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After initial optimism about the economy, some investors begin to worry about a 'Trump slump'

By Don Lee February 3, 2017

As President Trump began his second week in office, he sat in the Roosevelt Room, a glass of Diet Coke at hand, and crowed before small business leaders that the stock market has gone up “massively” since his election.

But that very Monday morning U.S. financial markets were starting to change course in what some say might mark an end to the post-election stock rally, or at least a good pause.

Stocks appeared to be heading higher Friday after a strong jobs report from the government. But while financial markets can bounce up and down for various reasons, analysts are beginning to report an overall shift in investor sentiments.

After a weekend of protests sparked by Trump’s immigration and refugee ban, on the heels of his spat the prior week with the Mexican president and confusing White House statements on import taxes, Wall Street is rethinking its assumptions about a Trump presidency and how good it will be for the economy.

“Investors are starting to change their tune on Donald Trump,” said Lindsey Bell, an investment strategist for CFRA Research in New York.

Business optimism — and stocks — had risen in recent weeks largely on expectations that Trump and a cooperative Republican Congress would be able to ramp up economic growth by making good on the president’s campaign promises to slash taxes, cut regulations and sharply boost spending on roads, bridges, schools and airports.

But Trump's executive order on immigration, seen by many as impetuous, and his proclivity for making harsh remarks, whether directed at foreign leaders, lawmakers or anyone else opposed to his agenda, have raised questions about his ability to govern, particularly as they stirred frustrations among Republican leaders and some inside his own administration.

"The concern in the business community and among investors now is that President Trump is using an excessive amount of political capital to try to recover from these mistakes and to defend himself from acting so impulsively," said **Bernard Baumohl, chief global economist at the Economic Outlook Group** in Princeton, N.J.

"We could see a gradual peeling away of support among the GOP," he said. "And if that's the case, it could not only delay tax reform and increases in infrastructure spending but seriously water them down."

Chris Rupkey, chief financial economist and managing director at MUFG Union Bank in New York, agreed that the early signs are not encouraging.

"I think people were expecting a little bit smoother sailing, simply because Trump would transition from campaigning hard and would become more presidential in the traditional sense," he said. "But the Trump model seems to continue — to bash your enemies … attack, attack and tweet…. If it looks like legislation is going to be stymied, the fallout will be that the Trump rally turns into the Trump slump in a hurry."

Rupkey and many others in the business world say it's still early days, remaining cautiously optimistic for substantial fiscal stimulus in the near term. And while the bloom may be off the rose, they point out, the broad S&P 500 stock index remains 6.5% above its close on election night, as of Thursday's close.

"The Congress and Trump are fundamentally on the same page with respect to tax reform, infrastructure investment," said Steve Woody, chief executive of Avadim Technologies, a 106-employee maker of skin-care and other health products based in Asheville, N.C. "I'm willing to give this some time to smooth out the process of changes."

Woody and other business owners took comfort in Trump's early moves to roll back federal regulations. On Friday, Trump was expected to sign an executive action that would start the process of unwinding much of the 2010 Dodd-Frank rules, which tightened oversight of banks and enhanced protections for consumers after the financial crisis.

It remains unclear how much Trump personally cares about the swings in financial markets. Not long ago as a candidate he declared that stocks were overvalued and urged investors to get out.

Yet Trump has pledged to double the nation's sluggish economic growth to 4%, a tall order that will be impossible to achieve if investors and markets lose confidence in his administration. Some wonder whether blowback from financial markets could be a force strong enough to impose some checks or discipline on Trump's behavior, reining in his eccentricities in a way that media criticism, public polls and protests thus far seem to have been unable to achieve.

Baumohl is dubious: "My sense is Trump will merely rationalize a sharp market decline and blame it on others," he said.

Trump's actions and words have not only sliced some confidence in corporate America, they are also driving a wedge on Capitol Hill — something that could haunt the Trump administration down the road if congressional Democrats take a hardened, obstructionist approach the way GOP members did with former President Obama.

Trump's plan to boost infrastructure spending, for example, is likely to garner more support from Democratic lawmakers than from the ranks of Republicans who have been influenced by the tea party's hard line on curbing spending and debts.

"But considering how much Trump has insulted Chuck Schumer [the Senate minority leader] in the last two weeks, whether or not Schumer is going to want to do anything to help him remains to be seen, especially when they have so many seats up next year," said Reed Galen, a Republican strategist. Trump taunted Schumer and claimed the New York senator shed "fake tears" over the plight of refugees caught in the travel ban.

Trump's immigration order, which barred entry into the U.S. from seven Muslim-majority nations, drew public dissent from a range of business leaders, including top executives at Ford Motor Co. and Goldman Sachs. And the order was met with particular disdain from the tech industry, notably in the Bay Area, where liberal CEOs previously have clashed with Trump over data privacy and worker visas, among other issues.

Travis Kalanick, chief executive of Uber, told Trump this week that he was dropping out of the president's business advisory council, saying Trump's executive order was hurting people across the nation, including former refugees whom Uber works with directly.

Of course, tech companies along with other industries stand to benefit from lower taxes. Trump's economic team has talked about slashing the 35% corporate tax rate by more than half and offering a 10% tax on repatriated cash now kept abroad, which would be of particular benefit to tech firms such as Apple and Google that have tens of billions of dollars sheltered in offshore accounts.

But tax reform efforts look to be fraught with obstacles, especially after White House Press Secretary Sean Spicer indicated the Trump team was considering a controversial 20% border-adjustment tax on imports. At the same time, Spicer and Trump muddied the proposal by suggesting the tax would focus on countries in which the U.S. has a trade deficit, like Mexico.

A border-adjustment tax, in fact, would affect imports from all countries and would be felt particularly hard by retailers and ultimately be borne by American consumers. More than 80% of members of the National Assn. for Business Economics said in a recent survey that they saw significant risks for their companies from such a tax. The idea has divided the business community and Republicans, and is broadly opposed by liberals as it is part of an overall income tax-cut plan that would disproportionately benefit wealthy households.

Despite these political and economic uncertainties, many companies are counting on tax reform and some have even incorporated it into their earnings projections, said Bell, the CFRA investment strategist, who has long followed the performance of S&P 500 firms. She reckons that investors and companies alike will be willing to be wait until the first 100 days of Trump's presidency, perhaps even the first 200 days, for concrete plans and clear direction on tax reform.

Many of the economic uncertainties now facing the markets and the economy under Trump have been there for some time, including slowing workforce growth, weak productivity gains and uncertainties involving China's economy and the anti-globalization wave that is threatening splintering in the European Union.

It's just that financial markets had been focusing on the positive, the glass half full, said Joshua Feinman, chief economist and managing director at Deutsche Asset Management.

With Trump, investors know that his "America first" creed carries risks of igniting trade wars, political tensions and other consequences that could offset, perhaps even swamp, potential economic gains from any fiscal stimulus.

"It seems to me that the markets were a little too optimistic about the speed in which some of those things [like tax reform] could get done, their likelihood even in some cases, and also were downplaying the downside risks from the new policymakers in Washington, everything from protectionism, worries about renegotiating trade agreements, the geopolitical risks, and negative blowback economic effects," he said. "So maybe people are now starting to say, 'Hmm, maybe we were underestimating those risks.'"

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