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Comments from 1st Global After the Election of Donald Trump As President-Elect

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The following was compiled from several sources as well as thoughts and insights from 1st Global.

U.S. and European stock markets were up sharply (1–to–2 percent) in mid-day trading Wednesday, a far cry from the tumult that engulfed global markets overnight after news trickled in of a surprise victory by Donald Trump in the U.S. presidential election. In addition, Republicans maintained control over both houses of Congress. According to Laffer Associates, Republicans will control every major position of political power in the government, including the presidency, the Senate, the House, state governors, state legislatures, justices of the U.S. Supreme Court and the chairman of the Federal Reserve.

Polls, bookmakers and forecasters had consistently pointed to a narrow victory for Democratic candidate Hillary Clinton, and markets had moved on those assessments. For many traders, it was a reprise of the Brexit vote in late June.

The initial shock of Trump's shocking Electoral College win caused a wave of uncertainty, and future markets trading overnight predicted sharp sell-offs of 4–5 percent when markets would open. However, a soothing acceptance speech by President-Elect Trump around 2 a.m. Central Time overnight seemed to calm the markets. Although Asian stock markets (which were already trading when the news broke of Trump's win) did sell off to the tune of 3–5 percent, it is likely that these sell-offs will be corrected when these markets digest the calmer environment of today.

After Mr. Trump's gracious victory speech, the dollar recovered its steep losses, gold shed some gains, and the sharp slides that had come as his electoral-vote tally mounted overnight receded. Interest rates rose substantially Wednesday morning, with the yield on the U.S. 10-year Treasury note backing up to around 2 percent and the 30-year Treasury bond's yield rising to 2.8 percent. This could be a potential drag on economic activity in terms of higher borrowing rates and tightening financial conditions. Higher rates are also an expectation of looser fiscal policy under a Trump administration. In the U.S., health care stocks emerged as winners, given the likelihood of significant changes to the Affordable Care Act under a new Trump administration.

This morning, bank stocks rose, given the potential for a break in the harsh regulatory environment under Trump and the rise in interest rates, which would help financial institution's profit margin. The tightening of financial conditions and rise in uncertainty following the election lower the prospects for a federal funds rate increase in December. However, a lot will depend on how markets digest the news over the coming days and weeks. Given strong support among Federal Reserve officials for a rate increase prior to the election, a hike still looks slightly more likely than not. The case for tightening would strengthen if market conditions were to stabilize. The consequences of a Trump presidency on the structure of the Federal Reserve may be even more important for the longer-run outlook. President-elect Trump will have an unusual degree of influence over the composition of the Fed's Board of Governors due to current vacancies and expiring terms. At this point, it is unclear whether he would prefer officials in favor of tighter policy or appointments more amenable to supporting growth.

It is well-known that Trump's unexpected victory brings with it a great deal of policy uncertainty, given his lack of specificity during the presidential campaign. Judging by the tone of his campaign, one can surmise that foreign trade will likely be a major focus of the new administration. It is quite unlikely that the Trans-Pacific Partnership will be ratified against the present backdrop, while the North American Free Trade Agreement (NAFTA) could be renegotiated or even abandoned. Uncertainty over immigration policy is likely in the near term, which could potentially impact labor markets. Trump's focus on trade during the campaign and the risk that NAFTA might be revisited could pressure the currencies of two of America's largest trading partners, Mexico and Canada. Additionally, emerging market currencies will likely be pressured, because any additional U.S. trade barriers would probably further slow the growth of global trade, which could negatively impact both producers of raw materials and of finished goods.

If the U.S. puts trade barriers in place on imports, U.S. exporters may be hurt as a result of trade partners retaliating against U.S. actions. With roughly 40 percent of earnings from S&P 500 Index companies earned outside of the U.S., there appear to be risks to U.S.-based multinationals. A full-fledged trade war would be damaging to growth and employment and could have ripple effects beyond U.S. borders. Companies whose businesses are more domestic in nature may fare better against a backdrop of global trade friction. If financial markets have a persistently negative reaction to a Trump victory in the run-up to the December FOMC meeting, odds of an interest rate hike could shrink.

On the campaign trail, Trump vowed to lower taxes and repeal the Medicare tax on investment income. He also promised to repeal the complicated alternative minimum tax and tax carried interest as ordinary income. If Trump's plan is enacted, corporate tax rates would be reduced to 15 percent from 35 percent, and repatriated foreign profits would be taxed at a one-time rate of 10 percent. Economists, however, question whether this package would spur enough economic growth to offset lost revenue from lower tax rates, which could widen fiscal deficits.

Sectors that may be advantaged under a Trump presidency include the following:

Energy

Trump repeatedly promoted U.S. energy independence during the campaign, calling for leasing federal land for energy exploration, repealing some regulations on coal and reviving the Keystone XL pipeline project. Trump will likely be friendlier to new oil drilling and pipelines and good for the oil and gas industry.

Pharmaceuticals

Price controls will be less of a concern for the industry than they would have been under a Clinton presidency.

Financials

Trump has called for repealing or significantly revising Dodd-Frank. Regulatory burdens could be reduced across the economy, based on his campaign rhetoric.

Given the political ebbs and flows of recent decades, it is reasonable to expect Republicans to try to pack as much policy change into the first two years of a Trump presidency as possible, much as Democrats did in the first two years of the Obama administration. Possible immediate executive actions include dismantling the Iran nuclear deal, withdrawing from the Paris climate accords and reviewing U.S. relations with Russia concerning Syria.

On the fiscal front, a Trump administration will likely pursue looser fiscal policy. This could be worth around 0.75 percent of GDP, with roughly 0.5 percent of that amount coming through tax cuts and 0.25 percent through additional spending on infrastructure and defense. Control of Congress will allow the Republicans to use the "reconciliation" process to pass fiscal legislation with a simple majority. However, they will still face some constraints, namely the need to secure the support of nearly all Republicans in the Senate, some of whom may have qualms about raising the deficit, and the juxtaposition of passing deficit-increasing legislation shortly before a vote to raise the debt limit, which will be necessary by the fourth quarter of 2017. We note that whatever fiscal policy changes are enacted would probably not take effect until at least mid-2017.

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Sources

Goldman Sachs Research (Jan Hatzius, Zach Pandi), Laffer Associates (Stephen Moore), Nataxis Global Asset Management (David Lafferty), MFS Investment Management (Eric Weisman).

The S&P 500 Index is a free-float market capitalization index of 500 large publicly held U.S.-based companies, capturing 75-percent coverage of U.S. equities. It is often used as a proxy for the American stock market.

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