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Trump's policies continue to evolve

– The Trump rally is not over

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Contrast between economic strength and political uncertainty is causing the lackluster performance of financial markets

The economic environment continues to improve even as the political outlook becomes increasingly unclear. Today's environment is defined most of all by these contrasting factors. Political confusion, contrary to the economic strength described below, has been used as an excuse for the lackluster performance of financial markets during the past few weeks (most likely a technical correction). Japanese stocks rose rapidly late in 2016 but have since been generally flat. US stocks as well have been showing increasing signs of a downward correction after reaching a new all-time high in the middle of March. The failure of legislation to replace Obamacare was the beginning of this correction. People are saying stock prices are sluggish because significant doubts now exist about the ability of the Trump administration to implement its policies. Furthermore, in Europe, Britain officially started the Brexit process on March 29 and there are concerns about the growth of populism as France's May presidential election nears and Germany looks ahead to a September general election. Political uncertainty is very high as a result. Because the media focuses much more on this political uncertainty, people tend to be pessimistic.

Signs of the Trump administration's evolution and growth are emerging

During the US-China summit at the end of last week, the United States bombed a military base in Syria. People will probably view this action as demonstrating the evolution and greater reliability of the Trump administration. President Trump stated that using inhumane chemical weapons to kill innocent children and babies crossed a lot of red lines. Taking this step dramatically alters the prior US strategy of working with Russia to destroy ISIS while affirming the existence of the Assad regime. At the same time, Steve Bannon was removed as a permanent member of the National Security Council. Mr. Bannon was opposed to overseas involvement and to bombing Syria because of his America-first stance. Moreover, at the US-China summit, President Trump stated that the United States may act on its own if China provides no cooperation concerning North Korea. Apparently, the Trump administration is in the midst of an enormous shift, abandoning its isolationist stance and returning the country to internationalism. US activities are an indication that the Trump administration is going back to being the world's policeman, a role that the Obama administration had discarded.

At the US-China summit, talks about the trade problem resulted in an agreement for a 100-day plan to reduce the US trade deficit with China. An action plan is going to be established for opening China's markets, correcting unfair trade practices and other items. There is also a verification system. These measures are aimed at building a fair bilateral trade platform without relying on multi-national organizations that have become irrelevant and ineffective. We should therefore view this step as a means of creating a more effective structure for free trade.

The public's evaluation of the Trump administration has declined due to the failure of the proposed restrictions on immigration and replacement of Obamacare. But we are now probably entering a phase in which this evaluation, which hit bottom last week, will start reflecting the evolution and growth of the Trump administration. In Strategy Bulletin No. 177 (February 13, "The true nature of the Trump administration – Imperialism, not protectionism, an offensive rather than defensive stance"), I stated that isolationism and protectionism would obviously have an effect completely opposite to President Trump's objectives of

(1) US strength, (2) a safe world and (3) a strong US job market. Furthermore, I said that radical discrimination could never take hold in the United States, the world's most democratic country. For these reasons, we can expect to see a rapid correction to the three negative images of the Trump administration (isolationism, protectionism, discrimination) due to the combination of the administration's growth and evolution and the end of distorted media coverage.

Until now, there were doubts about the Trump administration's ability to translate policies into actions. But now a big opportunity is appearing for people to take another look at the administration's business-friendly, growth-oriented policies. The administration has announced a series of deregulatory measures. If President Trump starts taking actions in April involving tax reform, infrastructure investments and other measures for economic growth, financial markets will probably start reacting favorably once again.

Markets cannot ignore the economy's remarkable strength

Major positive movements are currently taking place not only in the US economy but also in the economies of Europe, Japan and China. Particularly noteworthy is the big improvement in corporate earnings as the information and Internet revolution fuels innovation and higher productivity. This is creating the perfect environment for a global investment boom backed by these strong earnings.

In the United States, expectations about the Trump administration's business-friendly policies are reinforcing the country's entrepreneurial spirit. Since the global financial crisis, the US small business optimism index remained between 88 and 96. But this index shot up since December 2016 and is now almost at an all-time high of about 104. Although US interest rates have started moving up, the commitment to monetary easing is still solid. The large volume of funds worldwide available for investments at low interest rates have strengthened the animal spirits of entrepreneurs. Furthermore, a recovery is occurring in the natural resource, energy and mining sectors as the price of crude oil rebounds. The high-tech sector, where there was largely no growth in 2015 and 2016, is beginning to enter the growth phase of the high-tech cycle. Contributing to high-tech growth are completion of high-tech product inventory reductions, a more favorable product cycle, and rapid growth of semiconductor and liquid crystal investments in China. In Japan, rising orders for semiconductor manufacturing equipment, electronic components, machine tools and other products show that domestic and external demand are increasing.

No end of this global economic growth is in sight for the time being. Most significantly, there is very little inflationary pressure because the benefits of information technology and the use of low-cost labor in emerging countries are holding down wages. As a result, monetary tightening would be repressive. In the United States, a recession typically starts three to seven years after the first interest rate hike. The average is five years. Since the first interest rate hike was only a little more than one year ago, the likelihood of a recession will probably be small for several more years. Experience tells us that stock prices will not reach a peak as long as there is no recession. We must therefore conclude that the current upturn of stock prices can be sustained. If US stocks again climb to a new record high, any risk-off appreciation of the yen will be limited to around ¥110 to the dollar.

Year-end turbulence has ended – Stocks will start climbing again

Prospects are excellent for Japanese stocks to join the global rally led by the United States. The yen-denominated Nikkei Average has been flat. But when converted into dollars, the Nikkei Average is up about 5% during the first three months of 2017 and consistently set new record highs following the global financial crisis. Contrary to the past, stock prices are remaining firm even when the yen appreciates. This demonstrates that investors are beginning to recognize the resilience of Japanese companies to a strong yen. Consequently, Japanese stocks are poised to start moving up once the volatility that happens around the March fiscal year end for technical reasons settles down. Investors have good reason to expect stock prices to begin climbing again after the recent temporary pause in the multi-year Abenomics rally.