US Election: Outcome and Implications

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For the second time in 2016, the global geo-political landscape has shifted dramatically with the election of Donald Trump as the 45th President of the United States.

The victory by Donald Trump looks to have been much more comfortable than almost any commentator was expecting – and indeed the election has seen a much stronger vote for the Republican Party than even the Republican Party itself expected.

Words being used to describe the result are 'tectonic', 'revolutionary' and a significant vote against the political status quo. The implications are likely to be far reaching - in both a political and economic sense.

Donald Trump's policy priorities are expected to be:

- Tax reform: including a substantial reduction in both income tax (down to three basic rates, 12%, 25% and 33%) and cuts in the company tax rate to around 20%-25% (from 35% currently).
- Healthcare reform: Repealing Obamacare with a focus on reducing costs and entitlements.
- Defence: Increased spending on both Defence ($US450bn) and Veteran's programs ($US500bn).
- Trade policy: A much more aggressive trade policy, including naming China as a currency manipulator and imposing tariffs on selected Chinese imports, changing the terms and conditions and NAFTA and abandoning the Trans Pacific Partnership (TPP). We would note, however, that there is considerable uncertainty of whether Trump as President could act unilaterally on trade policy, or whether he would need the support of Congress (which may not be forthcoming) to change policy, especially treaties such as NAFTA.
- Immigration reforms: Reduce the flow of both legal and undocumented immigrants, including some deportation efforts and much tougher rhetoric.
- Infrastructure: An infrastructure spending program of approx. $US300bn over coming years.
- Other: Housing finance reforms, loosening M&A regulations, loosening media ownership and liberalizing energy drilling requirements, reversal of some climate change policies.

Implications of President Trump policies

It is our view that, over time, Donald Trump's policies would, as announced, be highly stimulatory, expansionary and, ultimately, inflationary.

In terms of implications for financial markets we see three phases for the period ahead – but with less confidence on the exact timing of these trends.

1. The initial market reaction, globally, was 'risk off'. Global equities were down, the USD was down against other major currencies and US Treasury bond yields were down. This is a very similar reaction to that seen after the 'Brexit' vote.

At one stage in the US (late afternoon on 9th November AEST), the S&P and NASDAQ Futures were down 5%, the maximum drop permitted by the Chicago Mercantile Exchange before trading curbs are triggered. Globally, the Japanese Nikkei closed down -5.4%, Hong Kong's Hang Seng -2.2% and the ASX200 down 1.9%. However, once US markets opened, the 'risk off' sentiment quickly reversed with most equity markets closing higher.

In bond markets, much like equity markets, we saw the initial 'risk off' sentiment quickly reverse as US markets opened and yields rose sharply on the result, with US 10yr yields up 20bps to 2.07%. Initially Australian 10yr bonds were down 14bp to 2.21%, but in overnight futures trading yields have increased 29bps to 2.49%.

The 'risk off' mode was based on the view that Donald Trump is a vote for significant change in the US political system. This change will likely bring uncertainty and, as we know, markets do not like uncertainty. However it is fair to say that phase one has been shorter than expected.

2. The second phase of the market reaction, which appears to have begun sooner than we anticipated, is likely to be 'risk on', with positive sentiment towards equities and weakness in bonds. This is based on the view, as already mentioned, that Donald Trump's policies are very stimulatory, expansionary and inflationary.

If he was able to get his election policies through Congress (which could be more likely given the Republican's majority in both the House and Senate), we are likely to see a near-term acceleration in the pace of growth of the US economy and a surge higher in the USD.

The equity markets could potentially respond positively to this stimulus - especially those with significant cash holdings off-shore and those companies involved in sectors of the US domestic economy that stand to benefit from Trump's nationalistic policy focus.

3. Phase three of response to President Trump's policies are, not likely to be as supportive. The key issue here, in our view, is that the inflationary implications of Trump's policies are likely to see the Federal Reserve raise interest rates much more aggressively than currently priced into markets as inflation takes hold.

This could be expected to see Treasury bond yields move sharply higher - short-circuiting the stronger economic data. Trumps anti-trade policies and commitment to increasing tariffs are also likely to be inflationary and negatives for growth. The implication here is that, perhaps within a year or so of President Trump's policies being introduced, the US economy could weaken significantly (possibly head towards recession), with the USD, bond yields and the equity markets all likely to decline as well.

If you have any queries about the US Election or its impacts, please feel free to contact GMB Infinity.

Source: Colonial First State Investments.

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