IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

The outcome of the Presidential Election and the reaction from the financial markets has surprised most observers. Many unknowns remain surrounding the eventual impact from the shift in the political landscape. However, we look to an improvement in the corporate profit picture as an important development.

The Presidential Election

The results of the U.S. Presidential election came as a surprise to most political observers. The polls had projected that Hillary Clinton would win the election. However, in the final weeks before the election, these polls began narrowing. The final results were close—Donald Trump won the Electoral College 306 to 232, but Hillary Clinton won the popular vote.

President-elect Trump campaigned on a few broad themes, including cracking down on immigration, renegotiating trade deals, and bringing jobs back to the U.S., particularly in manufacturing. It remains unknown if President-elect Trump can turn these ideas into actual government policy, especially on the economic front. During Trump's campaign, he made many promises but provided few details on achieving the said promises. He pledged to increase U.S. economic growth to at least 3.5%. However, since the "great recession" of 2008-2009, economic growth has been slow to recover, with annual economic growth averaging just 2.2% over the last six years. This compares to a post-WWII average of 2.9%. Looking back

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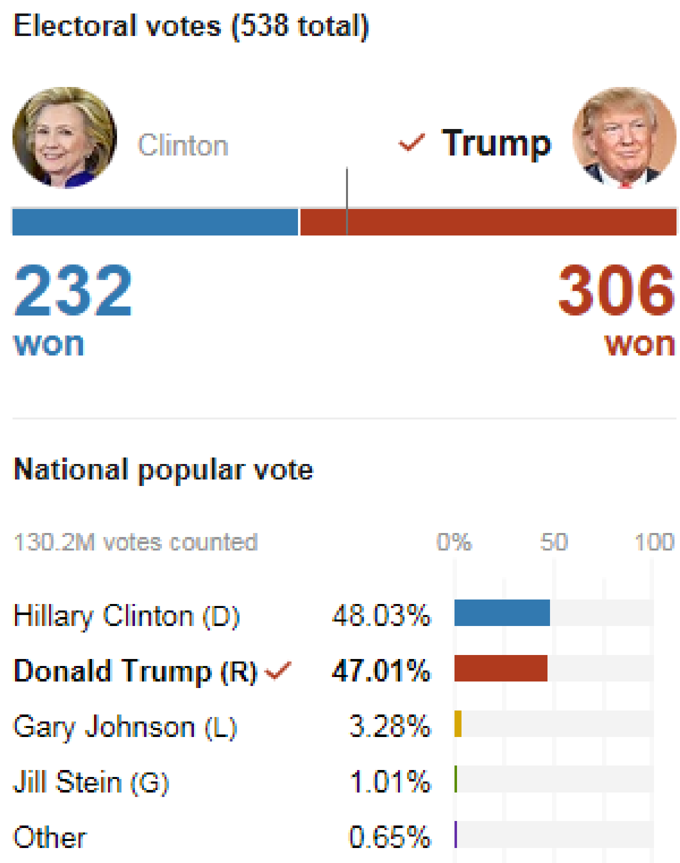
at the last eight decades, there has not been a decade with growth of 3.5% or higher since the 1960s. No specific details have been presented on how the U.S. will achieve these high growth numbers, but the assumption being President-elect Trump's plans for reducing regulation and lowering taxes. Looking back, the working age population grew an average rate of 1.8% per year in the 1960s and 1970s. However, since 1980, that rate has averaged just 1.2%. The change in the demographic situation has been a major contributor to the slower economic growth in the past 50 years. An increase in the labor force would likely be needed to boost economic growth above recent levels.



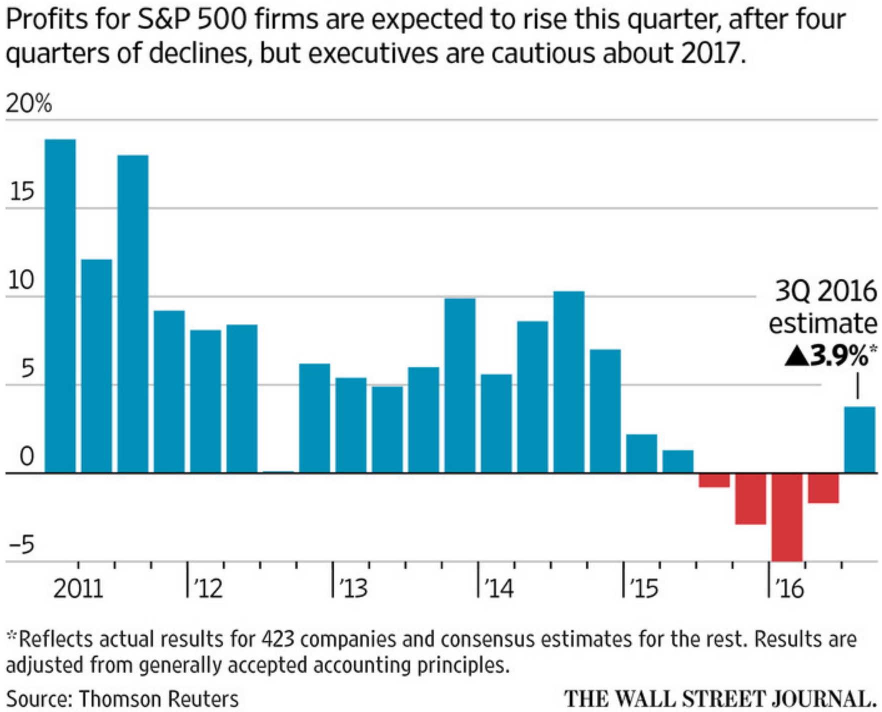
The President elect has proposed changes in the tax policy which would reduce the individual tax brackets from seven to three: 12%, 25%, and 33%. He also recommended a reduction in corporate taxes. These tax plans are inline with proposals made by congressional Republicans. However, President-elect Trump's views on trade are at odds with his party. The Republican Party has traditionally supported open trade, but he was a harsh critic of current trade deals. While most major changes to trade policy need to go through Congress, the President does have the power to unilaterally impose tariffs in certain circumstances.

An important development in the election was that the Republican Party now controls both Chambers of Congress. Following this year's unprecedented election rhetoric, the question will be whether the Republican Houses will unite behind the new President to enact his proposed agenda as more specifics are unveiled.

The Corporate Profit Recession

Operating earnings for the S&P 500 reached an all-time high in third-quarter 2014, but have since declined. The overall earnings decline represented a significant change from the relatively steady corporate profit environment experienced since the credit crisis in 2008. The sharp profit decline (see chart) has led many to refer to this period as a corporate "profit recession", since U.S. employment data and consumer spending held up relatively well in comparison to corporate earnings.

The primary driver behind falling corporate profits in the S&P 500 was the sharp decline in oil prices and resulting impact on the energy sector. Oil prices declined due to a combination of rising supply in the United States as well as a slowdown in demand from many emerging economies, especially China. A stronger U.S. dollar has contributed to the profit squeeze as it has helped reduce demand for U.S. exports and hurt U.S. multinationals when they convert foreign-earned revenues back into dollars.



Corporate earnings in the third quarter of 2016 are estimated to have increased 3.9%. Since the second quarter of 2015, S&P 500 earnings have declined on a year-over-year basis. In contrast, the third quarter results suggest that the recession in corporate profits has come to an end.

This rebound also comes despite the continued drag on earnings from the energy sector, as the drop in the price of oil once again hurt energy sector profits in 3Q, but the financial sector posted solid profit gains. In fact, the number of companies in the broader S&P 500 that beat analysts' estimates were well above average for the quarter. According to FactSet, 71% of companies that have reported beat their estimates, higher than the five-year trailing average of 67%.

Conclusion

Many market observers predicted that a Trump election would result in a sharp market decline. These proved to be incorrect as the equity markets experienced a post-election rally that pushed most major indices to all-time highs. The yield curve steepened suggesting that the market expects a further pick-up in economic growth. Despite this excitement, we expect that policy and economic changes may take time to work their way into the economy.

S&P 500 Index

3 Month	1.83%
Year-to-Date	9.79%
1 Year	6.90%
3 Year	9.04%
5 Year	14.47%

MSCI EAFE Net Index

3 Month	-3.34%
Year-to-Date	-2.34%
1 Year	-4.36%
3 Year	-2.21%
5 Year	5.55%

Barclays Aggregate Bond Index

3 Month	-3.15%
Year-to-Date	2.50%
1 Year	1.84%
3 Year	2.78%
5 Year	2.46%

As of 11.30.2016

Boise Branch
888 W. Broad St.
Boise, Idaho
208.373.6500

Coeur d'Alene Branch
622 E. Sherman Ave.
Coeur d'Alene, Idaho
208.664.6448

Las Vegas Trust Office
2850 W. Horizon Ridge PKWY, Ste 200
Henderson, Nevada
702.430.4747

Info@IdahoTrust.com
www.IdahoTrust.com

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