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Trump Presidency – Economic & Market Implications

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Surprise Trump Victory in U.S. Presidential Elections, Republicans Retain Control of Congress. Stocks Rally after Initial Sell-off as Trump Policies Seen as Pro-Growth. Bond Yields Rise on Expectations of Fiscal Stimulus

2016 U.S. Elections Summary:

Donald J. Trump won a surprise victory in the U.S. Presidential election on November 8, 2016. Opinion polls and markets were expecting a Hillary R. Clinton win. In addition, the Republican Party retained control of the House of Representatives and Senate, losing fewer seats than projected by opinion polls. With the Republicans winning back the White House and retaining control of both Houses of Congress, there is likely to be less gridlock and an opportunity to pass Trump's agenda through Congress.

Trump won 306 electoral votes, with 270 votes required, compared to 232 for Clinton. However, Clinton is projected to win the popular vote, with about 47.7% to 47.5% for Trump, though this will not influence the final result. In the Senate, Republicans maintained control, only losing two seats (one seat still undecided). Republicans are expected to have 52 Senate seats, down from 54. Meanwhile, the Democrats gained two seats bringing their total to 44. In the House of Representatives, the Republicans also retained control, winning 239 seats, losing just 6 seats. The Democrats gained five seats, bringing their total to 193 from 186 previously. Republicans were expected to lose control of the Senate and many more House seats.

Based on opinion polls and betting odds, Hillary Clinton was expected to win the Presidency followed by a positive reaction from the markets, given the general view that under a Clinton administration there is likely to be more certainty about policies and a continuation of current policies. Markets were expected to suffer a "Brexit" like negative reaction in case of a Trump victory, given the uncertainty about Trump policies and the fears of a trade war with China and Mexico. U.S. markets ended the Election Day with solid gains in anticipation of a Hillary win.

Market Reaction – Brief Sell-off & Sharp Rally as Markets Reassess Trump's Growth Agenda

As counting began and exit polls showed Trump doing better-than-expected, Asian markets and U.S. futures markets started falling, sharply. Dow futures fell around 870 points after Trump won Florida and was on track to win other key swing states. At that point, trading-loss limits kicked in and futures markets began to recover. By the time Trump was declared the winner and started to give his victory speech at 3 AM, the Dow was down only 500 points. ***The feared "Brexit-like" sell-off did not materialize and market rebounded sharply.***

The U.S. equity rally was driven by reassessment that Trump pro-growth policies (tax cuts, reduced regulation and increased spending) are positive for stocks markets, and with increased chances of Trump agenda being enacted with the Republicans retaining control of Congress. Markets were also relieved by the conciliatory tone of Trump's victory speech with focus on the positive issues like job creation, tax cuts and reduced regulation, and skipping the contentious trade and immigration issues. Financials jumped on expectations that Trump would relax/repeal regulations. Biotech stocks rose on relief as Clinton was expected to impose price controls. Expectations of increased infrastructure spending boosted materials and infrastructure stocks. However, Tech stocks fell on Trump's immigration stance. European and Japanese stocks rose but Emerging Markets sold-off as the dollar rose. Bond yields rose sharply on expectations that Trump's fiscal stimulus would lead to higher rates.

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Economic Impact:

- President-elect Trump's economic agenda is expected to focus on tax cuts/reforms, trade, fiscal stimulus, and cutting regulations. Trump's proposed tax cuts and expanding expenditure on infrastructure and defense are likely to provide a boost to U.S. growth. ***However, Trump's proposed trade policies could carry risks to global trade unless the actual policies are far more balanced than the contentious campaign rhetoric.***
- ***Trump's surprise victory combined with the Republican Party retaining control of both the Senate and the House of Representatives could enable Trump to pass his agenda through Congress***, at least in the first two years (before the 2018 midterm elections). However, the Republican establishment members have not been big supporters of Trump during the election campaign and he will need to secure their support to fully enact his agenda. This may not be very difficult as the Republican leadership seem to understand that the party managed to keep control of the Senate and House and their losses were far fewer than projected, in part due to Trump's solid win, especially in close races in some states.
- During the campaign, Trump had focused on trade and unfair trade as a significant drag on the U.S. economy. Among the trade issues, Trump favors a 45% tariff on Chinese goods and a 35% tariff on Mexican cars, re-evaluate the North American Free Trade Agreement (NAFTA), and label China a currency manipulator. However, it is believed that ***the actual policies are likely to be far different from the contentious campaign rhetoric as these policies could potentially lead to major disruption in global trade and growth.*** Congress is unlikely to go along with the Trump agenda on these contentious issues.
- Note however that unlike other traditional Presidential candidates, Trump's campaign pronouncements were more general proposals that he favors, rather than detailed policies and plans that he is committed to. For instance, tariffs on China and Mexico form a core of Trump's trade policy agenda. However, he may support more limited trade restrictions in order to avoid a trade war. Trump may also attempt to get concessions of some sort from China and Mexico***. Unlike Candidate Trump, President Trump is more likely to approach trade negotiations like a pragmatic businessman willing to compromise rather than a radical ideologue.***

Fiscal Stimulus, Tax Cuts and Increased Expenditures:

- ***President-elect Trump favors a significant increase in fiscal stimulus to boost economic growth. He has proposed significant tax cuts and sizeable increase in spending. Both of these should provide a boost to GDP growth in the short & long-term and lead to increased employment.***
- ***The cuts to individual and corporate taxes should fuel further stock market gains. Increased public spending could lead to a rise in interest rates, but given that rates are very low, a modest rise in interest rates is unlikely to choke off growth.***
- ***Tax Reform & Cuts:*** Trump has proposed significant tax reform, bringing the number of tax brackets down from seven to three with the top rate down to 33% from 39.6%. He also favors adjusting dividends and capital gains taxes and estate taxes. In addition, Trump favors cutting corporate tax rates to 15% from 35% with adjustments to depreciation rules and how income earned overseas is taxed. Trump has proposed significant cost savings in government programs, but has not been specific. Historically, cost savings have been hard to actually achieve. Trump has also favored either repealing or enacting reforms to the Affordable Care Act (Obamacare), which could potentially bring in some cost savings.
- ***Increased Spending:*** Trump proposes increased spending in areas like Infrastructure, Defense and National Security, and granting Veterans full access to Medicare providers. Trump has proposed a significant expansion to infrastructure spending, possibly double the $275bn that Hillary Clinton had proposed. He favors the creation of an infrastructure fund, financed at low interest rates. The funds will be used to develop transportation, water, and electricity projects.

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Fed Policy & Impact on Fed:

- ***Trump's election has raised some concerns that the Fed would not raise rates in December, as widely expected.*** While the election result was unexpected, there was no repeat of the market sell-off following Brexit and stock markets have rallied to all time highs. With the economic backdrop remaining healthy, ***the Fed is likely to go ahead with a rate hike in December,*** accompanied by a signal that the FOMC will continue to take a patient and cautious approach to tightening in 2017.
- Trump's economic policies are expected to be reflationary in the medium to long-term with a potential to lead to inflationary pressures either from fiscal stimulus or anti-trade policies. If Trump's fiscal stimulus is large enough that it leads to higher inflation expectations, then the Fed could raise rates at a faster pace than the current expectations of one or two rate hikes in 2017**.** ***Evidently, this fear has already put upward pressure on bond yields.***
- Candidate Trump had publicly criticized Fed policy and Chairwoman Janet Yellen during the election campaign. Despite the criticism in the heat of the campaign, Chair Yellen is unlikely to leave before the end of her term (in early 2018), and Trump is unlikely to force her to resign as it would send the wrong signal about Fed's independence. It is possible that Trump could nominate an alternative candidate to succeed Yellen as Chair when her term expires in February 2018. While Trump criticized the Fed's low rate policies, it is unlikely that he will pick a hawk as the next Fed Chair, as keeping rates low could supplement fiscal stimulus and give a bigger boost to growth. The risk with a more hawkish Fed Chair is that aggressive rate hikes could offset the impact of fiscal stimulus on growth.

Impact on Markets & Sectors:

Financial markets quickly moved past the initial shock of the surprise Trump win, focusing on the longer-term impact of the Trump Presidency and Republican control of the executive and legislature. While Asian markets and U.S. futures fell sharply as polls suggested a Trump victory, a Brexit-like sell-off did not materialize. ***Instead, U.S. and other developed market stocks enjoyed a strong rally over the next two days, fuelled by expectations of Trump tax cuts and reduced regulation with Republicans winning the White House and keeping control of Congress.*** The rally was also helped by the conciliatory tone of Trump's victory speech, Clinton's concession speech, and President Obama's post-election address, signaling a smooth transfer of power and reduced uncertainty. However, while U.S. stocks rallied, Treasury yields rose sharply, after falling initially, on expectations of Trump fiscal stimulus.

European and Japanese stocks also rose while Emerging Markets (EM) sold-off as the dollar rose on expectations of higher U.S. interest rates and on fears of increased protectionism. Within EM, Latin America posted the biggest decline led by Mexico on increased uncertainty in trade relations between the U.S. and Mexico.

Looking ahead, the stock market rally is likely to continue on expectations of Trump tax cuts/reforms, reduced regulations and increased spending. However, ***the rally is likely to be cut short if Trump embarks on the more contentious trade and immigration agenda*** rather than focus on the pro-growth agenda. ***Bond yields are likely to reverse*** as the sell-off would be seen as a buying opportunity and on reassurance that Fed is likely to remain on a modest rate hike path. ***EM stocks are likely to rebound*** on expectations of stronger U.S. GDP growth and Fed rate hikes likely to remain modest. EM stocks could also benefit if the Trump administration does not aggressively pursue trade protectionism and currency conflict.

Within Sectors, the Trump policy mix seems to favor Cyclicals over Defensives. Following several years of gridlock, there is now a single-party control of the White House and Congress. This is likely to secure approval of Trump agenda of individual & corporate tax cuts/reform, infrastructure spending, reducing regulation, and addressing rising health care costs.

- ***Financials: A Trump administration has the potential to be positive for the financial sector as it may lead to regulatory easing.*** Higher rates with increased expenditure and Fed rate hikes is likely to be a positive for banks. Any reforms that could potentially lower taxes on investments are also likely to benefit the sector. Higher yields are likely to benefit the Insurance sector.
- ***Infrastructure:*** Infrastructure spending is likely to increase significantly under a Trump presidency. The Trump proposals include approving private sector energy infrastructure projects, modernizing airports, bridges, tunnels & railroads and incorporating new technologies in the national transportation infrastructure. ***This is likely to be a positive for Infrastructure companies*** that could potentially receive federal construction contracts and construction equipment manufacturers. ***The call to use more U.S. raw materials, like steel, in these infrastructure projects is also a positive for the Materials sector.***

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Impact on Markets & Sectors (cont.):

- ***Healthcare:*** A Trump victory combined with Republicans retaining a majority in both Houses of Congress is likely to lead to significant changes to the Affordable Care Act, Obamacare. This is likely to create some uncertainty for the managed care sector in the near term. However, in the longer term, the sector may benefit as the Republicans have called for Medicare reforms that could benefit Medicare advantage plans. The Pharma/Biotech industry is likely to benefit as neither Trump nor Republicans have proposed any aggressive price controls or mandatory rebates in contrast to Hillary proposals. Republicans in Congress are also expected to seek to repeal a range of taxes that were part of Obamacare like the medical device industry tax, health insurance industry tax, and taxes on high cost health plans etc which are likely to benefit the sector.
- ***Defense:*** The sector is likely to benefit from increased Defense spending and the elimination/reversal of sequester under the Obama administration. While Trump is against intervention abroad, he favors increased military spending which could be approved by a Republican controlled Congress. ***This should be a positive for defense stocks.***
- ***Energy: The sector is likely to benefit under a Trump administration with a Republican-controlled Congress.*** Exploration & Production companies may benefit with Republicans being more open to offshore drilling and approval of new pipelines on which the Obama administration had been more restrictive. The coal industry may benefit with easing regulatory pressure and lower competition from the alternative energy sources like solar and wind. However, the revival of coal may be a negative for natural gas. Trump's Middle East policy could lead to deterioration in the relationship with Iran which could lead to changes in sanctions/policy just as oil companies start to return to Iran.

Reduced Regulations:

- Candidate Trump criticized excessive regulations under Obama and the need to cut regulations. Trump favors eliminating many regulations and reforming the regulatory code. Some of the key regulations he favors eliminating are the Waters of the U.S. rule and the EPA's Clean Power Plan. He also favors a moratorium on new regulations.
- Trump has proposed repealing the Affordable Care Act (Obamacare), but Congress is unlikely to approve this without a viable substitute. While outright repeal of Obamacare is unlikely, Congress is likely to seek changes that will improve the efficiency of health care infrastructure coverage and medical costs. Other measures, such as passing legislation to allow interstate competition among health care insurers and legalizing the import of select pharmaceuticals from lower cost countries, could be seen as a means to generate competition and reduce costs. During the campaign, Trump had threatened to withdraw from the Paris Climate Change agreements. As part of the Paris agreement, the U.S. pledged to reduce its greenhouse gas emissions by 26-28% below their 2005 levels by 2025. The U.S. could just withdraw from the Paris agreement in which case there could be significant diplomatic blowback. Instead, Trump could simply dismantle environmental regulations and undermine national efforts to reduce greenhouse gases. The other route would take significantly longer. Under the Trump administration there would be increased reliance on domestic coal, oil and gas industries which could see emissions increase further.
- Trump is also against the Trans-Pacific Partnership (TPP) on the grounds that it undermines the U.S. economy and independence. While the TPP has not been ratified by U.S. Congress, Trump's election is likely to have killed any chance of Congress voting on Obama's signature trade pact.