

Market Bulletin

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U.S. elections: A populist victory

After a long and brutal U.S. Presidential election campaign, Donald Trump has emerged victorious, with Hillary Clinton conceding in the early hours of the morning, and Trump congratulating her on a hard-fought campaign. Importantly, the swing to the Republicans also saw the party retain control of the U.S. Senate. In a much easier-to-predict result, the Republicans retained a comfortable majority in the House of Representatives.

Trump's victory was achieved by tapping into, and to some extent, stoking general voter discontent. While most of the campaign on both sides was negative, Trump's populist messages of lower taxes, gun rights and a conservative religious agenda, allied with opposition to trade agreements and illegal immigration, were ultimately successful in knitting together a winning coalition.

Markets had been anticipating a Clinton win, which would have represented a continuation of the status quo. Trump's victory, by contrast, has elevated global uncertainty, partly because of the danger of a trade war and partly because it is not clear which parts of a very ambitious agenda of tax cuts, increased defense and infrastructure spending and health care reform can, or will, be implemented.

Global financial markets have reacted in predictable "risk-off" fashion, with global stock markets and oil prices falling, and gold and U.S. Treasuries rising. The Mexican peso has fallen, as has the U.S. dollar.

For investors, however, the question is not how markets have reacted, but what is the long-term outlook in the wake of the U.S. elections? A few key points need to be made:

First, the U.S. economy that President Trump will inherit is in pretty good shape. Real economic growth has picked up in recent months while the unemployment rate, at 4.9%, is close to any economist's definition of full employment. S&P 500 earnings have rebounded smartly from the oil and dollar induced slump of 2015 and inflation is still moderate. Moreover, the global economy is also showing



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signs of life with the global manufacturing purchasing managers' index hitting a two-year high in October. All of this, absent political uncertainty, would be positive for stocks and negative for bonds.

Second, the uncertainty and volatility following the U.S. election will, for now, reduce the probability of a Federal Reserve (Fed) rate hike in December, although the Fed will want to leave its options open until it can assess the market and economic fallout from the election result.

Third, while last night's results represented a Republican sweep, actual policy change may be far less dramatic than was proposed by Trump during the campaign. First, it should be noted that there is a wide gulf between Trump's agenda and that of many "establishment" Republicans and the latter may well balk at unfunded tax cuts or spending increases. In addition, both the new President and Congress will likely act more slowly on dismantling the Affordable Care Act or trade agreements, until some better alternatives can be found.

Finally, it should be noted that, as has been the case elsewhere in the world this year, voters have chosen change over caution and politicians tend to respond to what voters want rather than what they need. While the Trump agenda is unlikely to be implemented in full, members of Congress may be willing to go along with some proposals to increase spending, lower taxes, reduce illegal immigration and increase tariffs. If they do so, they may well further stoke inflation in an economy that is already heating up. Longer term, increasing government debt to fund these initiatives has obvious dangers.

The knee-jerk reaction of investors to last night's election was to sell U.S. and global stocks and buy Treasury bonds. However, in the medium term, a warming economy, further stoked by expansionary fiscal policy, could favor the former over the latter.

In the long-run, investors would do well to make sure that they are well diversified outside of U.S. stocks and bonds and that they have sufficient exposure to alternatives and international securities. In light of the Brexit vote and the U.S. elections, 2016 has proven decisively that populism is a good political strategy—whether it proves to be good for long-term economic fortunes is another question entirely.

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