

TRUMP CARD ON MARKETS



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This unprecedented presidential race has finally come to an end and, once again, the anti-establishment vote has been underestimated by polls, journalists and analysts as the winner is Donald Trump. The first thing that comes to our mind is 'hope for the best, but prepare for the worst', as the campaign has provided many evidences Trump could be a terrible president.

His victory, to an extent, is also the symbol of current political failure to address key socio-economic challenges. It clearly has raised uncertainties – at least in the short term – not only about the current economic backdrop, but also in terms of geopolitical developments going forward. As a result, elevated volatility across global markets may prevail for the next few days and probably bring interesting opportunities if assets valuations reach exaggerated depressed levels at some point.

Beyond 2017, with a Republican clean sweep in Congress, will Trump be able to ease investor fears on protectionism, migration and foreign affairs? In other words, will he back away from the extremities of his campaign? And if he could manage that, what about tax reform, infrastructure spending and potentially bigger deficits? The immediate reaction now is to sell risk, especially EM assets, and buy safe-haven assets such as US treasuries and gold. Medium-term, his administration could be characterised by a powerful reflation trade, with a higher bond yields.

In this note, we try to assess how markets could react over the next few days and the trends that may emerge going forward.

Equities

We estimate a downside risk of 5-7% for global equities over the next two or three days. US assets should now trade significantly lower but, as usual, thanks to their defensive nature, they may outperform in relative terms.

The S&P 500 may fall to 2,000 and, in this case, we expect other markets to experience about 10% decline before stabilising. Geographically speaking, EM equities (especially LatAm and Asia) will be among the major losers. Europe, especially Switzerland, and Japan may also experience severe setbacks, especially if currencies tend to get much stronger against the greenback over the next few days (see below regarding forex).

Large multinationals are likely to be hit harder than domestic companies, given Trump's protectionist trade policy agenda. As a result, small caps should outperform large caps on a global scale.

Sector-wise, industrials (infrastructure) may prove more resilient on the back of expectations of large fiscal stimulus, especially with a Republican majority at Congress. Consumer discretionary should be torn between receding fears about the minimum wages hike and new concerns about trade. Same for financials: the good news is that Trump should prove less onerous on regulation, but the future path to rate hikes – especially in case of a very adverse risk-off scenario that could put the Fed on hold till next year – should remain the predominant driver.

Therefore, expect banks to behave relatively well in a benign correction, but to be among the major underperformers in a significant one. This has the potential to reverse the reflation trade rotation into financials and out of defensive yields (utilities, telecom, REITs) ob-

served since August. A relief rally in healthcare seems due, at least in the short term, though drug pricing concerns will not completely disappear. Energy – obviously excluding solar stocks – seems also likely to be a safe haven under Trump's new political regime.

Bonds

A December Fed rate hike is now less certain and, as explained here above, it should bring at least a pause, or a temporary reversal in the 'reflation' trade positioning experienced since the end of the summer. US Treasury yields, as well as other top quality government bond's yields, are expected to fall back at least 20bp. TIPS are expected to underperform in this environment, as well as credit markets, as spreads may get wider. Even if the spread widening appears to be limited at this stage, credit will anyway underperform government bonds.

EM debt, especially in local currency for LatAM ones (see forex below), is now expected to be hit hard, potentially erasing most of the gains posted so far this year.

Forex

This high-volatility environment should benefit the yen, the Swiss franc and may be even the EUR to a lesser extent (EURUSD may test 1.12).

It is clearly devastating news for the Mexican peso and is a bad hit to the Canadian dollar. MXN may now trade much above 20 against USD and remains quite volatile over the next few days. RUB and some Asian currencies, such as INR, should prove somewhat resilient in the EM space.