CIBC Asset Management

Market Insight

November 9, 2016

Trump wins – What now for Canadian investors?

The verdict is in. With Donald Trump declared as the next American President, Canadian investors question what the next four years could bring. We asked some of our portfolio management experts to share their thoughts on what could shape their particular investment space.

CIBC Asset Management

Luc de la Durantaye (LD)
Managing Director, Asset Allocation and Currency Management

Jeffrey Waldman (JW)
First Vice President, Global Fixed Income

Stephen Carlin (SC)
Managing Director and Head, Equities

RARE

Richard Elmslie
Director and Senior Portfolio Manager

DoubleLine®

Ignacio Sosa
Director, Product Solutions Group

WELLINGTON MANAGEMENT®

John Butler
Toby Johnston
Michael Medeiros
Global Bond Strategists

An unwelcome surprise for markets

(CIBC Asset Management - LD)

Since financial markets had been favouring a Clinton win, this result is clearly a surprise, and is likely to negatively impact financial markets. Under Trump, fear of the U.S. adopting a more protectionist trade approach is likely to lead financial markets to price in slower economic growth and higher inflation. This could lead to a correction in equity markets and a rise in bond yields. A strong U.S. dollar is also likely on the back of declining trade partner currencies such as the Canadian dollar and the Mexican peso, which both stand to lose the most in a likely change in U.S. policy.

U.S. Economic fallout

(CIBC Asset Management - JW)

At the end of arguably the most farcical and sordid presidential campaign in American history, Donald Trump takes office with one of the lowest approval ratings ever for a new president. Thanks to the controversies surrounding him, there will be no honeymoon period when he enters the White House in January, like there was when Barack Obama took office in 2009.

On the economy, Trump will try to impose fewer regulations in the energy sector and the banking sector by rolling back Dodd-Frank[1] but reinstating Glass-Steagall[2], a higher minimum wage, lower taxes on businesses and individuals, and new terms for trade deals that currently exist.

Perhaps some of these measures will help jumpstart an economy that has been growing at less than 2%, but not likely to the lofty levels that Trump is suggesting. There is a risk that trade frictions could actually trigger a backlash and slow economic growth.

Expect higher inflation and exploding budget deficits

(DoubleLine)

A Trump victory must be seen against a backdrop of several considerations, including higher inflation in the U.S. The Consumer Price Index (CPI) is likely to be 2.5% or so in the first half of 2017. One key reason prices are rising is that oil prices aren't falling anymore. This means you can no longer count on falling oil prices to drive down CPI, of which many components, such as housing, medical costs and health insurance premiums, are rising at a higher rate than the headline CPI. The fiscal side is also not looking good. In 2017 and beyond, we have entitlements (social security, Medicare, Medicaid) and those disbursements are going up substantially because of the aging population. These entitlements alone will put pressure on the budget deficit.

A Trump victory is also likely to see U.S. budget deficits rise substantially because of Trump's push for much discretionary spending. Trump has said he's someone who's very comfortable with debt. He's repeatedly used leverage throughout his corporate career. We expect he will look at current interest rates and say, "Why aren't we borrowing more?" He wants to cut taxes for corporations and for individuals, while also increasing infrastructure and defense spending. All of this points to a widening federal deficit against a backdrop of rising prices.

Repercussions of stance on Mexico, China & U.S. Fed

(CIBC Asset Management - LD)

Potentially, one of the biggest financial market consequences could result from Trump's stance on Mexico and China. He has expressed a strong protectionist position, and has suggested introducing tariffs and duties, particularly on China, as well as renegotiating free-trade agreements with Mexico and Canada. He has also threatened to label China as a currency manipulator. This could all worsen trade relations with China.

As well, under Trump's presidency, we will have to watch how much fiscal spending is increased, which could spur growth, and therefore steepen the yield curve. Trump has been very critical of the U.S. Federal Reserve (Fed) and how they are not meeting standards. If he decides to have it audited, and force changes at the Fed, this may also unnerve markets about the uncertain future of U.S. monetary policy direction and leadership.

Impact on Canada

(CIBC Asset Management - SC)

The Trump victory raises more questions than answers. Uncertainty about the future equates to a higher level of volatility. We expect that the market will initially react negatively to this outcome. The outcome of initiatives like potentially re-negotiating the North American Free Trade Agreement would have a potential negative impact for the Canadian economy. However, we note that most of the rhetoric on trade agreements related to lost jobs in America. It would be our expectation that Mexico could be more in the crosshairs of these discussions than Canada.

The Canadian stock market will not be immune to the U.S. market reaction—especially given that we remain strong trading partners. The Canadian government and the Bank of Canada will stand ready with a policy response to bridge a potential impact as a result of uncertainty. We see concern around many government policies translating into a higher level of market volatility until a clearer picture emerges. Trump has also conveyed a view relating to current Fed policy— this remains an important risk element not just for Canada, but for all global central banks and markets to absorb.

Bond market impact – winners and losers

(CIBC Asset Management - JW)

The bond market was reasonably priced going into the election, so now the markets will adjust to the outcome. The additional entitlement, defense, and infrastructure spending, if enacted, would likely ultimately increase U.S. Treasury bond issuance. This higher issuance would tend to cause longer-term yields to rise more than shorter-term yields since the Fed has been adjusting monetary policy at a very slow pace. And the shape of the yield curve would likely steepen. Congressional gridlock would be a better outcome from the standpoint of the bond market, as there would be fewer forces at play to increase yields.

Some sectors of the corporate bond market will likely do better than others. For example, the oil and gas sector will likely outperform alternative energy sectors such as wind and solar. The banking and healthcare sectors will face uncertainty due to changing regulations. Construction and defense contractors should benefit from more spending. Greater protectionism will hurt exporters, but the extent will depend on whether other countries retaliate.

Boost for global infrastructure

(RARE)

Trump's infrastructure pledge involves US$500 billion of spending, financed through the issuance of new debt, although he is yet to articulate specific details around the use of the proposed funding.

The Trump campaign has not yet targeted specific policies that directly impact electric utilities. However, the campaign has emphasized support for traditional fossil fuel infrastructure.* This may benefit utilities that have coal and fossil fuel generation fleets.

The value of infrastructure assets depends on economic growth, interest rates and inflation. It is anticipated that the proposed infrastructure spending of a Trump win amounts to an additional 0.5% boost to U.S. Gross Domestic Product (GDP).

Trump's policies, due to their lack of clarity and transparency, could lead to greater uncertainty and volatility in the financial markets. As such, it is difficult to accurately price in the impact of a Trump win. For instance, Trump's trade plans, which involve imposing trade tariffs of 45% on China, 35% on Mexico and amendments to the North American Free Trade Agreement, could lead to a recession.

Strategic portfolio shifts

(CIBC Asset Management - LD)

Overall, we continue to advise a more balanced approach to clients' portfolios until some of these uncertainties can be clarified. We recently marginally reduced our exposure to equity markets in general and the U.S. market in particular. This strategic shift represented our assessment that equity markets were becoming expensive. In addition, economic and political uncertainty, not only in the U.S. but also in Europe following the Brexit outcome, was growing at a time when central bank policymakers were running out of policy tools.

What could impact markets next?

(CIBC Asset Management - JW)

Janet Yellen's position as Fed Chair looks tenuous with Trump. So a new element of uncertainty has been introduced for investors with the election results. But once the fireworks from this surprise outcome are over, the market attention shifts to the Fed meeting and the Italian referendum in December, which could generate additional market volatility. Fasten your seatbelts; we could be in for some turbulence.

Trump victory	
Broad political / policy implications	• Corporate and individual tax reform that simplifies the tax code and lowers rates • Increase protectionist measures such as higher tariffs and import restrictions • Regulatory reform (financial and health care) • Possible entitlement reform
Initiatives with higher likelihood of enactment (bipartisan support)	• Higher defense and infrastructure spending
Initiatives with lower likelihood of enactment	• Negatives for EM, especially those countries which have benefitted from the structural rise in free trade (e.g. Mexico)
Potential market implications	• Initial risk-off movement driven by uncertainty over Trump's governing style • Fiscal stimulus even at a time when the U.S. is at/near full employment • Higher inflation through imported goods • Question marks over U.S. "willingness to pay" given Trump comments and history of selective defaults

Source: Wellington Management

Wellington Management Company LLP is a SEC-registered investment advisor and independent and unaffiliated investment manager to CIBC.

DoubleLine® is a registered trademark of DoubleLine Capital LP.

[1] The Dodd-Frank Wall Street Reform and Consumer Protection Act is U.S. federal law that places regulation of the financial industry in the hands of government.

[2] Glass-Steagall is a U.S. banking act that prohibits commercial banks from engaging in the investment business.

* John Carney (2016). Donald Trump Proposes $550 Billion in New Government Debt.
http://blogs.wsj.com/moneybeat/2016/08/02/donald-trump-proposes-550-billion-in-new-government-debt/

"For use in consultation with your Financial Advisor"

741