

Global Weekly

US elections: the aftermath

Investment
Communication
11 November 2016

Although it is too early to predict the course of Donald Trump's presidency, there are a few broad indicators regarding the direction of the new administration. Trump's key policies focus on immigration, taxes and trade. Economic growth is also expected to be emphasized. We expect policies in these areas may provide additional momentum for corporate earnings growth in 2017.

There is a lot of uncertainty about president-elect Trump's economic plans. What Trump will focus on (first) and what he will agree with Congress is unclear. However, it seems to us that fiscal stimulus and immigration will probably have priority over protectionism.

While fiscal stimulus would boost demand, curbing immigration would reduce supply. This combination points to higher inflation and possibly more Fed rate hikes. There are two elements to the fiscal stimulus. The first is an increase in infrastructure spending. Trump has not given many details here, apart from saying that his plan would be "double" the size of Clinton's proposed package. That points to spending

Equity index performance in local currency

	Value	One week change (%)	Year-to-date (%)
MSCI ACWI	411.8	2.2	3.1
S&P 500	2,167.5	4.0	6.0
AEX Index	450.0	2.2	1.9
EuroStoxx 50	3,046.6	3.1	-6.8
DAX Index	10,630.1	3.6	-1.1
Nikkei 225	17,344.4	2.6	-8.9
Hang Seng Index	22,839.1	0.9	4.2

Performance data as of Friday, 11 November 2016

Source: Bloomberg

of USD 550 billion over a 5-year period, worth around 0.5% of GDP per annum. Tax cuts represent the second pillar of Trump's fiscal stimulus plan. Trump's initial package of tax cuts have been estimated by the Tax Policy Center as being worth an enormous 4% of GDP in 2017-2018. However, there are signs that the president-elect is converging towards the more modest tax plans of House Speaker Paul Ryan.

Assuming that Trump would go with the more modest tax plan, and taken together with the infrastructure spending, total fiscal

stimulus in 2017-2018 would amount to 3% of GDP. This would significantly increase US economic growth over the period, all other things being equal.

Donald Trump has proposed reducing both legal and illegal immigration. His immigration plan aims to ensure that job openings are offered to American workers first. Other proposals relate to reducing illegal immigration, both through enforcing current law and by implementing new policies. Given the tight labour market, the impact of these measures could be large. At current levels of around one million immigrants per year, immigration is an important source of labour supply and economic activity. Migrants represent around 0.6% of the total labour force per annum. If we assume that around a third of the immigrant flow declines in one year, then the labour force would slow by around 0.2%-points and unemployment would – other things being equal – decline by a similar amount.

Higher economic growth due to fiscal stimulus would also push down unemployment, leading to a tighter labour market and higher wages. Although these are back-of-the-envelope calculations, they give an indication of the effect that these type of measures could have. A more radical stance of deporting ‘all’ illegal immigrants could have much larger economic implications.

Equity markets update

Equity markets were dominated by the US presidential elections this week. At the start of the week, markets were largely unchanged as investors anticipated Hillary Clinton to become the new president. When investors started to realize that Donald Trump would win, markets in Asia initially turned sharply lower. However, equity markets rebounded in the course of Wednesday, after Trump struck a moderate tone in his victory speech. Investors reasoned that a Trump presidency could turn out to be good for global economic growth, as fiscal spending is likely to increase under Trump.

Health care was this week’s best performing sector. Pharmaceutical stocks had been strong underperformers year-to-date, on fears that a Clinton presidency would lead to structurally lower prices for medicines. The Trump victory started a relief rally in health care stocks, as investors anticipate that a Republican administration will not ‘spoil the party’ for big pharma.

Industrials rose on hopes that additional fiscal spending will benefit sectors like construction and defence. Interest-sensitive sectors such as consumer staples, utilities and telecom were hit hard as bond yields rose. By contrast, financials benefited from the higher rates.

Reporting calendar

USG People, RWE	14 Nov
Vodafone, Merck KGAA, Easyjet, Home Depot, Teva Pharmaceutical Industries, TNT Express	15 Nov
Tencent, Cisco Systems, Bouygues, Target	16 Nov
Ahold, Applied Materials, KBC, Wal-Mart, Salesforce.com	17 Nov
CTrip.Com Int.	18 Nov

Government bond yields

	Yield (%)	One week (bp)	One year (bp)
US Treasuries 2-year	0.92	13.2	4.1
German Bunds 2-year	-0.61	3.2	-25.0
Japan 2-year	-0.25	1.9	-24.6
US Treasuries 10-year	2.15	37.4	-18.2
German Bunds 10-year	0.30	16.4	-31.2
Japan 10-year	-0.03	3.6	-34.2

Spreads

	Spread (bp)	One week (bp)	One year (bp)
CDX NA IG	75.45	-4.99	-5.26
iTraxx Euro 5-year	78.31	2.14	7.71
JPM EMBI+	369.12	5.90	-18.41

Performance data as of Friday, 11 November 2016

Source: Bloomberg

The third quarter earnings season is almost over now. The conclusion is that US companies reported sales figures that were in line with expectations. Earnings were generally a bit better than expected, with the energy sector in particular reporting strong earnings. In Europe, earnings also surprised positively in general. Energy and financial stocks had a strong quarter, while industrials disappointed somewhat.

Bond markets update

During his campaign, president-elect Donald Trump has proposed economic policies which, if introduced, would represent significant changes to the current situation. These policies would include sharp cuts in income and business taxes, significantly higher infrastructure spending and renegotiation of key trade agreements.

The Republican party will have a majority in both the Senate and the House of Representatives, which could be beneficial to Trump when seeking congressional approval of his policy plans. (For a more elaborate take on fiscal versus monetary policy in the US, see the report ‘Goodbye monetary policy, here comes fiscal policy’, published in October – before the US elections – by ABN AMRO Group Economics.)

If Trump manages to implement, for instance, tax cuts and increases in infrastructure spending during the first year of

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his presidency, this might give US growth a substantial boost. The US government would finance such initiatives through the bond markets. As a result, the long-end of the Treasury curve would see an uptick in yields. Bond prices, moving inversely to yields, would go lower. Supply conditions could lead to a wider spread between 10 and 30-year Treasuries.

The US economy is currently in better shape than during the run-up to the 2012 elections. Therefore, a rise in 10-year Treasury yields should not have a very negative impact. Since the summer, the 10-year Treasury yield is trading in a range. We believe a new range could be established at a higher level, not only due to the US election outcome but also because of the expected Fed rate hike in December.

With regard to corporate and financial credits, the market expects increased volatility due to stronger swings in risk sentiment. However, as corporate fundamentals are still positive, we left our forecasts for default probability unchanged.

Within emerging markets, we are still comfortable with our preference for government bonds in hard currencies. Emerging market corporate bonds could face some headwinds due to the possibility of higher trade barriers. As we still expect the Fed to gradually hike rate hikes, we believe emerging market sovereign spreads are likely to stay range-bound.

Currency outlook

Early Wednesday morning, when the probability of a victory of Donald Trump increased, financial markets became very jittery. Initially, safe haven assets such as gold, US Treasuries and the Japanese yen did very well. Meanwhile, the US dollar came under heavy pressure. As soon as the news came out that Donald Trump won the presidential elections and that Congress was in the hands of the Republicans, the US dollar started its recovery. This accelerated when Trump struck a moderate tone in his victory speech. Since then, the US dollar rebound continued and equity markets recovered.

What is more, US Treasury yields and US break-even yields have risen from the lows set on early Wednesday morning. The 10-year US Treasury yield has risen above the 2% level. Gold prices have mostly given up earlier gains and are back below USD 1,300 per ounce again. It appears to be difficult for gold prices to stay above the USD 1,300 per ounce, which is probably the result of the selling-on-rally behaviour of investors. This is a negative sign for the near-term gold price outlook.

Asset allocation

After increasing the equities allocation to overweight at the October monthly meeting, ABN AMRO's Global Investment Committee left the asset allocation unchanged. The bond allocation is strongly underweight; the allocations to commodities and real estate are overweight; hedge funds are neutral.

Published this week

Investment Strategy: Trump elected US president

The Global Investment Committee met Wednesday morning to gauge the effect of the US election outcome on financial markets. The committee believes that market volatility will return to more normal levels and that economic fundamentals and expected policies remain favourable for risky assets, such as stocks and commodities.

Bond Markets Monthly: Selection in times of uncertainty

Commitment to the current loose central bank policy is decreasing, while cautious sentiment continues to weigh on European peripheral bonds. We maintain our preference for European credits and emerging markets sovereign debt.

Bond sector note: industrials sector

Our view on industrials is mixed. We are positive on transportation sub-sectors that offer good opportunities. Due to low growth and the high bonds price, we are neutral on capital goods and prefer leading names.

Investment Strategy & Portfolio Expertise Group Economics



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