THE INVESTMENT IMPLICATIONS OF PRESIDENT TRUMP

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10/11/2016

INTRODUCTION

The 2016 US Presidential race has been run and won by Republican candidate Donald Trump. The result was one of the most extraordinary election upsets in political history, but at this stage it appears that the Republican candidate only won the Electoral College vote. Indeed, Democrat rival Hillary Clinton has seemingly won the popular vote by a wafer thin margin (similar to George W. Bush's win over Al Gore in 2000) which highlights the irony of Mr Trump's claim that the 'system was rigged'. Nevertheless, it was a stunning repudiation of the status quo in America with people wanting change. There appears little doubt that change is what they are going to get.

HOW WAS THE ELECTION WON?

There were three key factors which underpinned the Trump win. Firstly, the key to any US election win is getting your support base out to vote. Mr Trump's rhetoric about immigration culminated in a record Hispanic vote supporting Ms Clinton, but this impact was swamped by a large surge in Republican votes from white males without college degrees (these have already been labelled the 'forgotten Democrats').

These voters were particularly important in the old rust-belt states in the Midwest such as Michigan and Ohio and in Wisconsin (last won by a Republican in the 1984 Ronald Reagan landslide). Collectively, these states have been the bulwark of Democrat electoral success over the past 25 years.

The other key factor that most pundits missed was that there was a large and late surge for Mr Trump in these key swing states and the impact here was broad and enabled him to capture other states such as Florida, North Carolina and Pennsylvania (last won by the party that uses an elephant as its logo in 1988). This helped break the so called "blue wall" up north that the Democrats had built in the past eight years.

THE CATALYST FOR THE POSITIVE MARKET REACTION

Most people thought that Democrat candidate Hillary Clinton would not only win, but markets would rally with her election. Instead the outsider won and northern hemisphere markets surprisingly rose on the news. There are three causes of this unexpected reaction:

1. In June we had the Brexit shock, so global financial markets this time around were less extended in their positioning than they were mid-year. They may have also been better prepared for a surprise outcome and aware that markets could swiftly recover especially with so much cash on the sidelines.

2. The Republican Party enjoyed a clean sweep in the US Congress, which should greatly reduce the amount of political gridlock in the legislature and enable policy to be quickly implemented.

3. The President-elect's victory speech was very gracious especially when he thanked his opponent for her service to the nation and also spoke of the nation coming together, working with Democrats and Independents for the betterment of the United States. This contrasted with his aggressive rhetoric during the past 18 months. The impact of the gracious tone was reinforced by similar sentiments from both Hillary Clinton and President Barack Obama.

Yesterday Asian markets sold off aggressively led by Japan (-5.5%) after a large appreciation of the Yen on safe-haven flows, with even larger losses in the Asian emerging markets. It was a classic risk-off session with gold and the Yen rallying, but there was one important exception in that bonds had given up most of their early price gains by the close of Asian trading.

US and European sharemarkets shrugged off the steep falls from their Asian counterparts and the US Dollar put in a resilient showing, especially against the Yen. In addition, US Treasury bonds reversed early gains and gold gave back an initial steep advance. Even the Mexican Peso, which was a notable casualty given Mr Trump's determination to dismantle the North American Free Trade Agreement, closed well above its earlier record low.

However, it is far too early to say that markets are in the clear and that it is only blue skies above. There are major changes and stress points ahead in politics, regional trade and global security, not to mention a highly tenuous relationship between the new administration and the US Federal Reserve. However, markets seem to think that these are issues for another time.

A BREXIT REPEAT?

In many ways the markets seem to benefit from the time delay between the Election Day result and the policy implementation, much like it did after the Brexit vote. In June 2016 Britain voted to exit the European Union, but this won't occur until 2019 so the economic effect is much later than the market impact, which provides time for the shock to wear off and for economic agents to restructure supply chains and for politicians to renegotiate trade policy. Much in the same way, the US voted for change yesterday, but Mr Trump does not take office for another two and a half months and his major policies are unlikely to take effect until mid-2017, at the very earliest.

OUTLOOK

While the markets appear to be sanguine at present about a Trump Presidency, there is little doubt that global economic uncertainty will amplify if his policies are implemented. While, the conciliatory tone of his victory speech has initially eased concerns about his leadership, that may not last and it will undoubtedly be a case of 'don't listen to what I say, watch what I do'.

Having said that, it appears that a very large fiscal stimulus program in the form of higher infrastructure spending and lower taxes is likely to be delivered in the next 12 months, which will be very constructive for consumer confidence and economic growth. Despite fears to the contrary, ironically there may be a rise in confidence in the US from the implementation of Mr Trump's policies. There is little doubt that the electorate will be pleased that they have finally broken the dysfunctional US political system and that the forgotten workers are likely to see some financial relief after decades of hardship. This has the potential to unleash a wave of optimism and consumer spending growth.

BE CAREFUL WHAT YOU WISH FOR

The key to the success of this fiscal strategy is for the incoming President to provide enough stimulus that corporations decide to invest to increase capacity. If that is the case and employment rises further, then the multiplier effects of his program could be large and help lift growth. Business investment has been one of the missing ingredients in the US recovery which still remains the weakest in history. Indeed, over the past seven years, the US economy has expanded a total of +16% (+2.0% per annum) relative to an historic average of +40% (+4.7% per annum) over the past 21 business cycles dating back to 1873. However, while replacing depreciated assets (like highways and bridges) reduces downside economic risks, it does not expand the production possibility frontier, nor will it boost productivity (which remains extremely low by historical standards) by much.

INVESTMENT IMPLICATIONS

However, there is little doubt that Mr Trump's policies will be inflationary and will push Treasury yields up higher, potentially impaling conservative investors who have a large exposure to government bonds. How the US sharemarket reacts to a world of higher earnings growth and a higher cost of capital is hard to gauge, but there is likely to be some sector rotation with value stocks outperforming their growth peers, with financials well positioned to benefit from both better growth and a steeper yield curve.

There is also little doubt that the level of US debt, which is already at a peace-time high of 106% of US GDP, is also likely to rise further. Overnight, ratings agency Fitch stated that Trump policies will be negative for US sovereign credit worthiness even though there will no near-term implication for the US’s AAA credit rating from the agency.

There is one other interesting consideration. President-elect Trump's major policies are lower taxes for the rich, limiting access to health care for lower income families, reducing population growth through immigration control and reducing corporate tax rates. Most of the benefit of these policies will go to higher income workers who own assets, and it’s hard to see even a small portion of the benefit of these changes going to the struggling US workers who won the election for Mr Trump. So the key considerations are how long can Mr Trump hold onto his political capital and how he will use it to structurally lift growth and living standards. That remains the great unknown.