Subject: FW: US Equity Insights - Trump: the huge picture for stocks
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Sent: Friday, November 18, 2016 3:55 PM
To: Stewart Oldfield
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Deutsche Bank - Equity Research - North America

US Equity Insights - Trump: the huge picture for stocks
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Download the complete report: http://pull.db-gmresearch.com/p/-2035-59D3/93036413/0900b8c08c0f591b.pdf

Trump and stocks: S&P 500 likely to reach 2250 by the inauguration

In the first week of President elect Trump, most of our investor conversations centered on their concerns about a higher fiscal deficit lifting Treasury yields and pressuring PEs and a stronger dollar/ weak oil prices pressuring the EPS outlook and the possibility of protectionism. While we don't ignore such risks, we think the market is under appreciating the likely big boost to S&P EPS from a lower corporate tax rate and the boost to Bank profits from rising yields (and lower pension expense) and the much higher chance now of a long lasting economic expansion that rivals the 10 year US record. We're more confident now that the S&P will reach 2500 in 2018 before suffering its next bear market.

With corp. tax cuts S&P EPS should be at least $130 & $140 in 2017 & 2018

We’re unsure how much the US corporate tax rate will be cut, but we think a significant cut is likely, and we see ~25% as most likely because it aligns with the OECD avg., it shouldn’t raise the deficit more than 0.75% of GDP, it significantly reduces repatriation taxes and it provides small businesses that want to reinvest their profits for growth a more tax efficient alternative than pass trough entities generally taxed at higher individual rates; this alternative would be especially attractive if the C class dividend tax rate is not over 15%. We're unsure what happens with personal income taxes, but we don't see cutting the top marginal income tax rate as the top near-term priority if C class treatment can be made more attractive to small businesses. Every 5pt cut in the US corporate tax rate from 35% boosts S&P EPS by $5. Assuming that the US adopts a new corporate tax rate between 20-30%, we expect S&P EPS of $130-140 in 2017 and $140-150 in 2018. We raise our 2017E S&P EPS to $130.

Treasury yields have a long way to climb before threatening our PE targets

We're comfortable with the 17-18 trailing PE that our 2350 S&P target for 2017 end and 2500 in 2018 imply, provided 10yr yields don't exceed 3% in 2017 or 3.5% in 2018. We stress our over-weights on big Banks and Health Care and see upside at Tech, Cons. Disc. and Utilities, but find valuations too demanding at Energy, most Industrials & Materials. Staples have FX risk. The pace of the climb in yields is as important as the destination, as any rapid climb in yields could shock real estate and fixed income and weigh on growth. However, this is why we think Congress will try to find the right balance in its fiscal package and why we think it important that the Fed hike at a moderate pace to prevent the labor market from overheating and to slow the ascent in long-term yields.

If you are OW bonds or need a reliable real yield asset then look to Utilities

Utilities benefit from: 1) a lower US corp tax rate given nearly 100% US profits and thus no FX risk, 2) likely continued 15% tax rate on dividends vs. income tax rates for interest income and the 3.8% ACA tax is likely dropped, 3) more Federal infrastructure grants and loans for transmission upgrades, 4) a safe haven for retirees and institutions looking to reduce fixed income exposure. We expect corporate sponsored pension plans to reduce their equity allocation in favor of long duration IG corporate bonds, but public sponsored pensions and retirees will still likely seek reliable real yield bond substitutes like Utilities.

You've got a lot of questions about corporate taxes, we have lots of data

Inside we include many summary exhibits of our data on S&P 500 effective tax rates by sector, industry and company, both the domestic and foreign pieces.

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