November 2016 Market Commentary

In a year of rank outsiders winning, Donald Trump's Electoral College swamping of Hillary Clinton to become the 45th US President early next year tops everything.

The portentous Brexit vote in June paled in comparison to the seismic shift in US and global politics by perhaps the unlikeliest candidate ever to seek election as POTUS and win.

There are a slew of European elections due in 2017, including Presidential elections in Germany and France that could embolden voters to stage similar coups for left field candidates or parties. Along with the Italian referendum and general election next year, there is ample scope for further political upheaval in response to the refugee crisis that has engulfed Europe.

Setting aside Trump's unusual personality, the economic ramifications of potential new policy direction for the US and hence the rest of the world are substantial, if fully enacted.

Trade Torpedo

As President, Trump will have extensive power to unwind many of Obama's Executive Orders particularly those pertaining to international trade.

NAFTA is likely to be renegotiated while America's participation in the Trans Pacific Partnership is unlikely and the Trans-Atlantic Trade and Investment Partnership (TTIP) being negotiated with Europe.

Members of the APEC trade group, which account for approximately 60% of global GDP, told President Obama that it would proceed with trade pacts with or without the USA. China (not part of the TPP 12 member group) is already seizing the opportunity by proposing an alternative RCEP (Regional Comprehensive Economic Partnership) which could be a pact of 16 countries excluding the US.

China clearly does not want to see tariffs of 45% on its exports to the US, as threatened by Mr Trump, so like any river that has been partially blocked, it will flow elsewhere. Trump's (day 1) declaration that China has manipulated its currency to gain a trade advantage forms the basis for his potential reaction to Chinese exports.

Fiscal spend-up

One of the standout policies proposed by Mr Trump is the intention to spend around US$1 trillion on infrastructure.

The Republican-controlled Congress and Senate is likely to support much of this program. So the real question centres on how the government will pay for it and the answer is, the private sector will. But once again the details are lacking and it remains questionable as to how the private sector can be lured into such co-operation without the necessary inducement.

Without it, public sector debt could rocket from 78% of GDP to well over 100% of GDP over the next decade.

And yet, that might be the catalyst the economy requires to take the burden of economic growth off the Federal Reserve's monetary policy initiatives.

A large cut to the corporate tax rate from 35% to 15% would make investing in the US more attractive and is perhaps designed to encourage domestic job growth. Interestingly, the UK is also contemplating lowering its tax rate to 17% but probably as a carrot to keep corporates from shifting headquarters to Europe or beyond.

Offering a cash repatriation deal might provide yet more financial ammunition to invest in the US. The top ten technology companies have approximately US$500 billion between them that remains marooned offshore.

Repealing some of the major regulatory barriers of the past eight years, such as the Dodd-Frank rules, could also unshackle the financial sector to invest in domestic ventures.

Other key economic elements such as Obamacare are also likely to face remodelling under Trump's clear-felling approach.

The Defence budget has shrunk in the last two years but might receive a massive boost of $500 billion to supersize the navy among other things. If that happens, the US would be spending over $1 trillion a year on defence.

Yet until the President-elect is sworn in and his executive team organised, most of what we know is still a "known unknown" as former Defence Secretary Donald Rumsfeld fumbled over in 2002.

It seems evident that the US is now on course for higher interest rates and inflation to accompany what they hope will be higher economic growth.

Market impact

The initial market tremors caused by Mr Trump's surprise victory have passed but the direction of equity markets appears to be generally positive given the (mostly) positive economic decisions on the agenda.

Historically, Bill Clinton's term (1993 to 2001) presided over the largest equity market return of 210% (S&P500), followed by Barack Obama (2009 to 2016) at 152% - both were Democrats.

Trump begins his term as the Dow Jones Industrial Average has scaled new heights past the 19,000 mark so the starting point is already a challenge. Whether or not the market return is indeed correlated with the President is debatable but interesting nonetheless.

George W Bush's term (2001 to 2009) coincided with a 40% decline in the S&P500.