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Picking Wall Street's next phase key for a smart investor

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Fed chair Janet Yellen, whose term comes up for renewal in February, 2018. Source: AFP

Advising ultra high net worth clients means you must always remain focused upon the foreseeable future and do so while maintaining firm strategic positions today.

At the same time, you must operate a fluid tactical allocation in anticipation of tomorrow's ever changing realities.

Such guidance seeks to provide a lens through which to interpret what is going on.

Running commentaries on Greece, China "wins and woes" and iron ore spot price levels make for important and equally interesting reading but should never be confused for the Tortoise when they are, in fact, really, the Hare.

With this longer-term pace in mind, the 58th presidential elections in the US, the world's most important economy, on November 8, 2016 becomes a very timely conversation and an investment horizon we now need to think about heading towards 2017 and beyond.

US politics do matter and have real material impacts on global investment markets both in the short and longer terms.

Traditionally, Republican victories during such elections are more welcome on Wall Street, but given the current levels at which the US stock, greenback (US dollar) and bond markets sit, the more important question this time around becomes who can resolve the current gridlock in the US congress.

Such impasses have placed a hex on future fiscal capital expenditure, desperately needed corporate taxation reform and other important legislation that impacts the US real economy and respective investable markets.

The resurgence of the US dollar, as seen in the graph today, talks more to the historical "price reversion" of the greenback than its recently subdued valuations, which were primarily caused by the now finished unconventional monetary programs, which included US quantitative easing.

In terms of our "reflective" Australian dollar, the greenback is, at this time, reverting to its fair valuation and is no longer suppressed by unconventional stimuli, colloquially referred to as "money printing".

These are all important conversations to have framing our post-2016 presidential election thoughts, surrounding the future of the US economy. This future US economy, in 2017, will be stewarded by a fresh fiscal government mandate, a real economy at the tail-end of a seven-year business cycle and one which will be half a year out from a potentially new custodianship of the monetary arm of US government, with US Federal Reserve chair Janet Yellen's four-year term up for renewal on February 3, 2018.

One of the decisions the global investor needs to decide at today's fork in the road is whether current S&P 500 stockmarket valuations are reasonable or excessively stretched?

As of this week, the S&P 500's averaged P/E ratio is 20.34 and this is estimated from the indices' respective constituents' latest reported earnings and current market pricing.

Additionally, during an epoch when pricing remains distorted thanks in a large part to the formerly mentioned QE programs, reviewing what is referred to as the CAPE ratio — cyclically adjusted price earnings, which are based on average inflation-adjusted earnings from the previous decade — can be a particularly insightful aid during this timely decision process.

This week's S&P 500 CAPE ratio averaged in at 26.72.

Dr Robert Shiller, the Nobel Laureate, lionised for establishing this particular valuation metric, poignantly said last year that a CAPE score above 25 was "a level that has been surpassed since 1881 in only three previous periods: the years clustered around 1929, 1999 and 2007. Major market drops followed those peaks."

The difficulty faced by the global investor today is deciding which becomes a more important gauge for our decision making — the fact that the underlying US real economy continues to naturally expand due to genuine growth through an organic business cycle expansion, or whether valuation metrics that currently are flashing red lights should be prioritised, even if we know that fundamentals since QE have become unavoidably distorted (referred to as the "Great Distortion")?

As discussed previously in this column, this is where ultra high net worth wealth advisory becomes more art than science as, objectively speaking, the above decision branches both hold true.

Knowing that S&P 500 currently trades at a historically high multiple of 17 times forward EPS, the following three investment pathways balance both of these options without having to miss out on future "market action".

Examples to keep an eye on include the US Consumer Staples, CVS Health Corporation (CVS) and Tyson Foods (TVN)

It is important to remember that the information technology, materials and US energy sectors face the higher sales exposures to foreign revenue sources.

The only exception within the S&P 500 energy sector subset is US domestic "frackers" who currently continue to face some prohibitions on international sales of US energy.

Remembering that the 2016 US presidential elections will, in part, be a proxy battle for the support or repeal of the US Affordable Care Act, dubbed Obamacare, taking tactical positions today in such entities as CVS Health would be framed through a strategic lens, which accounts for geopolitical fallout if Republicans win the executive branch of US government.

Both CVS Health and Tyson Foods satisfy these dual parameters.

The global investor can only establish firm strategic positions and maintain fluid tactical allocations when guidance is sought through a lens that looks towards the future and not the present or the past.

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