Ardea Flash note – Trump Election

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Ardea have been monitoring markets closely over the past 24 hours as you can imagine, and while the volatility has been significant, we think overall these events are favourable for markets and good for investors.

While the pathway there may be somewhat convoluted, Trump is ultimately likely to succeed in his objectives to cut corporate taxes, cut personal income taxes, and raise tariffs.

While the economic benefits of these policies are questionable, none of them are unambiguously bad for economic activity in the US, or elsewhere. Indeed a loosening in fiscal policy, which is what tax cuts represent, is what many officials and analysts have been calling for, for some time. Tax cuts also place spending in the hands of the consumer, who can arguably do a better job of spending it than the government.

Raising tariffs is bad, however the global imbalances that had built up over the past decade, with the world's largest economies holding large external deficits or surpluses, was also bad – tariffs may have a positive element if they force policy action to bring about reductions in these imbalances. **Put another way, China's export-led growth model and the US' debt-financed consumption model were healthy for neither – a rebalancing between these two would be positive, and this already appears underway.**

In terms of other economic impacts, while Trump's election also creates a period of uncertainty, in our view this uncertainty is not the type likely to lead to immediate layoffs or other decisions which could lead to a contraction in economic activity. It's implications for private investment activities are also ambiguous – companies may now be more willing to undertake investment simply because of a unified Republican US Government.

The implications for the Fed may also be more muted. While the Fed has in the recent past used uncertainty in markets to defer rate hikes, the uncertainty of Trump's election is more around the surprise element rather than a shock with clear economic downside, and the Fed will treat this accordingly. **Trump's loosening in fiscal policy also runs the risk of the economy running even hotter than it would have done under a Democrat victory, so if anything the Fed may feel the need over the coming year to tighten monetary policy more quickly than otherwise**. A rising Fed funds rate and increasing bond yields due to rising government issuance will naturally create more expensive funding costs for companies needing US dollar funding – but this is the natural consequence of more capital being deployed in the US economy, which ultimately is a good thing for longer term returns.

The implications for the bond market have so far been consistent with this impact, with bond yields rising as investors begin to price in the rising fiscal spending plans of the US under a Trump presidency. Stock markets have also increased on expectations of an environment more favourable to business and corporate profits, reflecting both corporate tax cuts and the rolling back of financial sector regulation.

The implications of fiscal stimulus are also significant for the inflation linked bond market. More fiscal spending means more debt, more issuance, and ultimately more inflation due to the additional demand that fiscal spending creates. Inflation linked bonds have already begun to price this outcome, with pricing of inflation expectations increasing rapidly as investors seek to add to inflation hedges and inflation protection, ahead of a likely increase in inflation in future. With oil prices also rising this has only added to upward pressure on inflation.

Our strategy to date has been to protect fixed income portfolios against uncertainty by being overweight volatility, while also retaining an exposure to inflation. Given the volatility experienced over the past 24 hours we feel this strategy has served investors well. Existing inflation linked bond holdings are benefiting from the rise in inflation, and with current market exuberance we are continuing to monitor whether greater defensiveness against outright increases in yields is required.

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10 November 2016