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BOTTOM LINE PERSONAL

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WILL TRUMP'S SETBACKS END THE BULL MARKET?

Top Economist Allen Sinai Answers the Questions on Every Investor's Mind

Will the Trump administration's setbacks trip up the eight-year-old bull market? Top economist Allen Sinai says no. Despite widespread skepticism that the US can break out of a "new normal" of weak economic expansion, Sinai tells *Bottom Line Personal* that President Donald Trump and Congress still have a chance of achieving at least some of his business-friendly growth agenda of lower taxes, less regulation and more government spending.

That, combined with a strengthening economic outlook in other parts of the world, could help rev up the US economy for the next few years and extend the stock bull market through 2019, Sinai says. We asked him to explain why he remains confident despite a host of challenges facing the US economy and the market.

Here's what Sinai sees ahead…

SINAI'S FORECAST FOR YEAR-END 2017

Dow: Up 12%
S&P 500: Up 14%
GDP: Up 2.5%
Inflation rate (including food and energy): 2.3%
Unemployment: 4.1%

A SOUND US ECONOMY

No matter what happens to the Trump agenda, it's important to realize that the US economy continues to be fundamentally sound. I expect economic growth to improve the rest of this year driven by wage and employment gains…solid consumer demand fueled by low unemployment and higher wages…rising home sales and prices…and modest gasoline prices. The chances of a recession this year or in 2018 are remote.

At the same time, the president and his economic team remain committed to passing the largest tax-system overhaul since the Ronald Reagan era and the biggest tax cuts since George W. Bush's first term. Regulatory rollbacks and lower corporate taxes would improve business profits and spur companies to ramp up capital spending. Simplifying the tax system by eliminating many deductions and reducing the number of tax brackets would bolster consumer spending. And increasing federal spending for infrastructure would not only create jobs but also would make the economy function more efficiently by improving ports, bridges and the US electrical grid.

THE TRUMP RISK FACTOR

Of course, the worst-case political scenario—that Trump is forced out over the controversies that have been swirling around the White House—could crash the US dollar and the stock market. And even short of that, those controversies strengthen members of Congress who find fault in Trump's plans. Fiscal conservatives in Congress will continue to fight him over soaring federal deficits. Democrats will object, rightly so, that his proposed tax cuts disproportionately benefit the wealthy.

But here's the good news: Even a modified tax overhaul—for example, cutting the top corporate tax rate from 35% to 28% instead of the 15% Trump has proposed—could help raise annual growth in gross domestic product (GDP) above 3% in 2018 and 2019, compared with the 2% average over the past eight years. That should be enough to keep stocks rising.

GLOBAL ECONOMIC GROWTH

There are two other factors that are positive for the bull market right now…

• **Stronger foreign growth.** After years of the US accounting for most of the world's economic growth, there now is strong expansion in various nations that is helping to support higher stock prices. Stronger foreign demand for US goods is a key reason that profits for companies in the Standard & Poor's 500 stock index grew an average of nearly 13% in the first three months of the year. For 2017, I'm forecasting a 2.9% rise in global economic growth, compared with 2.3% in 2016.

Bottom Line Personal interviewed Allen Sinai, PhD, CEO and chief global economist at Decision Economics Inc., a financial-advisory firm based in New York City. He has been an adviser to several US presidential administrations. DecisionEconomicsInc.com

My international GDP growth forecast: China, 7%, up from 6.8% last year…Japan, 1.5%, up from 0.7%…the eurozone, 1.9%, up from 1.7%.

• **No trade wars.** Trump has scaled back his protectionist rhetoric and avoided alienating important trade partners. Although he recently slapped a tariff of up to 24% on Canadian lumber, he decided to renegotiate, rather than terminate, the 1994 Nafta trade treaty with Mexico and Canada.

HOW AND WHEN THE BULL MARKET ENDS

Federal economic stimulus could produce stronger stock market returns in 2017 through 2019. By 2020, however, as low unemployment spurs greater increases in wages, I think we could see inflation heating up so much and interest rates rising so high that consumer spending starts to slow, hurting corporate earnings. As a result, the economy could fall into recession. And that could cause a 20% or more drop in stock prices, the definition of a bear market.

Right now, however, the biggest risk threatening to short-circuit the bull market is Trump and the controversies that lead him to expend his political capital and focus. That could cause him to lose the confidence of the Republican Congress and compromise his ability to get meaningful stimulus legislation enacted. If that happens, the economy still could produce the kind of tepid 2%-plus annual GDP growth we've had since the recovery began in 2009. But the bull market would be likely to end much sooner.

KEY ECONOMIC INDICATORS

Here's what I expect for the rest of this year and beyond…

GDP: US economic prospects are improving even though GDP, a key economic measure, grew less than 1% in the first quarter. That anomaly was due in part to a warm February that hurt utility companies and March snowstorms on the East Coast, which caused automobile sales to tumble. For 2017, annual GDP growth should be 2.5%. In 2018, as the effects of the expected federal tax and economic stimulus legislation take effect, I expect that GDP growth will increase to 3.3%. However, in 2019, that growth may slip below 3% as higher interest rates begin to create a drag on the economy.

Unemployment: The US should continue to add about 175,000 jobs a month, pushing down the unemployment rate to 4.1% by the end of 2017, compared with the recent 4.4%. In 2018, the unemployment rate should fall to 3.6%, even lower than in the economic boom years of the 1990s. That should translate into accelerating wage gains as companies pay more to attract and keep employees.

Inflation: As measured by the Consumer Price Index (CPI), inflation should average 2.3% for 2017, up from 2.1% in 2016. By the end of 2018, I expect, inflation will approach 3%.

OUTLOOK FOR STOCKS

Stocks should continue to make gains this year despite increased volatility. I expect the Dow Jones Industrial Average to return 12% for 2017, including dividends. The S&P 500 should return 14% for the year, including dividends.

Reason: I expect significantly stronger growth in corporate earnings. Earnings for the S&P 500 companies should rise more than 10% in 2017 and another 10% in 2018.

Best sectors: Consumer discretionary goods and services—especially airlines and restaurant companies, which will benefit from rising consumer spending worldwide. And information technology, which is outperforming all other sectors on the expectation that corporate tax cuts will give companies extra funds to spend on upgrading technology.

Avoid: Utilities, real estate investment trusts (REITs) and telecommunications stocks, whose dividend yields will look less attractive in comparison to rising interest rates.

More from Allen Sinai, PhD

The Outlook for Bonds

Bond losses are likely as interest rates rise. I expect the Federal Reserve to lift short-term rates a total of three times in 2017 and an additional four times in 2018 in response to strong jobs growth and higher price inflation.

I expect 10-year Treasuries, recently yielding 2.3%, to end this year at 2.75% and to reach a yield of 4% or more by the end of 2018.

While bonds remain important for income and diversification, I suggest that instead of investing in bond funds, whose shares typically lose value as interest rates rise, investors will be better off holding individual bonds to maturity. They lose value as well, but it doesn't matter if you don't sell them before maturity.