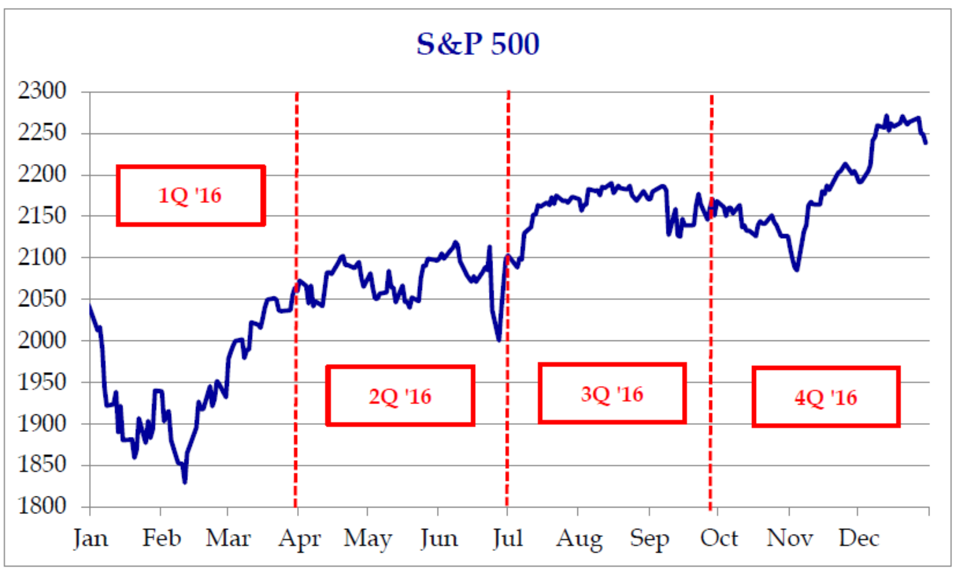
KINGS POINT
CAPITAL MANAGEMENT LLC

Trump Means Business
Congress Means Bureaucracy
Let the Games Begin

The last eight years were dominated by the equity markets' focus on the U.S. Federal Reserve's policies and actions. Until November 8, 2016, the general economic consensus was for a gradual rise in interest rates, subpar GDP growth and an equity environment that was likely to generate low to mid-single digit returns for the foreseeable future. However, in one extraordinary election night, investor views of the global financial markets shifted as focus turned toward the possibility of aggressive fiscal stimulus, tax reductions, de-regulation and improved trade practices. Within the first three weeks of Donald Trump winning the U.S. presidency, many economists altered their expectations from low, long-term interest rates with below average GDP growth to one that reflects a return to "near normal" growth. The "much improved views" have its roots in the fiscal policy announcements that the incoming Trump administration is planning to enact once in office.

Table I



Source: Strategas

Reactions in both the bond and stock markets were swift and powerful. The 10-year Treasury yield increased from 1.6% to 2.5% and the S&P 500 increased ~4% in the first few weeks after the election. (See Table I.) Even with no empirical evidence on any "real" improvements, investor confidence grew due to the "Republican Party sweep." The basic outline for the fiscal policy changes encompasses a number of critical areas.

t: 516.439.5100 f:516.439.5102
111 Great Neck Road, Suite 310, Great Neck, NY 11021
t: 800.259.1331 t: 615.620.3900 f: 615.620.3920
112 Westwood Place, Suite 210, Brentwood, TN 37027
www.kingspointcap.com

While the detailed information remains elusive, the new administration has suggested the following key changes:

- Cutting corporate tax rates to 15%-20% from the current 36%.
- Implementing a one-time "business repatriation" tax at substantially reduced rates.
- Cutting individual income tax rates dramatically and eliminating the Federal estate tax.
- Streamlining or eliminating many Federal regulations that are viewed as excessive or too burdensome for most companies. This suggests a significant reduction in certain financial regulations developed within the framework of Dodd-Frank after the 2008–2009 financial crisis.
- Repealing and/or modifying the Affordable Care Act (Obamacare).
- Negotiating current trade deals in an attempt to improve our balance of trade positions, i.e. China and Mexico.

Needless to say, these are very ambitious goals for any administration much less one not familiar with the intricacies of our political process. We identify two main risks beyond whether any changes are actually implemented:

- As mentioned earlier, President Trump has vowed to renegotiate trade policies. While he espouses bringing jobs back to the U.S., any negotiations could take months, if not years, and the rhetoric about imposing substantial tariffs on imports could clearly lead to trade wars and a higher level of inflation.
- While Central Bank monetary policies are relatively benign, the proposed fiscal policies are very growth-oriented and could substantially increase the deficit. With the economy already reaching full employment, any aggressive increase in interest rates could pressure equity valuations.

Nevertheless, investors currently believe that many of the aforementioned policy changes, taken in tandem, will lead to improved growth in corporate profits and individual wealth over the next few years. As with anything, the devil is in the details.

We believe that a reduction in corporate tax rates concurrent with the elimination of many deductions would act as a positive growth stimulus to corporations. At a minimum, a reduced benefit from interest expense would shift cash flows toward capital investment versus balance sheet leveraging for share buybacks and acquisitions. Additionally, a more balanced trade policy and a focus on incentivizing exports would also be viewed as a positive stimulus to GDP. Of course, all these programs must be close to revenue neutral to have a clear chance of being enacted by Congress.

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t: 800.259.1331 t: 615.620.3900 f: 615.620.3920
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The Trump election comes at a pivotal time in our economic history. U.S. interest rates have bottomed after a 30 year descent and started to recover. Inflation has risen slightly (versus years of deflation), and the U.S. labor market appears tight. This has resulted in rising wage growth. Generally, these are positive signs of renewed GDP growth. Add a powerful fiscal stimulus program of tax cuts and investment incentives and it's not hard to expect some additional level of economic growth moving forward. This would also result in a rise in inflation as well.

Given our expectations of a positive economic impact from these fiscal policy initiatives in the next 12-18 months, we are modifying our investment strategy to take advantage of the expected upcoming shift in government policies. As you know, we are very diligent in our investment process and do not tend to make wholesale changes in a short period of time. However, making changes to add additional exposure to both industrial and financial sectors was warranted as fiscal policy is now in the forefront of economic growth. We anticipate that the proposed changes will ultimately shift subpar GDP growth to a stronger level over the intermediate term. Additionally, corporate profits are also likely to benefit from these proposed policy shifts. Rising corporate profits (after two years of flattish trends) are needed to move the equity markets higher since rising interest rates will likely pressure valuations.

In recent months, we have added aerospace and defense companies in anticipation of rising levels of government spending. Additionally, we have chosen selective industrials and financials to augment our growth portfolios. We are still of the belief that interest rates are more likely to rise gradually than at a very rapid pace. Thus, we expect good investment returns in companies with strong corporate profit and dividend growth.

The Trump presidential era promises to be a period of major changes, and as such, we expect more volatility in the global equity markets. While we like many of the proposals to stimulate our economy, it will be the details and timeframe which should ultimately dictate the slope of the positive trend we envision. We will continue to adjust our portfolios as more evidence emerges of a sustainable positive impact from pending fiscal policy stimulus and government regulation reform.

Please contact our offices with any questions.

Jack L. Salzman
Senior Managing Partner

Jeffrey P. Bates
Managing Partner

John A. Marshall, IV CFA, CFP®
Managing Director

Nathan T. Fend
Investment Advisor

Jason D. Beaird, CFA
Investment Advisor

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