



CIO Flash

The U.S. elections

Hold your nerves

Republicans on track to win it all

In the end, it was quite a nail-biter. Votes continue to be counted in several states. Donald Trump has already won a majority in the Electoral College. In all likelihood Republicans will also retain a clear majority in the House of Representatives and a narrow one in the Senate.

Market implications

Donald Trump's victory has stunned financial markets. Equity markets in Europe and Asia have moved down sharply on the news. For the S&P 500 Index, futures point to an opening 4% below yesterday's closing.

In currency markets, the Japanese yen has been strengthening against all major currencies, reflecting its perceived safe-haven appeal. The Mexican peso is down 10% against the U.S. dollar. There could be turbulent days ahead for emerging markets, in particular, reflecting concerns about the U.S. turning more protectionist. Yields on U.S. Treasuries are down 5 basis points, reflecting the murkier economic outlook. Credit spreads are widening across the board.

In coming days, we expect volatility to remain high, as the full impact of the election results sinks in. In part this reflects policy uncertainty of a magnitude arguably unprecedented in recent U.S. history. In addition to trade policy, we would expect the following areas to come under particular scrutiny:

- **Fiscal policy:** Congress will probably make it hard for Mr. Trump to make good on his extravagant campaign promises. Taken at face value, however, Mr. Trump's plans for lower taxes and higher spending would amount to a massive fiscal stimulus, at a time when the U.S. is already close to full employment. If enacted at anywhere near the scale indicated during the campaign, the effects would be higher economic growth in the short term, eventually leading to higher inflation and higher interest rates. The relative calm in Treasuries markets could prove short-lived.
- **Monetary policy:** The chances of the U.S. Federal Reserve (Fed) raising interest rates in December would recede, if market turmoil continues. Less reassuringly, there is now significant uncertainty about the future composition of the Fed board, not to mention closer congressional oversight potentially limiting the central bank's scope for maneuver during the next downturn.
- **Headline risks:** Mr. Trump is a political newcomer. On many of the specialized topics of concern from the perspective of a

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Expectations in a nutshell

- Donald Trump's victory stuns financial markets.
- Both volatility and underlying policy uncertainty are up.
- Looking beyond the immediate hubbub, the outlook may not be that gloomy.

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particular sector or company, his views are hard to divine. It also remains fairly unclear who he will appoint for key positions and who he will turn to for advice.

These are legitimate concerns. And yet:

The outlook may not be that gloomy

Historically, markets have tended to applaud Republican success at the ballot box. With Republicans in control, you would usually expect a lighter touch on regulation, swift progress on corporate-tax reform, and across-the-board tax cuts. On all these issues, Mr. Trump's stated positions line up with those of Republican leadership in Congress. The end result may well be prioritizing a more-or-less conventional Republican agenda over economically detrimental campaign promises in areas such as trade and immigration. Indeed, Mr. Trump himself stated in May:

"Look, anything I say right now – I'm not the President. Everything is a suggestion. (...) I am totally flexible on very, very many issues, and I think you have to be that way."¹

Mr. Trump has just won the U.S. Presidency, having never previously run for office. He is clearly a quick learner. Do not underestimate his capacity of turning his latest endeavor into a success. His uneven performance on the campaign trail suggests that today's market reaction may not be the last time that politics causes jitters on Wall Street. In weeks to come, they may also create solid buying opportunities for disciplined investors willing to look beyond the immediate risks.

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¹ Johnson, Jenna, "Trump: All policy proposals are just flexible suggestions", The Washington Post, 5/13/16



Glossary

Republicans

The Republican Party (Republicans), also referred to as Grand Old Party (GOP), is one of the two major political parties in the United States. It is generally to the right of its main rival, the Democratic Party.

House of Representatives

The United States House of Representatives is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each state's representation is based on population as measured in the previous Census.

United States Senate

The United States Senate is a legislative chamber consisting of 100 Senators, with each state being represented by two Senators. Senators are elected for six year, overlapping terms in their respective state.

S&P 500 Index

The S&P 500 Index includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Futures contract

A futures contract is a standardized, contractual agreement to trade a financial instrument or commodity at a pre-determined price in the future.

Emerging markets (EM)

Emerging markets (EM) are economies not yet fully developed in terms of, amongst others, market efficiency and liquidity.

Spread

The spread is the difference between the quoted rates of return on two different investments, usually of different credit quality.

Volatility

Volatility is the degree of variation of a trading-price series over time.

U.S. Federal Reserve (Fed)

The U.S. Federal Reserve often referred to as "the Fed" is the central bank of the United States.

United States Congress

The United States Congress is the legislature of the federal government. It is comprised of the Senate and the House

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of Representative, consisting of 435 Representatives and 100 Senators.

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