Comment on US elections

On 20 January 2017, the Republican Donald Trump will assume office as President of the United States. As expected, congress remains under Republican control. The Democrats hoped until the very end to at least reach a majority in the Senate, but here too, the "Grand Old Party" prevailed. The financial markets were betting on a first female President and were consequently under shock the morning after.

Trump's political agenda

The election result generates high uncertainty. Trump's populist statements and his erratic behaviour during the campaign only leave room for fragmentary conclusions as regards the future political agenda. Within the system of "checks and balances", the President has to work closely together with Congress on many issues. Congress enacts laws and decrees tax as well as spending policies. The Republican controlled House of Representatives is eager to keep the budget under control and may therefore cut back certain fiscal expansion plans. Within the domain of foreign and trade policy, the president enjoys ample room for manoeuvre. Trump's statements on foreign policy and on the NATO alliance suggest that transatlantic relations may undergo a stress test. The NAFTA as well as WTO agreements are being questioned. In particular, imports from low-wage economies are bound to be restricted. In the domain of domestic policy, Obamacare should be abolished and Trump wants to reverse efforts done in environmental policies. Due to these uncertainties, it remains to be seen if the Fed will indeed lift rates in December. This largely depends on how fast financial markets will be able to recover and on how volatile the environment presents itself until then.

Consequences for the economic outlook

The most certain building block for the short and midterm economic scenario is the increase of infrastructure spending. A higher contribution of fiscal spending to overall GDP growth is certain. However, the financing of these investments remains vague, especially so since tax cuts for corporates were promised at the same time. Despite being under control of Congress, the budget deficit is bound to increase. Trump's protectionist attitude puts a strain on trend growth und should lead to higher inflation. Moreover, trading partners around the globe will be negatively impacted as well.

Reactions on financial markets

The mexican Peso, which served as an indicator for Trump's chances to win, depreciated temporarily by more than 13% against the US Dollar. There were clear losses in equity markets (see figure 4). Yields on 10-year government bonds in the US and Europe declined temporarily by a few basis points. The US Dollar depreciated against major currencies. The world economy depends strongly on the US and free trade. Therefore and in contrast to the aftermath of the Brexit vote, we foresee a longer lasting impact on the world economy. In the short-term, we expect a high level of uncertainty and volatility for a broad spectrum of asset classes. Over the medium-term, yields and equity indices of the developed world should recover somewhat. However, for emerging economies and commodity markets we expect a stronger and longer lasting impact.

Swiss Life Asset Managers is prepared for high volatility

We went into the US election with a close to neutral positioning in terms of credit and duration risk. Although we anticipate credit spreads to widen slightly in the coming weeks, we expect the election outcome and subsequent market reactions to only have limited impact on relative performance of our fixed income funds and mandates. The same holds true for our high yield portfolios. In our diversified funds and mandates we kept a rather neutral equity weight. At the same time, we increased allocation into equity strategies which reduce volatility and down-side risk. This provided us with a buffer heading into nervous markets. The portfolio construction of our equity funds is also geared towards reducing market risk systematically. Over the coming weeks we expect that equity markets will recover again as investors who hoarded cash over past months use the market correction as an entry point.

Copy deadline: November 9, 2016
12:00 am for text and 3:00 pm for charts

Figure 1: Mexican Peso falls back to lows of September

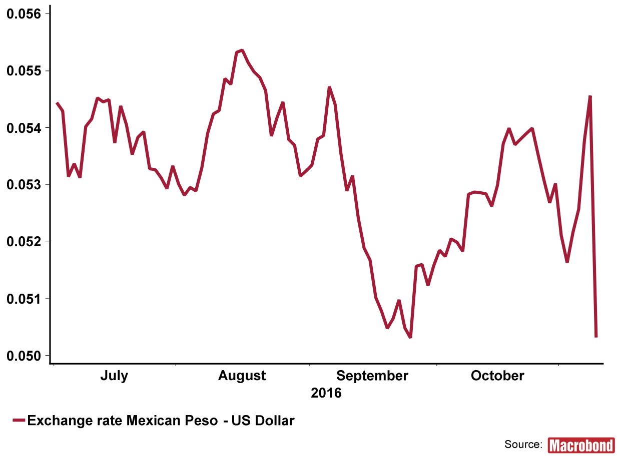


Figure 2: US Dollar depreciates somewhat versus Euro

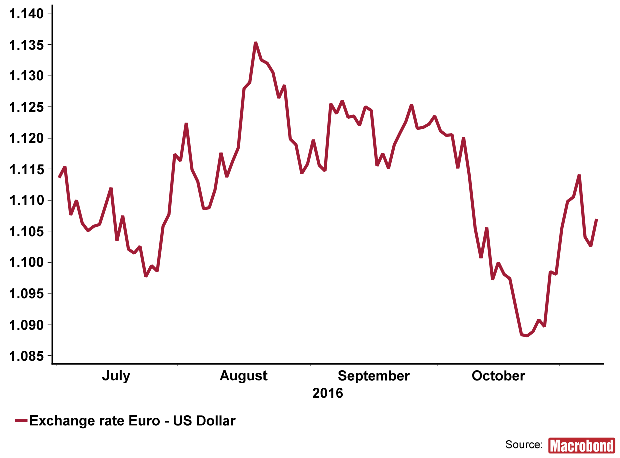


Figure 3: Have equities signalled a Trump win?

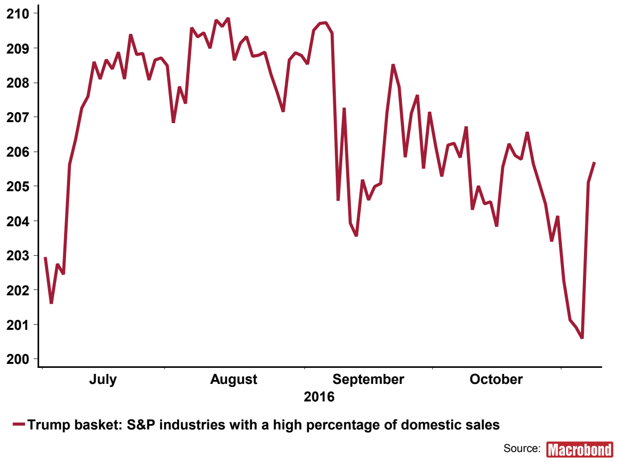


Figure 4: Reactions on equity markets (8.11.2016=100)

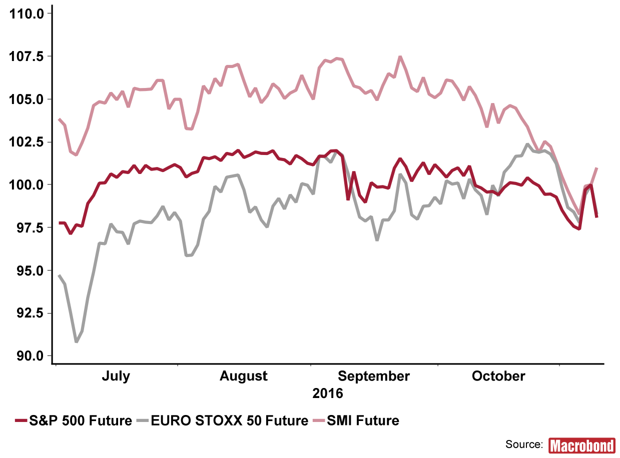


Figure 5: Will the Fed hike rates in December?

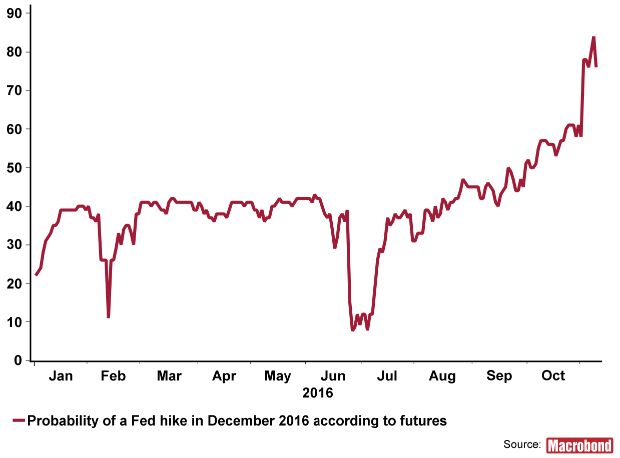
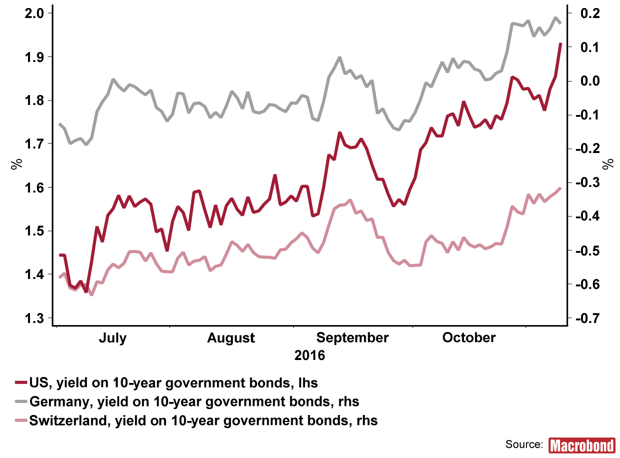


Figure 6: Upward trend of yields continued for now



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