# Trumponomics: Analyzing what a Trump win means for markets

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## Fooled by the election polls

Similar to how Brexit went from an unlikely scenario to grim reality overnight, investors once again found themselves in a world heading in the opposite direction of what election polls had predicted. On the 8th of November, Donald Trump emerged victorious while Hillary Clinton joined Al Gore in the history books of having lost the presidential election while holding the majority votes. Despite this, markets reacted more positively than expected as major U.S indices reached all time highs and the U.S Dollar flexed its muscles against other major currencies. We've also seen a broad sell-off in the government bond market, surge in inflation expectations (bottom right chart showing US 5Y5Y forward inflation expectation rate) and gold unexpectedly falling to new lows. Now what exactly is fueling this reaction and what are we to expect come 2017?

The nature of Trumponomics can be characterized by protectionism, tax cuts and large-scale Fiscal stimulus. We will begin the analysis with a lay-out of Trump's expected policy implementations followed by our view on how the Fixed Income, FX and Commodity markets will react.

## Expected Policy Implementations

### Trade Policy

Trumponomic protectionism can be summarized to three main actions: Firstly, Trump advocates to renegotiate or withdraw from the two decade old North Atlantic Free Trade Agreement, NAFTA. While he has stated his disgust for the current state of the trade agreement, we find that complete withdrawal is unlikely, since Trump is forced to battle congress in the matter. The second trade agreement to fall victim to Trump's agenda is the Trans-Pacific Partnership, TPP. The newly elected president has expressed clear intent to fully withdraw from the partnership on his very first day in office and has the mandate to execute this without congressional support. Third, Trump has chosen to take on China by labelling the Asian powerhouse as a currency manipulator. He has also declared to implement severe tariffs on imports from China.

### Tax Cuts

In addition to the wide tax cut on personal income, Trumponomics includes a significant decrease in corporate tax, from 35 to 15 percent. The tax plan also creates incentives for U.S corporates with large amounts of cash abroad to bring money back home by repatriating profits with 10% tax.

### Energy Sector

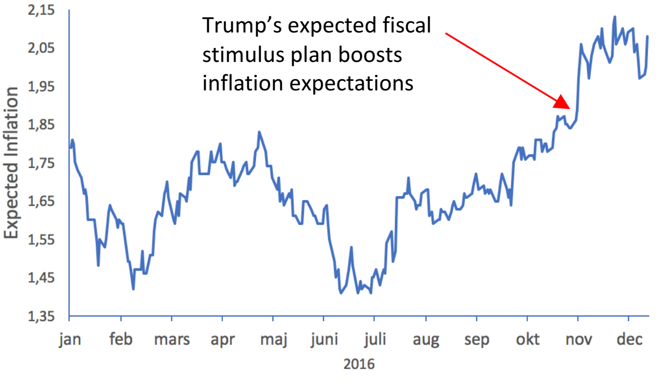
Trump has pledged to remove all "unnecessary regulations" and subsequently "unleash an energy revolution that will bring vast new wealth to America". He has previously stated a desire to cancel the Paris Climate Agreement and withdraw support to the UN global warming program. Even though Trump might have changed his stance on the matter, focus remains directed towards augmenting the domestic fossil fuel market. The first step could be to resume discussions concerning both the Keystone and Dakota pipelines.

### Infrastructure

Trump is committed to pass an ambitious investment plan in infrastructure through congress, covering roads, hospitals and airports amounting to $1 trillion over the coming decade.

### The Federal Reserve

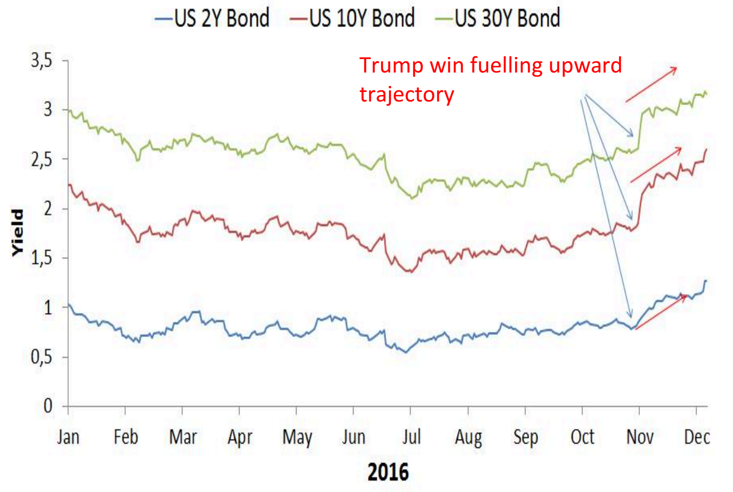
Even though the Federal Reserve is an independent central bank, the President is able to influence its policy through nominations. In the current state, two positions are open for nomination to the Fed Board. A third spot will open as chairman Janet Yellen's position expires in early 2018. Trump has previously stated that he wishes to replace Yellen with a more hawkish candidate.

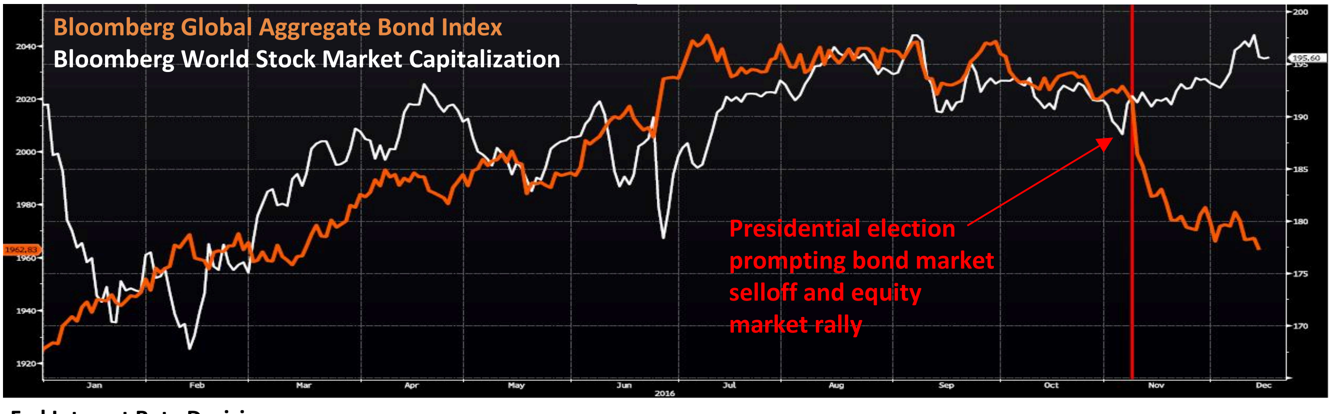



| Policy Action | Primary impact |
|---|---|
| Withdraw or Renegotiate NAFTA | Increased costs for U.S. Businesses having to redirect production chains. Heavy blow to the Mexican economy. |
| Withdraw from TPP | Negative impact on emerging markets. |
| Tariff on imported Chinese Goods | Increased costs for U.S. Businesses having to redirect production chains. Potential costs of a trade war. |
| Domestic Tax Cuts | Boost to U.S. growth and inflation. Increase in national debt. |
| $1 Trillion Infrastructure investment | Boost to U.S growth and inflation. Probable increase in commodity prices. Increase in national debt. |
| Replace Janet Yellen in the Federal Reserve | Increased pace of rate hikes. |
| Energy Sector Deregulation | Boost to domestic fossil fuels producers, slight impact on oil prices. |

**Fixed-Income Market**

The large-scale selloff of government bonds continued in the wake of trumps victory on November 8th, accelerating a trend that began just before the election. Donald Trump's win could also be described as a $2 trillion shock, which is roughly the amount eroded from the bond market since the election, largely due to increased inflation expectations. The yield on US 2, 10 and 30 year notes are up significantly since the election and the upward trajectory seems to be sustainable for the foreseeable future. Considering the improving growth prospects of the United States and fiscal expansion on the horizon, we firmly expect interest rates in the U.S. continue reflecting this reflationary dynamic in the short-medium term, meaning yields continuing their upward path. Rising inflation is also paving the way for money from the bond market making it's way into the stock market as can be seen below.



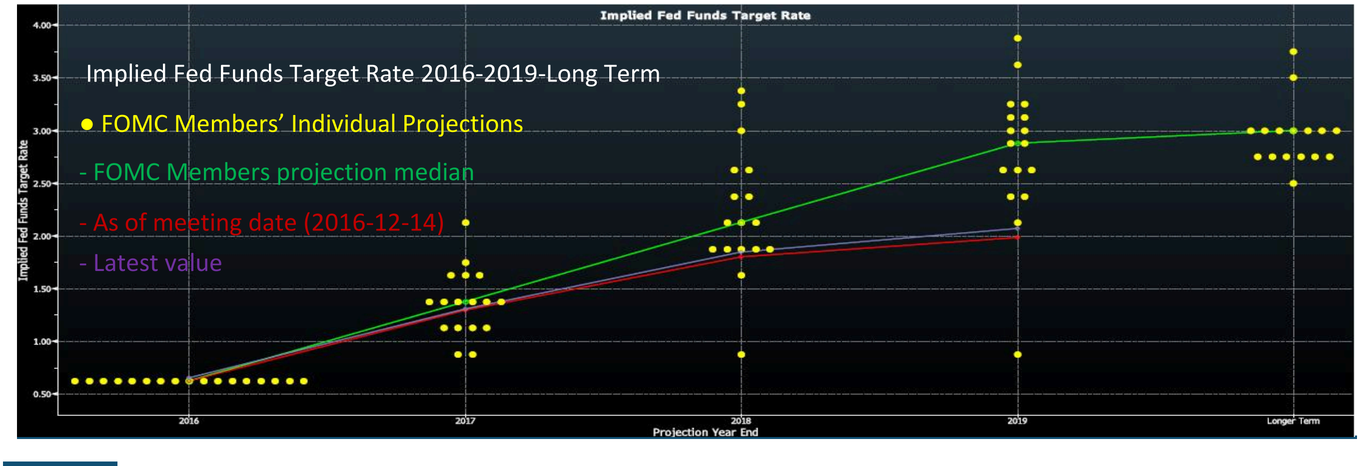




**Fed Interest Rate Decision**

The FED decided to raise the federal funds rate by 25 basis points, which was in line with expectations. The market seemed to have priced in this rate hike but the Fed's outlook for 2017 was something of a surprise. The median estimate from FOMC expects three rate hikes in 2017 compared to the previous estimate of two. We believe this shift is a product of the expected fiscal expansion from the Trump administration. Markets seem to have reacted to the more hawkish view from the FED as bond prices continued to fall, equity markets took a slight hit and the dollar continued to strengthen. The decision by the FED is seen by us as a sign of improvement in terms of growth, unemployment and inflation in the United States. Baring this in mind, we don't see rapid movements upward for bond yields in 2017. The long-term goal of the FED besides their 2% inflation goal is a 3% long-term Fed funds rate as seen below in the implied Fed fund target rate chart.

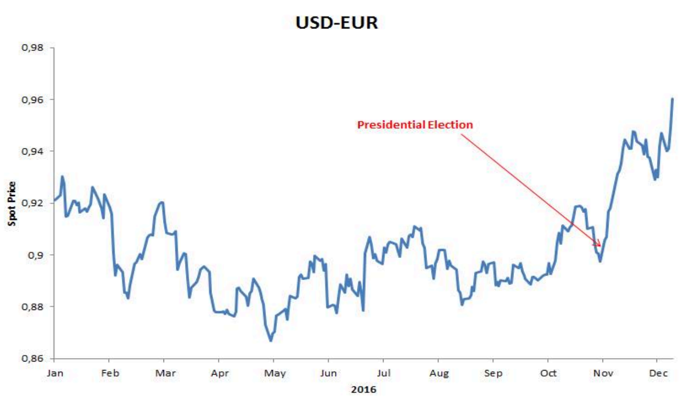
**Who are the Winners and Losers of The Bond Selloff?**

This question obviously depends on who you ask but for those who rely on fixed-income assets for what the name entails: A fixed source of income over time, this rally couldn't have come at a better time. Banks could see their Net Interest Margins (NIM) improving as billions in extra income due to the higher rates will become available. The ones who most likely will emerge as the big winners after largely being left behind in the cheap money era are savers, who may finally see interest they get from Treasuries rise after several years of declines. Yields on U.S. 30-year treasury bonds have risen since the election as can be seen in top right corner chart. The bond selloff will obviously be bad news for investors holding long-duration bonds, as their investments lose value. Increased inflation will also erode the value of future coupons.



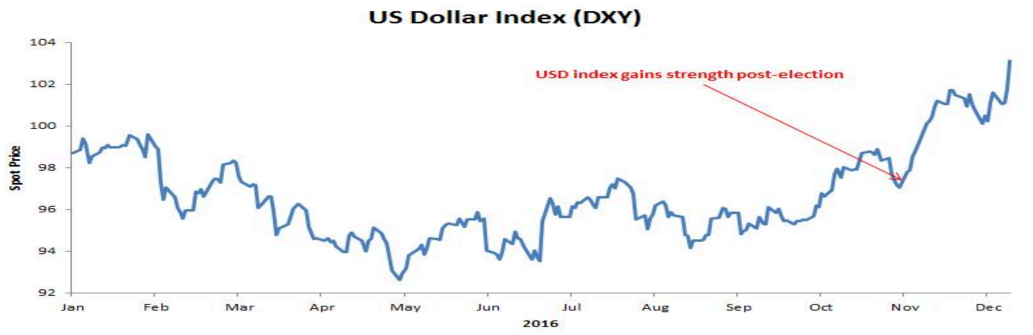
**Protectionist trade view weighing on trade partners and EM**

When Donald Trump was announced as the winner on election night, many investors foresaw the NAFTA deal potentially collapsing, which sent the Canadian Dollar and the Mexican Peso (especially) tumbling against the US Dollar. The immense move in the Peso seems to be more idiosyncratic, but it remains clear that the major trading partners of the U.S. should remain cautious given Trump's protectionist stance on trade. Trump has also suggested that he intends to impose tariffs on goods imported from China and label them currency manipulators, which has seen the U.S. dollar strengthen by roughly 2,5% against the Renminbi since the election. Trumps rhetoric can be seen as a psychological negotiation tactic but investors should keep a close eye on how the trade situation evolves. The potential withdrawal of the United States from the Trans-Pacific Partnership (TPP) could potentially lead to an economic shock to the nations involved. The new era of dollar-dominance in 2017 will spell bad news for some of the worlds developing economies, which are usually more susceptible to negative externalities. The vulnerability of emerging markets are twofold; capital outflows as a result of higher U.S. interest rates and Trumps protectionist trade view weighing on economic growth for countries highly dependent on the U.S. markets. Policy uncertainty has historically also affected Emerging Market currencies negatively and considering Trumps determination to withdraw from various trade agreements, we see Emerging Market Currencies struggling, at least in the first quarter of 2017.

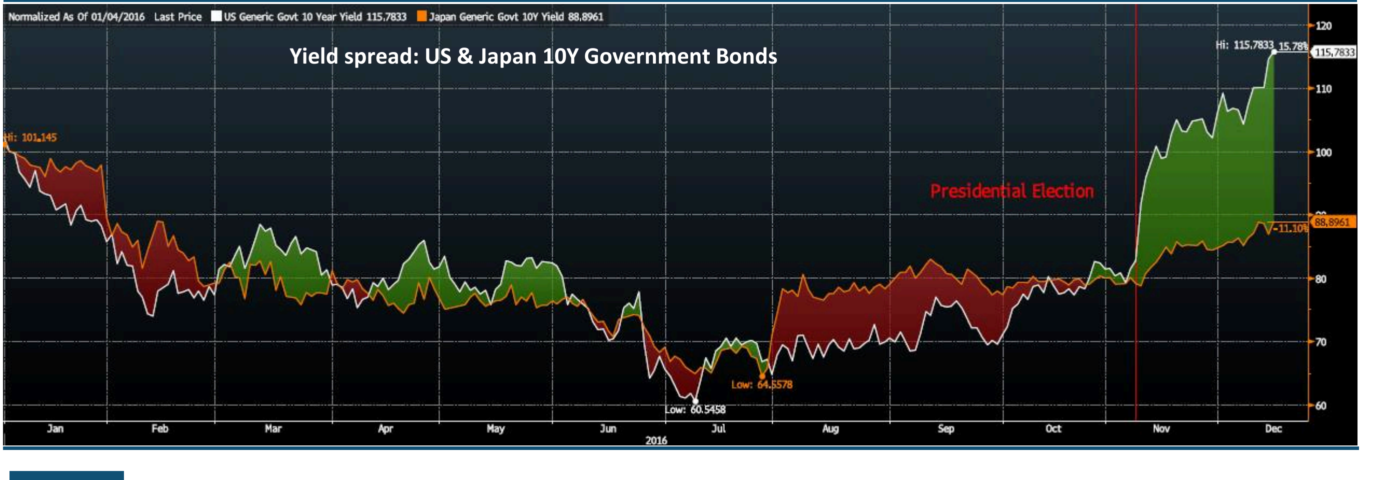



**Global monetary policy divergence seen strengthening USD**

The continued divergence in global monetary policy will help keep the USD at strong levels against other low-yielding currencies. The easiest place to find potential for further divergence is between the Federal Reserve and the Bank of Japan, especially if the FED will look to hike interest rates multiple times in 2017 coupled with the BOJ's insistence on fixing their 10 year yield at 0 percent. Since the election, the spread between the US and Japanese 10 year government bonds has widened by about 250 basis points, as depicted in the bottom figure. This has been a major reason for greenback strength against the yen. If the spread between these two securities continue to rise, it will surely be indicative of this currency pair persistenting it's upward trend. In addition to the yen, the price of the dollar against the Euro has risen to 2016 highs amidst the U.S. election and continued political uncertainty in the Eurozone.




The Euro may be undermined amid concern that the result in the Italian referendum could raise anti-EU sentiment and put pressure on the domestic banking sector. The divergence in U.S.-Europe Monetary Policy will likely put downward pressure on the Euro as the ECB opted to continue its Quantitative Easing program (albeit at a lower pace). This will make sure interest rates are kept lower for longer in the Eurozone as Draghi pledges to do what's needed to reach the 2% price stability target. The increase in U.S. inflation should force the FED to tighten at a faster pace, paving the way for investors to carry on buying U.S. Dollars against the Euro in the short-medium term. Moving forward, we are keeping an eye on the major elections in Europe i.e. France, Germany and the Netherlands as we believe that political risk will continue to weigh on the Euro. We see this currency as highly event driven in 2017 and outcomes of the elections will be crucial to how this currency pair develops next year. Bad election results i.e. Eurosceptic parties gaining power could see USD-EUR reach parity. The figure to the left shows how the USD has performed against the Euro year to date.



**Gold - In contrary to popular belief**

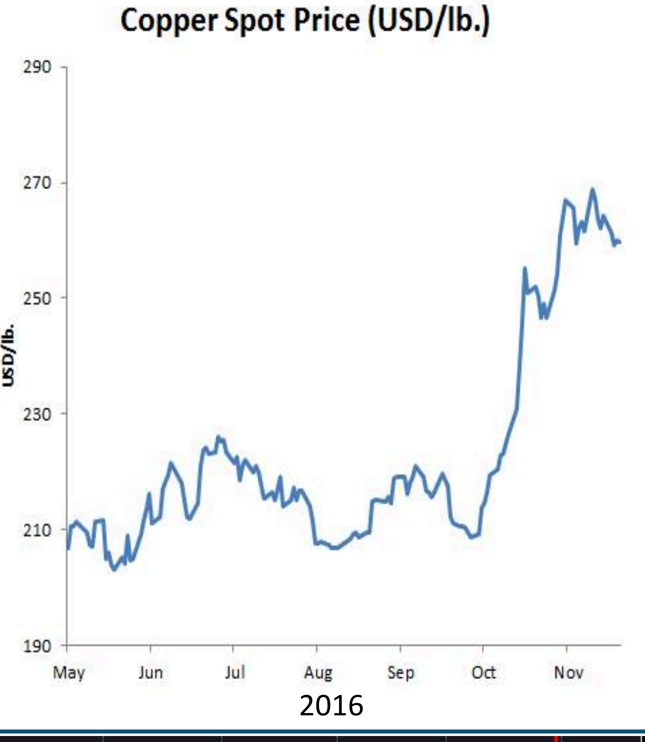
Most analysts (including us) predicted that a victory for trump on Election Day would be excellent for Gold but what actually transpired was the opposite. Since the election, we have witnessed a dollar rally and higher interest rates, which usually translates into a bearish outlook for the precious metal. The safe-haven asset is denominated in dollars and struggles to compete with yield-bearing assets when borrowing costs rise. Considering the upward trajectory of yields in 2017, a rally in U.S. equities and high correlation between government bonds and gold (figure below), the short-medium term outlook for the commodity is a bearish one in our view.

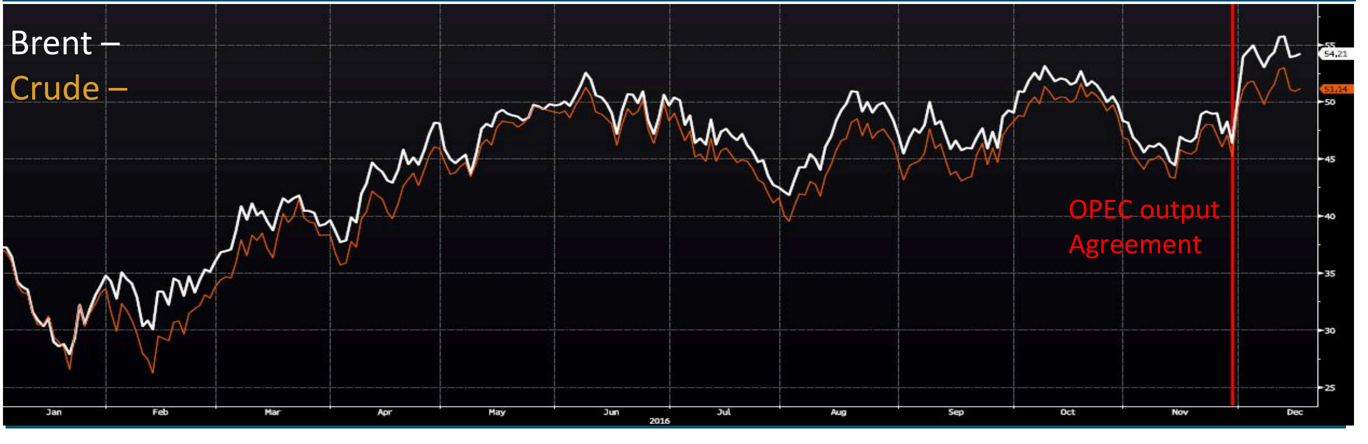

**Increase in US oil production but OPEC deal still main focus**

Trump's intentions to deregulate the domestic energy sector coupled with the price of oil rising of late should lead to US oil production becoming more profitable, thus increasing US oil production. Even though this should have a negative impact on the price oil, our opinion is that the price is more reliant on an OPEC output deal than anything else. Considering that an OPEC production agreement has historically proven to be a hard task, we see Brent and Crude prices continuing their volatile trend in 2017, hovering around 55-60 dollars. We also believe that uncertainty surrounding what Trump manages to push through congress adding more volatility to the oil market.

**Copper rally could be offset by slowing demand in China**

Copper began its upward trend before the election as both Trump and Clinton promised to invest heavily in American infrastructure. "Rebuild the country's infrastructure; nobody can do that like me, believe me" was Trump's rhetoric during his election campaign. Copper investors are certainly hoping that his hefty plans to rebuild the nation pass through congress as enormous amounts of copper and other industrial metals will be used. However, China dictates much of the future of copper as the Chinese construction sector constitutes close to 10% of global demand. Recent data points towards lower infrastructure spending in China in the coming year, which leaves us neutral to copper in the near future.



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