Mint Asset Management

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The US Presidential election 2016

US votes for Donald Trump

The US presidential election was widely tipped to go to former Secretary of State Hillary Clinton. On voting day however, the polls were confounded and Donald Trump was returned as President-elect. Market reaction has been fascinating – the increasing probability of the surprise result first arose yesterday afternoon while the NZ, Australian and Asian markets were open; but while European and US markets were closed. Our markets sold off sharply, mainly due to uncertainty around what a Trump election victory means and even what his policies are (as the election was fought on personality, not on policy).

The UK market opened down around 4% last night (our time), and futures markets were pricing a similar sell-off across European and US equities. At the same time currency markets were volatile and bond yields were pushed down. The very negative initial reaction was driven by a high degree of uncertainty over how clear cut the election outcome would be, what the new Administration's policies would be, and deep discomfort with the heated and divisive rhetoric on display throughout the election campaign.

However, as the European markets were opening, Mr Trump was giving a victory speech to his supporters gathered at the New York Hilton. The tone of the speech was very pragmatic, inclusive, and reassuring. Mr Trump was gracious towards his adversary Mrs Clinton, and he talked of being a president for "all Americans" and that it was time for the US to come together "as one united people". More pertinent to markets, Mr Trump also specified infrastructure investment as a priority – highways, bridges, tunnels, airports, schools, and hospitals. He also stated that he will always put America's interests first but that the US will deal fairly with all countries.

Any speech is just words; however, this speech was reassuring for the complete absence of discussion on the more heated campaign talking points. There is still little known about policy – aside from the commitment to infrastructure spend. At the same time, it was becoming clear that the election outcome was about as clear-cut as it gets in American politics, and the Republican party now controls the Presidency, the House of Representatives (Congress), and the Senate. This latter point is a fundamental shift as, for the last several years, the Presidency has been held by the Democrats while the Congress was dominated by the Republicans – leading to something of a governmental stalemate. With all branches of government in Republican hands that stalemate may lift and the US government may be able to actually govern.

And so, markets started to rally back as the sun came up on America. The UK share market (that started down 4%) finished the day up 0.5%. Most European markets finished up over 1%. The US market finished the day up 1%. Oil is up around 1% and gold (which was up 5% at one stage) is now flat for the session. The big moves though are in the bond market – with the US 10-year bond rate rallying down to 1.71% at one stage last night, and then selling off back up to 2.05%.

What might it mean

At face value (i.e. based on the election campaign statements) the change in Administration in the US could lead to:

- Stricter immigration policies
- Fiscal easing through tax reductions and spending increases
- Less activist foreign policy (maybe)

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- Reduced regulation
- Potential change at the Federal Reserve (given the criticism levelled at the Fed during the campaign)
- Protectionism or opposition to trade deals

Most of the more divisive policies are likely to be less extreme than expressed in the campaign (e.g. immigration and protectionism); however, the direction of policy will reflect the campaign statements. The tax reductions (largely via the corporate tax rate) and the fiscal spending will be positive for the US economy and equity markets. Equally, because they have to be paid for somehow, they are initially bad for bond markets and interest rates will rise as the fiscal easing (when it eventually happens) should boost inflation, and the pressure on monetary policy (the Fed) will reduce, thereby allowing the Fed Funds rate to rise.

While the market has responded positively to begin with, we believe volatility will remain high until we get a clearer picture of who will take up the key posts in the new administration and how policy settles and unfolds.

Implications for our portfolios

The rise in bond yields, and potential for future higher inflation, will hamper yield sensitive assets like bonds, infrastructure, and property. We think the Australasian equity markets will have a relief rally in the short term (our equity portfolio currently has 8% in cash and 15% in Australia). In the Diversified Income portfolio, we had removed the holdings in global equities a couple of weeks ago due to the very high uncertainty around this event, and reduced the property holdings to 8% of the portfolio. We are likely to redeploy some cash into selected US and UK equities shortly. Our property portfolio is largely focused on domestic NZ listed entities. With the Australian listed property sector more sensitive to bond yield movements we remain happy with this positioning. Along with the rest of the NZ equity market share prices have largely recovered post the weakness of yesterday afternoon. The listed Australasian property sectors have had six weeks of negative performance and are currently trading at robust yields and very reasonable prices relative to NTA and other valuations.