US presidential elections

(Part 2)

Elections are typically "noise," which is define as events that cause short-term market moves but seldom have a lasting impact.

Brexit has been a recent reminder of these kneejerked reactions.

We have learned from it and bought the dips.

The “Unthinkable” has happened

- Following one of the most controversial presidential races we have seen, Donald Trump will become the 45th president of the United States, defying the recent opinion polls.
- The populism that appears to have underpinned the UK’s Brexit result is a global phenomenon has been successfully exploited by Donald Trump, who presented himself as the anti-politician.

A “Brexit like” market reaction

- The Trump victory represents an uncertainty shock to markets, and has been followed by a predictable selloff in global risk assets, the peso and the dollar and a rally in gold.

- At the time of writing the Dow and S&P 500 are turning positive led by sectors that appear poised to benefit from a Donald Trump presidency (healthcare, energy, financials)

- How markets will continue to adjust to this result will depends in part on the tone of the incoming Trump administration and, in particular, whether Trump continues the more conciliatory tone in his acceptance speech or reverts to the rhetoric he has used throughout the campaign.

- We expect the election impact to fade as investors return focus to the fundamentals. Before the elections, economic conditions were improving, with stronger growth, low unemployment and rising earnings, a positive environment for equities.

- Even though the Republicans will technically have control of the House and the Senate, they don’t have strong control, which will handicap the President’s ability, to push through extreme policies.

A reassuring change in tome

- There is a high probability that Trump will not implement what he said. Trump’s acceptance speech is already shifting from a divisive and radical stance to a more moderate and centrist view. Trump already showed signs that he will carry a more moderate approach to foreign policy. Indeed, he mentioned his willingness to work with countries that are open to deal fairly with the US. If this is interpreted as an indirect message to China, this should be supportive of our short Asian EM currency stance.

Portfolio positioning

On the election day, we were slightly underweight equities via the sale of futures on the S&P500 and the Eurostox50 (net exposure at 48%) with the aim of taking advantage of any market dislocation to buy the dips as the global economic environment remains fairly positive and company earnings fare better than expected.

This morning, our limits to buy on a 4-5% correction were triggered, so immediately raising the net equity exposure to 58%.

We did some adjustment in the portfolio
On the region level: We reduced Emerging markets to increase US and Europe equities.

On the sector level: we increased exposure to Energy and Financials and Healthcare at the expense of Consumer discretionary, Staples

Financial markets implications – Not entirely negative

- Until the ballot, markets appeared to prefer a Clinton victory. Indeed, history shows that markets do usually better under a Democrat presidency.
- While difficult to predict, a Trump presidency may eventually turned less negative than originally feared
- **Trump's pro-growth agenda** is "quite positive" for the US economy and businesses. The prospect for fiscal stimulus and lighter regulation would boost several sectors like technology, financial services, energy, consumer discretionary, consumer staples, and industrials. The sharp corporate tax cuts will boost corporate earnings.
- However it is fair to say the US would likely move towards **protectionism** by erecting trade barriers and implementing a strict control on immigration. Such a path would disproportionately hurt **emerging assets** and eventually stoke inflation.
- US stocks should remain supported by accelerating earnings growth, forecast at 8% in 2017.
- **US Treasuries** will likely suffer from the higher perceived risk of inflation, higher budget deficits, and uncertainty surrounding the conduct of monetary policy. Any sort of haircut on Treasuries would be negative for the asset class.
- **US inflation-linked bonds** should do better than Treasuries
- **Credit**: a repatriation holiday - a tax break for individuals and/or businesses who repatriate income earned in other countries - would bring a lot of potential investment back to the US economy. The extra cash on US corporate balance sheet could improve credit quality
- **US High Yield** might suffer more than EU HY given higher duration.

Sector approach

- **Infrastructure related stocks** (industrials, materials, transportation, construction and house builders) should be supported by the huge financial pledges to upgrade the US infrastructure
- **Energy**: Trump has a less stringent controls on the sector than Clinton. The sector would benefit from the removal of restrictions to increase oil exploration and production
- **Defence companies** should benefit from increased defence budget. **Security and safety themes** should also get a boost.
- **Healthcare** will face significant uncertainty over Obamacare reform but the threat of tough action on drug pricing should recede.
- **Financials** should benefit from a rise in the short end of the yield curve (Fed normalization) while inflation also boosts the log end of the curve preventing a bear flattener.

- **Services:** Increasing labour costs, as populism is often labour market friendly, may weigh on corporate margins, especially for industries with poor pricing power (services, restaurants, retail).

- **EU automobiles and luxury goods** may suffer from increased protectionism

- A trade war would tend to hurt revenues and profits of many **multinational companies.**

Downside risks

Volatility in the markets may remain high until the market gains comfort in the way forward under a Trump presidency

- The uncertainty surrounding the outcome of the US election will likely continue to trigger bouts of market volatility in the months ahead.
  - Trump's lack of governing experience makes it hard for investors to anticipate how he will exercise power, and he is the first president since the 1950s to have never held public office prior to being elected to the White House.
  - We are not going to have a Trump President until January. So, the markets have all that time to react to all of the noise regarding any policy Trump puts in.
  - Uncertainty will prevail until a Trump administration unveils its true intentions, which might strongly differ from the candidate’s stated proposals. Trump’s unpredictable style widens the range of potential policy outcomes.

- Uncertainty about the Fed policy together with other looming political (Italian referendum in December, French and German elections next year) have all the potential to unnerve investors.

Monetary policies outlook

- **A Fed rate hike in December** is not necessarily out of the table as the US economy before the elections was in pretty good shape with stronger growth, low unemployment and rising earnings.
- Still, not all market-watchers agree that US interest rates will increase this year, with some expecting the Fed to take a step-back, as it did following Brexit. Others believe the Fed will go ahead with a rate rise as the central bank seeks to prevent the US economy overheating if Trump proceeds with plans to cut taxes and boost infrastructure spending. Only in case of serious election-triggered market volatility might the Fed might respond to by avoiding a December rate hike.

- **The ECB** may weigh the U.S. election in the size/duration of QE extension at the ECB's next scheduled meeting in Dec-2016.

Disclaimer

- *Bolero Capital Sàrl is an independent research firm providing global macroeconomic analysis, financial markets research on behalf of third parties, including fund managers and family offices. The company deliver insightful investment conclusions and asset allocation recommendation based on a top-down approach.*
- *This report is for informational purposes only and should not be considered an offer or solicitation of an offer, or any advice or recommendation to purchase any securities or other financial instruments and may not be constituted as such.*
- *The information contained in the presentation is for exclusive use by professional customers/eligible counterparties and not the general public. The information is being given only to those persons who have received this document directly from Bolero Capital Sarl.*
- *While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Bolero Capital Sàrl can accept no liability whatsoever in respect of any errors or omissions.*
- *Because market and economic conditions are subject to rapid change, comments, opinions and analyses are rendered as of the date of the posting and may change without notice. The material is not intended as a complete analysis of every material fact regarding any country, region, market, industry, investment or strategy.*
- *This report may not be reproduced or redistributed to any other person, in whole or in part, without the prior written consent of the issuer. Information, opinions and estimates contained in this document reflect a judgment at the original date of publication and are subject to change without notice.*
- *The information contained herein including any expressions of opinion or forecast have been obtained from or is based upon sources believed by us to be reliable but is not guaranteed as to the accuracy or completeness. While every effort has been made to ensure that the data quoted and used for the research behind this document is reliable, there is no guarantee that it is correct, and Bolero Capital Sàrl can accept no liability whatsoever in respect of any errors or omissions. This document is a piece of economic research and is not intended to constitute investment advice, nor to solicit dealing in securities or investments.*
- *No part of this document may be copied or duplicated in any form or by any means or redistributed without the written consent of Bolero Capital Sarl.*

Bolero Capital Sàrl
Marie-Christine Lambin
Luxembourg
Tel 00352 621 35 46 24