore

“Monetary policy cannot achieve by itself what a broader and more balanced set of economic policies might achieve; in particular, it cannot neutralize the fiscal and financial risks that the country faces. It certainly cannot fine-tune economic outcomes.”

– Ben Bernanke, 2012 Jackson Hole Speech

Big Three Policies



Tax Reform

Proposals

- **Reduction of federal corporate tax rate from 35% to 15% under Trump Plan, or to 20% under House plan***
- **Move to territorial taxation**
- **Cash Repatriation: Trump taxed at 10%, House at 8.75%*, approximately 2 trillion in cash abroad⁺**
- **Immediate expensing of business investment**
- **Non-Financial Companies lose the ability to deduct interest expense from taxable income**
- **Border adjustment tax (BAT) on all imports?**

*Source: JP Morgan Global Equity Strategy March Chartbook –March 6, 2017

+Source: Jamie Dimon, CEO JP Morgan Chase *Shareholder letter* - April 4, 2017

Border Adjustment Tax (BAT) – Pros/Cons

Pros

- **Raises nearly \$1 Trillion under House tax proposal***
- **Incentivizes domestic production and manufacturing**

Cons

- **Companies that are highly dependent on imports will face higher costs/lower profitability**
- **Negative for Retailers, who are already struggling**
- **Strengthening dollar poses risks**
- **Inflation Risk**

* Source: Dave Koeing, VP for Tax at the Retail Industry Leaders Association, Piper Jaffray Border Tax Call – January 6, 2016

Tax Reform Scenarios

Figure 2: Tax Reform Scenarios: Impact on S&P 500 EPS

Estimated impact on S&P 500 EPS

	House Plan	Other Potential Tax Scenarios*		
	20% Rate With BAT	25% Rate No BAT	27.5% Rate No BAT	31% Rate No BAT
A S&P 500 Base Case EPS (no policy reform)	\$128.00	\$128.00	\$128.00	\$128.00
B Benefit from Lower Tax Rate	+ \$15.50	+ \$10.20	+ \$7.50	+ \$3.70
C Border Adjustment Tax (BAT)	- \$7.80	--	--	--
D (+) Total Benefit from Tax Reform (B + C)	+ \$7.70	+ \$10.20	+ \$7.50	+ \$3.70
E S&P 500 EPS (pre-buyback) (A + D)	\$135.70	\$138.20	\$135.50	\$131.70
F (+) EPS Benefit from Repatriation Buybacks	+ \$1.30	+ \$1.30	+ \$1.30	+ \$1.30
S&P 500 EPS (post-buyback) (E + F)	\$137.00	\$139.50	\$136.80	\$133.00
<i>Total Upside to Base Case EPS</i>	+ \$9.00	+ \$11.50	+ \$8.80	+ \$5.00
<i>EPS Upside (%)</i>	+ 7.0%	+ 9.0%	+ 6.9%	+ 3.9%

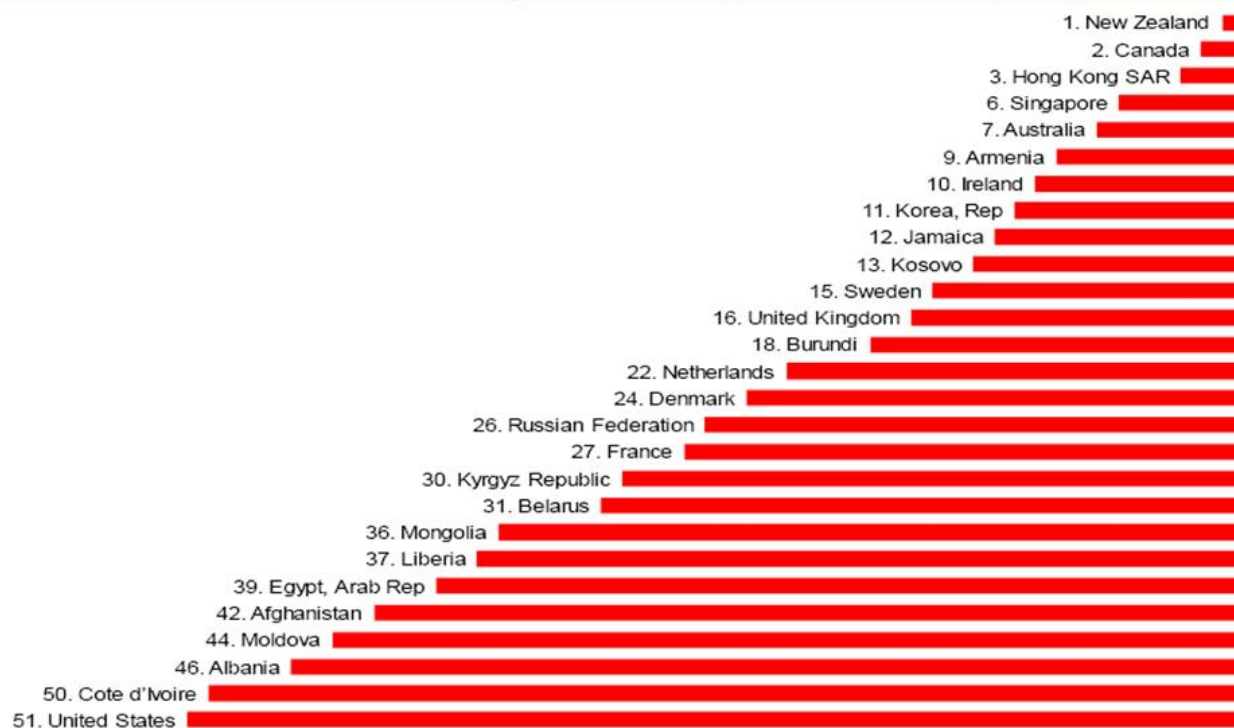
* assumes no changes to other components of tax reform (territorial taxation, interest, capex/depreciation)

Source: J.P. Morgan US Equity Strategy & Global Quant Research

* Source: JP Morgan Assessing the Impact of Tax Reform -Feb.9,2017

Deregulation

How does the United States rank on the “ease of starting a business”? – Very badly indeed



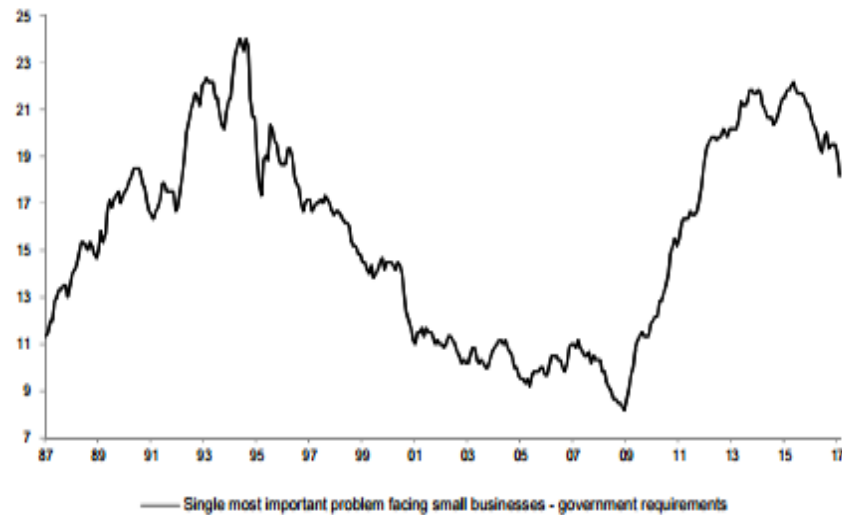
Source: World Bank (selected countries)

* Societe Generale Global Strategy weekly - Feb.2,2017

Deregulation

- **Financials – Rolling back Dodd Frank and Financial Regulation. Using an Axe or Scalpel?**
- **Energy – Slashing EPA, Clean Energy policies, Fracking, Dakota Pipeline**
- **Telecom/Internet – Net Neutrality**
- **Healthcare – ACA Repeal/Replace, Drug Pricing?**
- **Technology – Positive or Negative?**
- **Small Business vs Large Business**

Most important problem facing small businesses - regulation



Source: NFIB

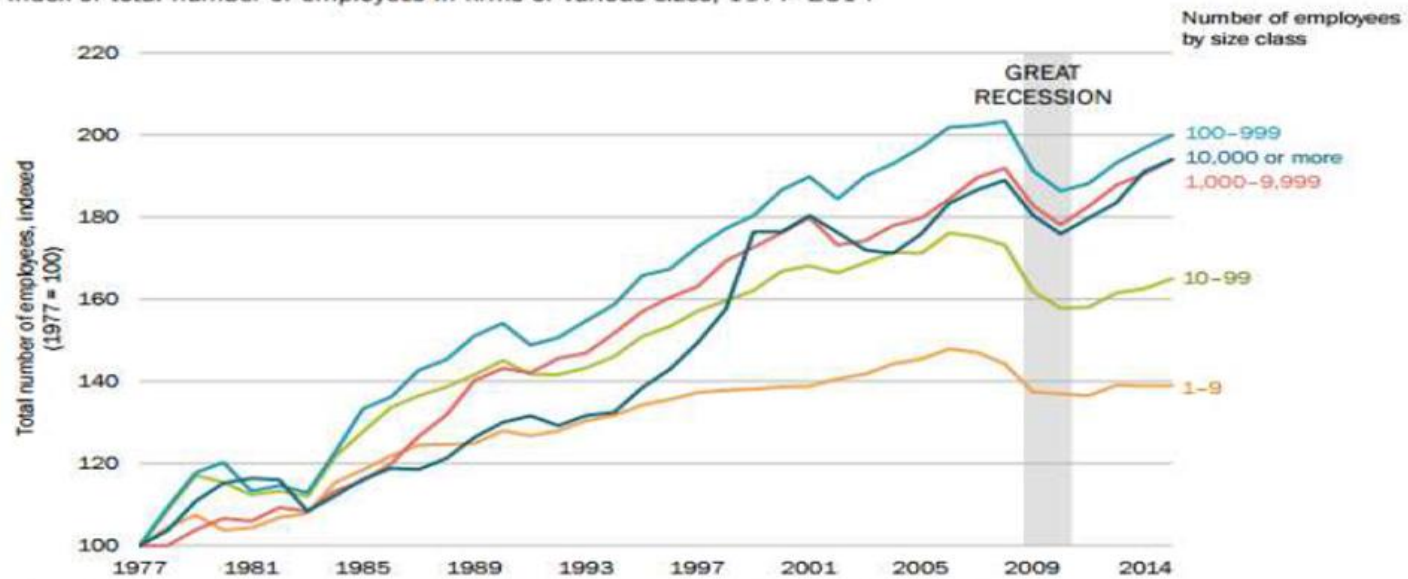
National Federation of Independent Businesses

Source: JP Morgan Global Equity Strategy March Chartbook - March 6, 2017

Deregulation

FIGURE 13: SMALLER BUSINESSES STRUGGLE TO CREATE JOBS

Index of total number of employees in firms of various sizes, 1977–2014



Note: Shaded area indicates the recession of December 2007 to June 2009 as defined by the National Bureau of Economic Research.

Source: U.S. Census Bureau Business Dynamics Statistics.

Infrastructure

\$1 Trillion Infrastructure Program*

- Roads, bridges, electrical grid, airports, broadband, VA hospitals
- American Society of Civil Engineers grades the U.S. infrastructure condition and needs a “D+”
- How to pay for it? Public-private partnerships?
- Will it add to the fiscal debt? Timing?
- Inflationary impacts?

*Source: Wall Street Journal,
“Trump Begins to Map out 1 Trillion Dollar Infrastructure Plan”
March 8, 2017



Risks

Protectionist Measures

Geopolitical Recession

Execution Risk & Unintended Consequences

Protectionist Measures

- **Reversal of Globalization - Negative for economic growth, trade and innovation**
- **Tariffs and BAT risks retaliation from other global players (notably China)**
- **The Robots are still coming despite immigration and trade policies**
- **U.S. Immigrants are 2x more likely to start a business***
- **More than half of the current U.S.-based startups valued at \$1 billion or more were founded by immigrants – National Foundation for American Policy⁺**

*Source: Hoover Institute, *Facts on Immigration*– 2014

+Source: Wall Street Journal “*Study: Immigrants Founded 51% of U.S. Billion-Dollar Startups*” March 17, 2016

Geopolitical Recession

Top Geopolitical Risks

- **China Backlash**
- **North Korea Tipping Point**
- **Russia Cold War 2.0**
- **Global Populist Movement**
- **European Union Breaks Apart**
- **Middle East Instability**



Execution Risk & Unintended Consequences

- **High Expectations on the Big Three**
- **2018 Elections Looming**
– no time to waste – Tax Reform is critical in 2017
- **Deregulation may boost growth short-term, but may make long-term growth less sustainable**
- **Distraction/Obstruction Risks**



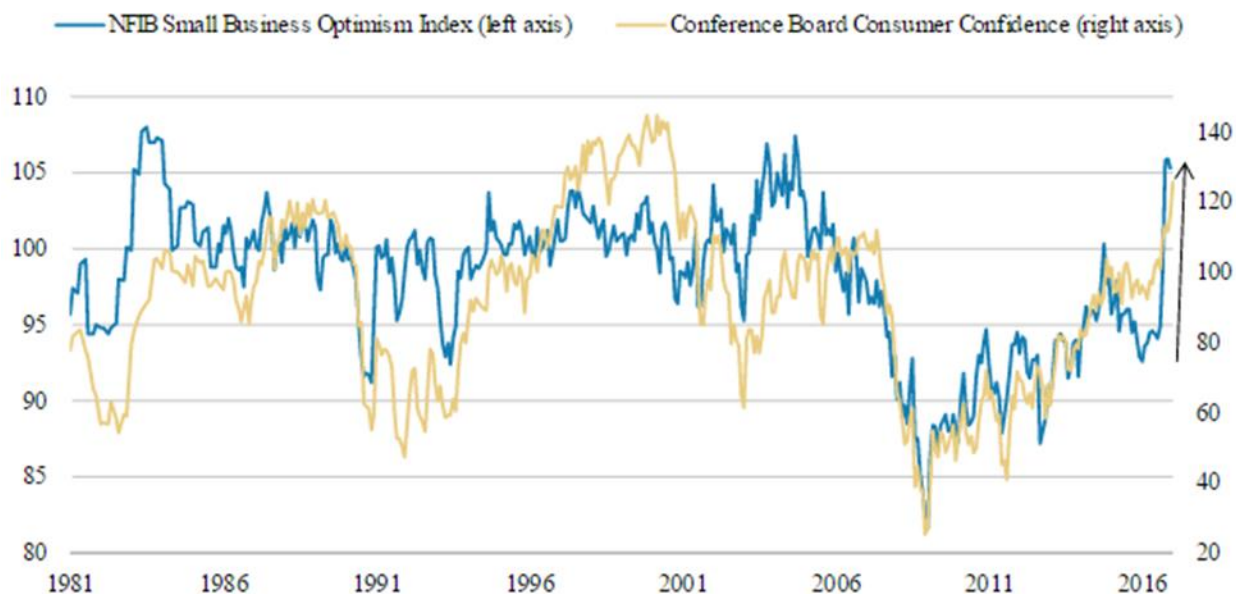
Market Expectations & Outlook

Soft Data vs Hard Data

Animal Spirits kicking in

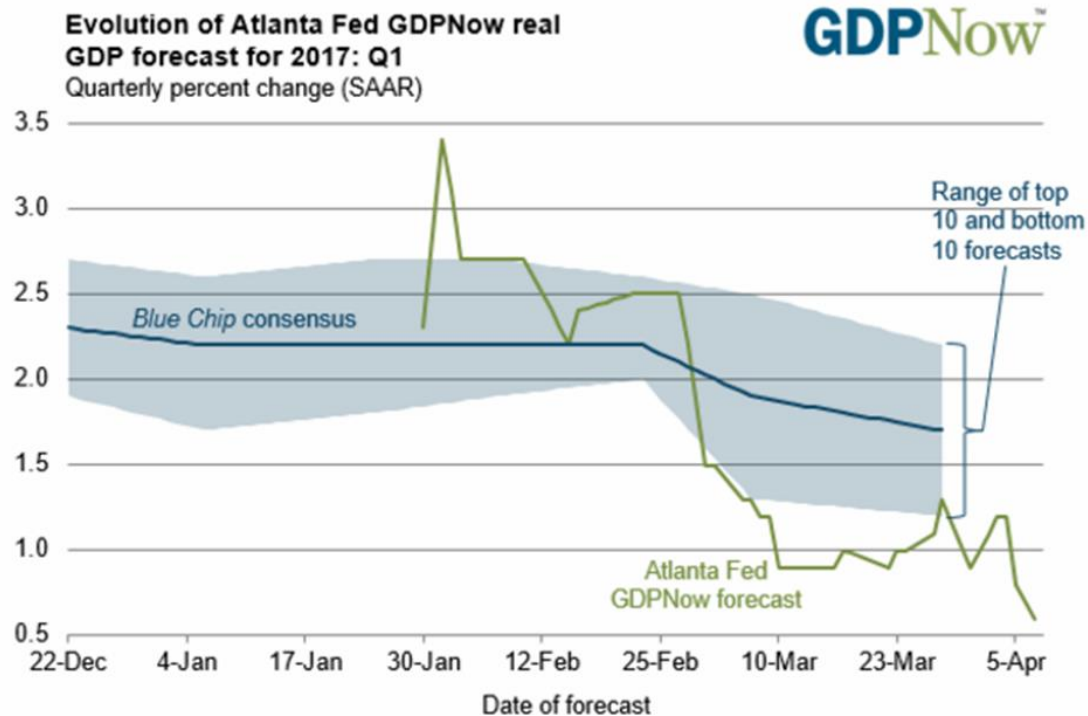
Market Valuations – high expectations

Optimism and Confidence High



Source: Morgan Stanley Research, NFIB National Federation of Independent Businesses - March 2017

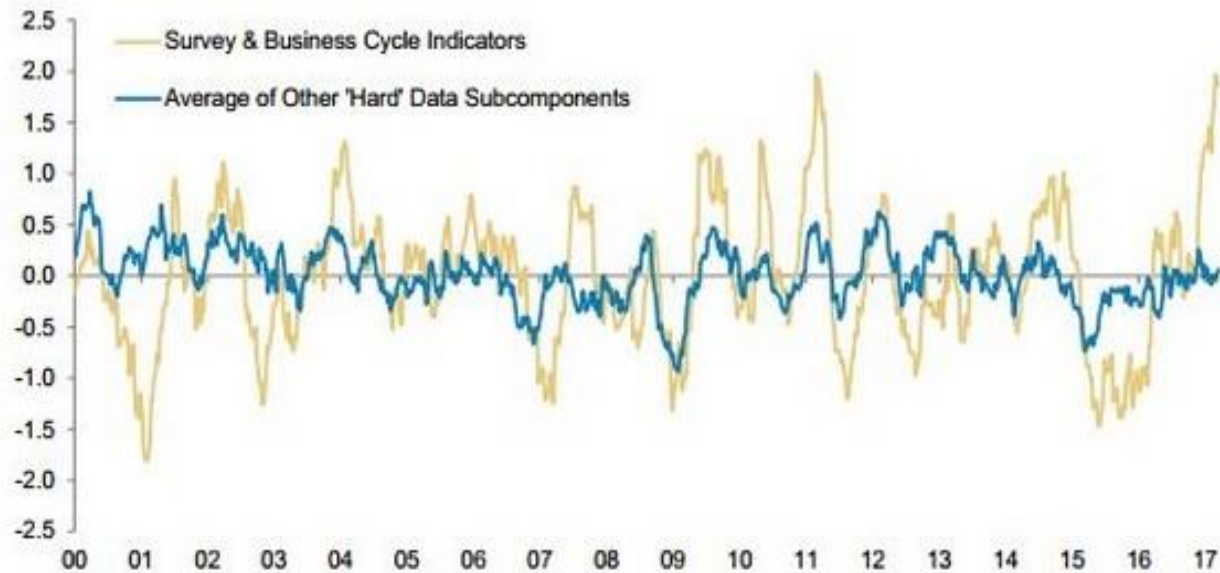
Hard Data is Sluggish



Sources: *Blue Chip Economic Indicators* and *Blue Chip Financial Forecasts*

Note: The top (bottom) 10 forecast is an average of the highest (lowest) 10 forecasts in the *Blue Chip* survey.

Soft Data vs. Hard Data Divergence



Source: Bloomberg, Morgan Stanley Research
March, 2017

Fundamentals are Improving

- **2015/2016 Earnings Recession**
- **Strong Dollar & Collapse of Energy**
- **Normalizing in 2017**
- **Largest contributors to earnings growth Energy, Financials & Technology**
- **Policy impacts are wildcard**

S&P 500 Operating EPS Consensus Summary		
	Bottom-Up Operating	
	EPS	YoY
FY 2013A	109.68	5.7%
FY 2014A	118.80	8.3%
FY 2015A	117.46	-1.1%
1Q16A	26.97	-6.0%
2Q16A	29.61	-1.6%
3Q16E	31.21	4.1%
4Q16E	31.28	6.0%
FY 2016E	118.04	0.5%
1Q17E	29.43	9.1%
2Q17E	32.07	8.3%
3Q17E	34.02	9.0%
4Q17E	35.44	13.3%
FY 2017E	130.88	10.9%
FY 2018E	146.83	12.2%

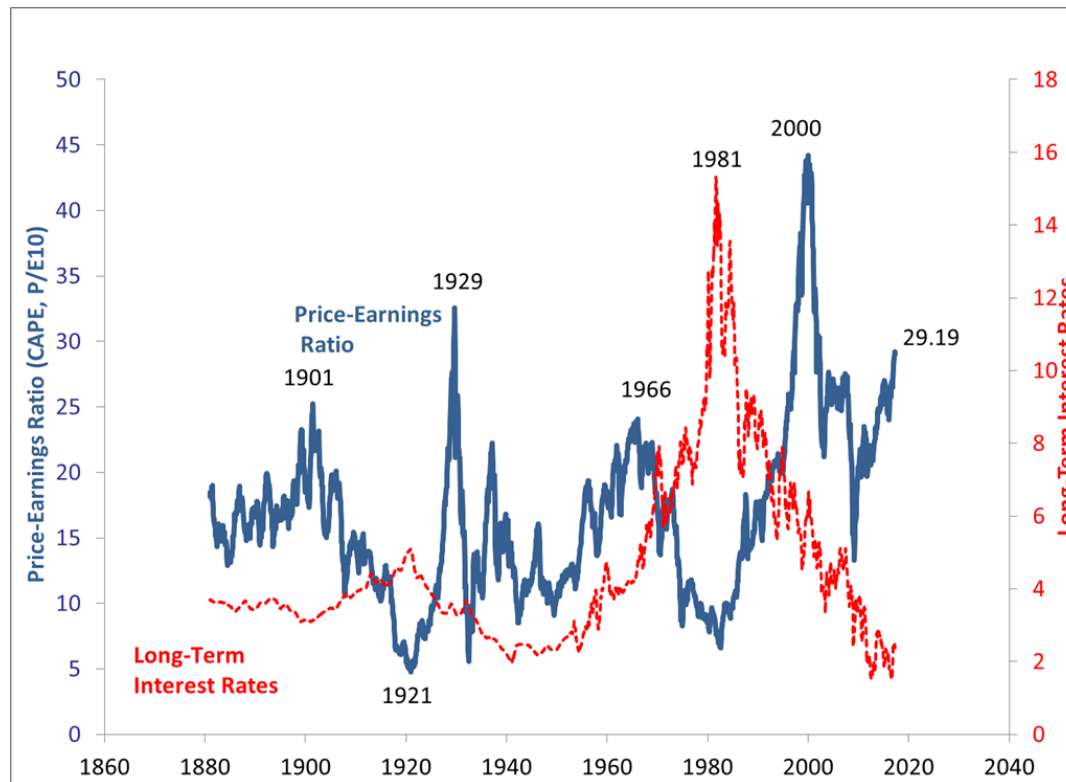
Sources: Wolfe Research Portfolio Strategy, Compustat, Standard & Poor's, Thomson Reuters, and FactSet. March, 2017

Market Valuations High



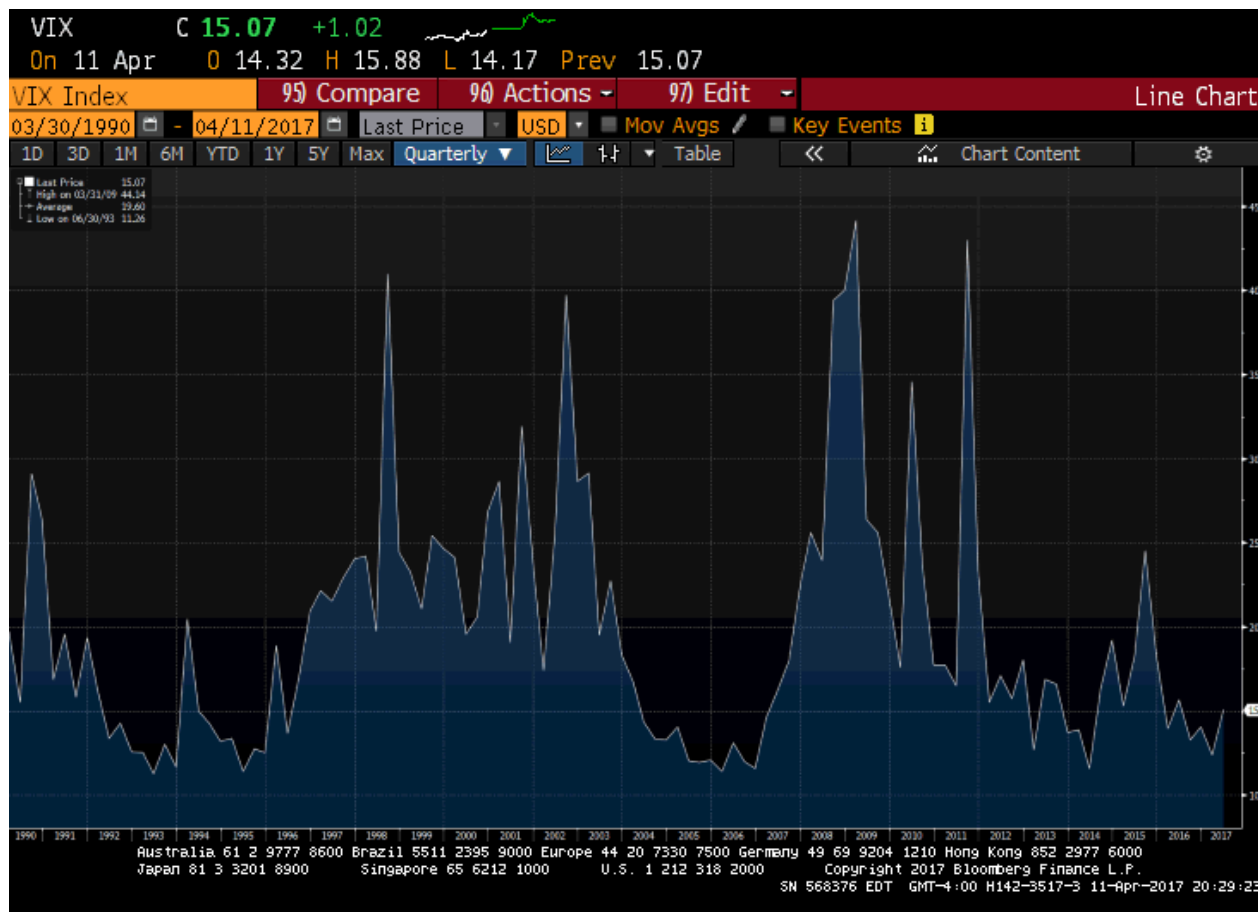
Source: Bloomberg April 11, 2017

Shiller CAPE P/E Alarming



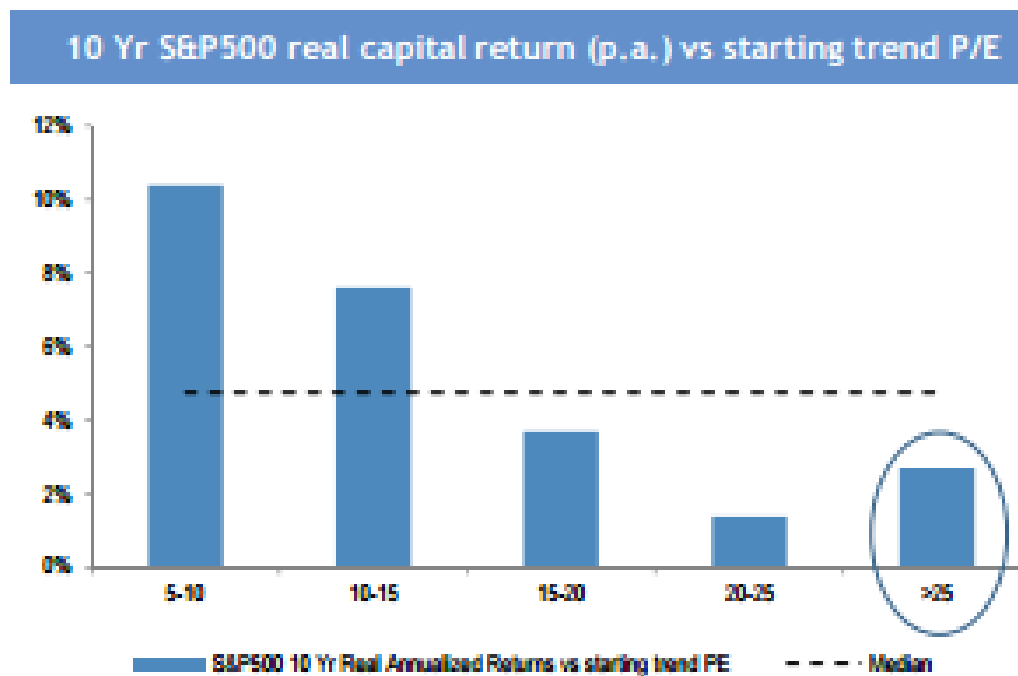
Source: Shiller Data - April, 2017

Volatility Remains Low



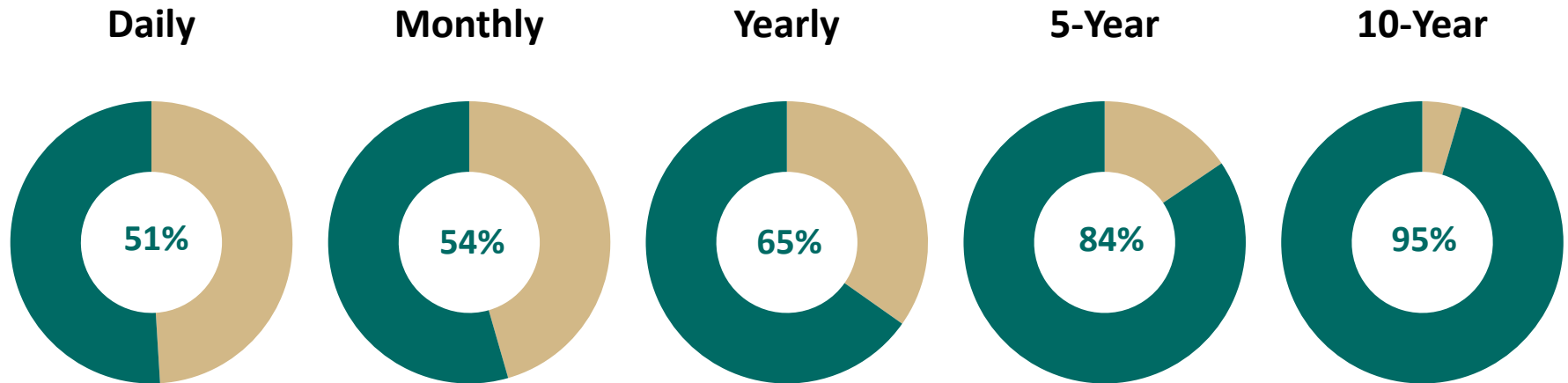
Source: Bloomberg April 11, 2017

Risk of Lower Future Returns



Source: Shiller Data
March, 2017

Probability of Positive S&P 500 Returns (1927-2017)



Source: Bloomberg (April 2017)

How We are Positioning



VALUATION RISK

- Not reaching for growth



REFLATION THEME

- Happening pre-Trump
- Better economic growth, broader participation, and favor more value oriented areas
- Bond Proxies: High Valuations, Weak Fundamentals:
- Small/Mid Caps over Large/Mega Cap



FIXED INCOME

- Rates on the rise
- Recession risk
- Credit exposure
- Duration



Disclosures

Russell 3000® Index

The Russell 3000 Index measures the performance of the largest 3,000 U.S. companies representing approximately 98% of the investable U.S. equity market. The Russell 3000 Index is constructed to provide a comprehensive, unbiased and stable barometer of the broad market and is completely reconstituted annually to ensure new and growing equities are reflected.

S&P 500® Index

The S&P 500 is widely regarded as the best single gauge of large-cap U.S. equities. There is over USD 7.8 trillion benchmarked to the index, with index assets comprising approximately USD 2.2 trillion of this total. The index includes 500 leading companies and captures approximately 80% coverage of available market capitalization.

Blue Chip Economic Indicators® include Manufacturing ISM Report on Business, U.S. International Trade in Goods and Services (FT900), Wholesale Trade, Monthly Retail Trade Report, New Residential Construction, Advance Report on Durable Goods Manufacturers, and Personal Income and Outlays. Other data releases, such as Industrial Production and Capacity Utilization and Existing-Home Sales, are incorporated in the model as well and their impact on the model's forecast will be shown on the next weekday with one of the data releases. The proprietary forecasts from Blue Chip Economic Indicators and Blue Chip Financial Forecasts shown in the chart are available from Aspen Publishers.

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Index performance assumes the reinvestment of all distributions, but does not assume any transaction costs, taxes, management fees or other expenses. Indices are not available for direct investment.

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