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Will the Flynn Investigation Reverse Market Gains?

Mid-May volatility may be a sign that Wall Street won't remain immune to the growing political crisis.

By Brian O'Connell, Contributor | May 19, 2017

Due to the chaos of the Trump White House, the Dow Jones industrial average fell 372 points May 17. (The Associated Press)

The Dow Jones industrial average fell 372 points May 17, losing 1.78 percent of its value and rattling nerves on Wall Street, thanks to the broadening controversy that enveloped the Trump White House.

Just in May, President Donald Trump's White House endured the following:

- Allegations that his former national security adviser, Michael Flynn, was subject to Russian blackmail.
- Trump fired former FBI director James Comey, who was overseeing an investigation into Russian interference in the 2016 election, and offered differing reasons for doing so.
- Trump appeared to threaten Comey on Twitter by saying the ex-director should hope there are no tapes of their conversations.
- Published reports revealed that Comey kept copious memos of his interactions with Trump, including the president's alleged request that the director drop the FBI investigation into Flynn and Russia. Trump has denied those reports, but Congress demanded the FBI turn over all memos and records of Comey's meetings with Trump.
- In a White House meeting, Trump shared highly classified information with the Russian foreign minister concerning the Islamic State's plans to use laptop computers in terror attacks, according to published reports. The information had been obtained by an ally – later confirmed to be Israel – who had not authorized that the material be shared with Russia. White House officials denied the story, although Trump appeared to confirm it the following day on Twitter when he wrote that he had "the absolute right" to share information with Russia.
- Widespread reports of infighting and dissension among Trump's advisors, including shouting behind closed doors and White House leaks that Press Secretary Sean Spicer and others will be replaced.

Now former FBI director Robert Mueller has been appointed as a special prosecutor to oversee the investigation into Russian involvement. Mueller will have broad powers to expand the investigation and will be able to bring criminal charges. The appointment of a special prosecutor less than four months after Trump took office threatens to stall his ambitious domestic and foreign policy agenda, including overturning the Affordable Care Act, tax reform, renegotiating NAFTA and foreign trade agreements, infrastructure improvements, more military spending and constructing a wall on the Mexican border.

But despite the chaos of the Trump White House, Wall Street has seen dramatic gains since the New York businessman took office. And even after Wednesday's market shudder, stocks have once again stabilized.

"The [Standard & Poor's 500 index] is up nearly 12.5 percent since President Trump was elected and up 7 percent year to date," says Michael Sury, chief executive officer of Indorus Holdings and a lecturer in finance at San Diego State University. "Investors have been primarily bullish about Trump's policies regarding dramatic tax reductions and the loosening of regulations across a spectrum of industries."

Sury says that many U.S. assets have become "significantly overvalued based upon Trumpian promises."

"As a result, market complacency has set in, with one measure of market fear, the CBOE VIX, at multi-decade lows," he says. Although it remains low, the VIX, or volatility index, spiked nearly five points on May 17 to 15.54.

Why the disconnect between Wall Street and events in Washington? Sury says having a business-friendly president in the Oval Office is paying dividends for investors – literally.

"For one, the administration's policies are generally supportive of the capital markets, even as there are a number of legislative and regulatory hurdles that must be cleared for them to be passed," he notes.

Others agree, noting that historically the stock market has acted independently from Washington's political volatility if the president's economic policies work in investors' favor.

"Wall Street is not immune to D.C. chaos, but right now, the market is simply forward-looking," says Ty Young, founder of Ty J. Young Wealth Management in Atlanta. "Market investors are assuming tax reform and regulatory relief will be coming down the pike because that will be good for business for the politicians regardless of the drama."

Another reason why the stock market has mostly kept its cool while political drama engulfs Washington: Conflict between the president and the media, or even the president and Congress, is "baked into the cake" with Trump as president, Young says. "The U.S. remains the strongest adherent to the rule of law, and we retain the deepest capital markets, the most innovative economy, the most diverse labor pool, even as all our global competitors have significant headwinds such as slowing growth, Brexit and geopolitical instability."

"By comparison, we remain the shining city on the hill," he adds.

Political tendencies do come into play, other investment industry insiders say, especially as the White House changes from blue to red, from the Obama administration to Trump.

"The old adage addition by subtraction comes to mind," says John Boyd, principal at The Boyd Company in Princeton, New Jersey. "Now, Obama is out of office, and his policies and executive orders, which increased regulations and business costs in a myriad of areas, have given many job creators hope for a more positive climate for new investment."

Couple that with Trump's pledge to cut taxes, invest in infrastructure, eliminate costly regulations and develop a new trade policy, along with other business-friendly initiatives, and it's really no surprise the markets are percolating, Boyd says.

"Savvy investors can walk and chew gum at the same time," he notes. "They are very aware of the polarized do-nothing climate in D.C."

Boyd also thinks the investment class still hopes that in a few key areas, like infrastructure, trade policy and even tax reform, there will be sufficient support in the GOP-led Congress to make some market-friendly moves.

And there's also common sense. Investors, like most Americans, pay little attention to politics and instead focus on important issues like jobs and the economy, both of which have been positive for the market.

"While politicians can cause intense near-term worry for investors, the stock market should be tied to the U.S. economy and corporate earnings, not Washington," says Andrew Wang, a managing partner with Runnymede Capital Management in Mendham, New Hampshire. "Currently, positive fundamentals continue to underpin the financial markets."

"Despite our built-in global advantages, chickens always come home to roost," he says. "Eventually, debt and dysfunction will cause a market reversal."