Don't Worry About Trump; Worry About Earnings

If you?re concerned about President Trump?s influence on the stock market you?re concerned about the wrong thing. That?s not because political leaders ? and their problems -- don?t influence stock prices temporarily, but because if you own stocks you should own them for their long term earnings prospects (which is why retirees should have reduced stock exposure). Stocks are ownership units of business. And although the political climate influences the business climate, a stock?s price reflects anticipation of earnings far into the future, beyond any politician?s time in office. Procter and Gamble will be selling Tide laundry detergent and Crest toothpaste long after President Trump is out of office. And that doesn?t mean you should own Procter at its current price. It just means, barring any concerns with capitalism or the stability of the country in general, Procter?s current price relative to its? long-term future cash flows is what an investor should concentrate on. President Trump has been in office for a year and a half, and stocks have shrugged off much of the turbulence that has accompanied his administration. There have been specific policies that seem friendly toward stocks such as the tax cut. But there have also been policies that have been unfriendly to them such as tariffs. No matter, the S&P 500 Index surged nearly 22% in 2017, and is up another 9% this year as of this writing. From taking his time to fill key posts, to feuding openly with his attorney general and the press, to an investigation into his campaign?s contacts with Russia and payments to women with whom he?s had extramarital liaisons, to often betraying a lack of understanding of constitutionalism, to an erratic foreign policy that simultaneously displays abrasiveness but also a diminished role for the United States in global affairs and questionable friendliness toward obvious U.S. enemies, markets have continued rising through it all. The last week may represent a turning point, but it?s too soon to tell. Trump?s longtime attorney Michael Cohen pleaded guilty to violating campaign finance laws in buying the silence of a pornographic film actress and former Playboy model. In the process Cohen, who taped meetings with Trump when Trump was his client, implicated the president in conspiring with him to commit the crimes. Moreover, Trump?s former campaign chairman, Paul Manafort, pleaded guilty to 8 counts that included tax fraud and bank fraud. Although Manafort?s trial didn?t touch directly on the accusations that the Trump campaign colluded with Russia to exploit damaging information Russia had on Hilary Clinton, the income that Manafort didn?t report came from advising a pro-Russian political party in the Ukraine. Finally, the chief financial officer of the Trump Organization, Michael Weisselberg, and tabloid executive, David Pecker, were granted immunity by the Southern District of New York regarding its investigation into Cohen. All of this may or may not lead to impeachment, but the threat looks greater now than ever before. The outpouring of emotion over the death of John McCain, with whom President Trump also openly feuded and mocked for being captured during the Vietnam War, may also push public opinion further against Trump and make impeachment more possible. Perhaps sensing his vulnerability from these recent events, Trump himself said in a recent interview that impeachment would cause the stock market to fall. ?If I ever got impeached, I think the market would crash. I think everybody would be very poor. Because without this thinking (pointing to his head) you would see numbers you wouldn?t believe ? in reverse.? But will it? Alex Shepard notes in the New Republic that stocks fell in 1974 when President Nixon resigned from office, but recovered the next year. (The S&P 500 Index lost 26% in 1974 and gained 37% in 1975.) Also, the stock market rose after Bill Clinton was impeached in late 1998. (The S&P 500 Index was up nearly 29% in 1998 and another 21% in 2009.) But Shepard argues that Nixon left before impeachment and that Clinton sailed through his problems with consistently high approval ratings. Trump, by contrast, remains unpopular, and almost certainly wouldn?t leave without a fight. Therefore, Trump?s reaction to impeachment would probably be bad for markets, Shepard concludes. Interestingly, Trump?s recent poll numbers haven?t moved much. And markets continue to surge, uninterrupted by political concerns or anything else. That should tell investors how hard it is to forecast market moves based on the political climate. President Trump just suffered his worst week in office, and the market?s aren?t registering the problems he?s facing at all. None of this is to say that the market can?t fall on increasing political problems. But the real problem investors face is valuation ? stock prices relative to earnings. Stocks are trading at higher prices relative to past earnings than they have in all but two other moments in history ? 1929 and 2000. Often, political tumult can sink a market already vulnerable from high valuations. So far it hasn?t. But if you own stocks, that?s your real problem -- the extent to which prices are divorced from past earnings and to which they are anticipating future earnings growth that is unachievable.