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Trump's Win: Its Possible Impact To Global Economy And Global Financial Markets

On 9 Nov 2016, to a certain extent surprise to the market, the Republican candidate Donald Trump has won 289 electoral votes and will become the 45th President of the United States.

This was another time (since the UK Referendum) the market was surprised by the election results (although the polls showed Hillary was just 2-3 percentage points ahead of Trump, the lead was not very significant).

As Trump has won the election and will become the President, it is no longer worth discussing why he was elected. It is better to analyze the Trump's ideas and policies to see whether under his leadership, the US economy, the global economy, as well as the global financial markets will be affected and so as to make the appropriate investment changes

Trump's main economic policy

Before we discuss Trump's main economic policy, we would like to state clearly our view on Trump's win. First of all, we do not think that Trump's win will be a disaster to the global financial world. It is not because we think Trump's policy is perfect. It is just because we believe that the US Congress can make checks and balances against him to prevent him from making some radical and destabilizing policies endangering the US economy.

1. "US priority" is the core of Trump's policies. In trade policy, he advocated the re-establishment of foreign trade agreements, such as the North American Free Trade Agreement (existing) and the Trans-Pacific Strategic Economic Partnership Agreement (waiting the final approval from all signed members). It is because he believes that the current trade agreement is unfair to the United States and needs to revise. On the other hand, Trump also favors to apply a significant tariff hike to countries such as Mexico and China, which he says they are exporting large quantities of goods to the United States and take away a lot of American jobs.

We are most worried about the above protectionism. It is because we think that it is only a few Trump's policies that will probably be implemented and will eventually harm the US and the global economy. In fact, we are quite confident that the US Congress will be the ultimate watchdog, checks and balances Trump to prevent him from making some wrong policies. But the results of the election clearly reflect a phenomenon that many Americans are supportive to the protectionism (especially related to trade policy). So if Trump eventually raised the tariffs on imports, we really fear that the Republican lawmakers may not have enough guts to stop it. If Trump finally implemented trade protectionism, it must have a negative impact on the US and the global economy (first of all, we do not believe by increasing tariffs, the US Government can force the US manufacturers to move their production base back to the United States; on the other hand, once the US Government increases tariffs on the imported goods, the relevant exporting country's economy will be damaged and any increase of tariffs on Chinese goods must lead to the retaliation from the Chinese Government. It will increase the risk of having a trade war between these two Superpowers).

2. As for Trump's other disgruntled policies or remarks, such as he proposed not to allow Muslims to enter the United States; asked the Mexican government to pay to establish walls along the US border to prevent Mexicans stowing away to the United States. While the above policies or remarks may be unpleasant or unsettling, we believe that the chance of these policies being implemented will not be too great, or if finally being implemented, it will not cause any significant damage to the US or the global economy.
3. As to his tax policy, he proposed to reduce the US tax rate significantly (reduce the corporate profits tax from

the current 35% to 15%; the top rate for personal income tax from 40% to 25%) in order to increase the competitiveness of the United States. Although there are many economists criticized such a substantial tax cuts will significantly expand the government's fiscal deficit (economists estimate that such a substantial tax cuts may increase the budget deficit by US\$10 trillion in the next decade), and increase the risk of the occurrence of debt crisis. Although the tax cuts may lead to a more serious budget deficit, it will also be able to stimulate the economic growth. As Trump said, he believes that the tax cuts can enhance the US economic growth from the current 2%, with a substantial increase to 4%, or even 5%. Of course, the above projection may be overly optimistic, but it is already be proved that the tax cuts serves the same function of an increase in government spending, can stimulate the economic growth (at least at the very beginning). Therefore, we believe that the investment market will not feel too worried about the possible tax cuts (because the tax cuts at least will have a short-term positive impact to the economy and its negative consequences will be only appeared in long run).

4. Another Trump's policy that may cause panic to the investment market is his immigration policy. He has said that once he becomes the President, he will deport the 11 million illegal immigrants in the United States and tighten the current immigration application process. The expulsion of illegal immigrants has always been a matter of course. But many of these 11 million illegal immigrants are middle-aged and productive. The losses of such labor force will likely lead to harm to the US economic development, especially as the United States is facing the aging problem. However, we believe that even if the policy eventually can be implemented, its impact will be only appeared in long run.
5. Finally, Trump's policy is not totally unpleasant or unsettling. Like Hillary Clinton, he promised to spend aggressively on infrastructure projects after he was elected as President. He expected the Government will spend US\$1 trillion in infrastructure projects for the next 10 years. But where does the money come from? Trump proposed to attract private companies to invest by providing tax incentives. He targets two-thirds of the capital for the infrastructure investment can be raised from the private sector. Of course, it is still unknown how much eventually will be committed to the infrastructure investment; however, even though the ultimate amount committed to the infrastructure investment is less than expected, it is still a positive factor to the economic growth (it will be ridiculous to regard it as a negative factor to the economic growth!).
6. In addition to the US government policy, some investors are also concerned that after Trump becomes the President, he will intervene on the Fed's operation. In the past, Trump has repeatedly expressed his dissatisfaction with the Federal Reserve Board Chairman Janet Yellen. He argued that the Fed has kept the interest rates for too low and too long and it has led to asset bubbles. Therefore, some investors worried that he will fire Yellen, or even forced the Federal Reserve Board to raise the interest rates sharply once he becomes the President. However, we believe that they are over-worried. First of all, Trump has never said that he hates "low interest rates" (on the contrary, he agrees that low interest rates can help economic growth). On the other hand, the real purpose of his criticism to Yellen should be to attack Obama's incapability to the economic recovery (Trump always argued that the economic recovery was only due to the low interest rates maintained by the Fed). Last but not least, the situation has changed significantly after the Trump's win. As being the next President, Trump also needs the Fed's low interest rates to maintain or further stimulate the economic growth. Therefore, we do not see any rationale Trump must do something to against Yellen, or force the Federal Reserve to raise the interest rates substantially!

Conclusion

In inclusion, as we have said earlier, no matter who eventually become the President of the United States, his / her policies will also need to be approved by the Congress before it can be implemented. Therefore, we do not need to be too worried for Trump having any significant negative impact to the US economy, as well as the global economy. It is because even though Trump was elected as the President, we believe that most of his unfavorable policies ultimately may not be implemented (if most US people were against it). It is because the policy will not be approved by the Congress. Therefore, do not need to worry too much about the "Crazy Trump", because Trump also subjects to the Congress checks and balances. Obama is a good example. We are not saying that Obama is a crazy guy. But he has well illustrated that if the President did not have the support from the Congress, he still was not able to do anything! On the other hand, although Trump is a "non-ordinary" politician, but politicians are used to not comply with their commitments. Thus, it is not a surprise to see that Trump to change his views or policies after being the President.

Therefore, for Trump's win, we are most worried about his trade policy. We are afraid that under his leadership, the United States will change to more trade protectionism. If unfortunately, the protectionism eventually leads to a trade war, the global economy as well as the financial markets must be seriously affected.

Finally, apart from the risk from his trade protectionism, Trump's another possible impact to the financial market is that investors may feel that the market's uncertainties will be increased after Trump was selected as the President.

It is because his speeches and his policies advocated have let the public having an impression that it is not easy to predict his action and his policies sometimes tend to be radical. Since most investors hate uncertainties, it is likely that the Trump's win may lead to short-term risk aversion and affect the market momentum. It will eventually lead to a short-term negative impact on the stock market (whether the Trump's win will lead to a medium to long-term decline, it will mainly depend on whether his trade protectionism will lead to trade conflicts or even trade wars with other countries).

As we said earlier, once Trump was elected, the stock market may suffer a 5% short-term decline due to the worry about the increased uncertainty from the Trump's win. Although the decline in the stock market was short-lived (the decline has been significantly narrowed for most Asian stock markets; some of the European stock markets and the US stock markets have even rebounded from the sharp sell-off recorded during the Asian time), but we believe that this does not mean investors do not worry about Trump. We expect that the risk aversion will be increased and the market sentiment will eventually be weakened. This will lead to a correction in the stock market. However, we are not expecting any sharp decline in a medium to long term perspective (such as the 10-15% drop happened in the beginning of this year).

Since we have substantially reduced the equity funds exposure before the election (partly because we expect the stock market will correct from the sharp rebound since Feb 2016; partly because we would like to take profit as we have bought some equity funds during the bottom in February this year). After a deliberate reduction in equity funds exposure, our portfolios now hold 25-40% of non-equity funds or cash. Therefore, we do not mind if the market occur any short-term correction (if so) arising from the increase of uncertainties after the Trump's win. It is because the correction will give us another chance to have bargain hunting. If the market corrects 5-10% from the current level, we will use the existing reserves (bond funds and cash) to increase the equity funds exposure again.

Financial markets were abnormal yesterday

The financial markets' performance in Asian time yesterday was within the reasonable range (the stock market has dropped and the safe-haven asset has increased when Trump was more and more probably to become the President). It is because no matter Trump's policies is good or bad for US or global economy, the market movement has shown in the past that investors were every worried if Trump was elected. They were afraid that Trump's win will lead to more uncertainties to the US and the global economy, as well as the global financial markets. As a result, the stock market will fall and the safe-haven asset will increase. However, the financial markets in Europe and US did not move as expected. The stock markets in Europe and US have increased rather than decreased after the Trump's win (the Dow Jones Industrial Average Index eventually rose 256 points and the German DAX Index rose 163 points). The safe-haven asset, such as the Japanese yen and gold price, has retreated from a sharp rise in the morning (the Japanese yen has sharply increased from 105 to 101 during the Asian session, but eventually returned back to 105 during the US session; the gold price also retreated all its gain [US\$70, more than 5%] recorded during the Asian session).

We would not be surprised if the stock market remained unchanged after the Trump's win. However, we are quite surprised the stock market has increased substantially after the Trump's win. It is because we cannot understand why the Trump's win was suddenly being classified as a positive factor to the stock market. Therefore, we believe that the current market reaction may not be used as a reference. We do not expect the stock market can continue to rise (like to rise 5% more from the current level). We maintain our view that the Trump's win will not be a disaster to the US or the global economy, but in the short term, the Trump's win will increase the uncertainties to the financial market, which will probably make the stock market to occur a short-term correction.

* Unless otherwise stated, all figures and information are collected from WSJ, Bloomberg or Haver Analytics.

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