

AFTER TRUMP?

Surprise!!! To say that Trump's ascension to the Presidency caught the markets off guard would be an understatement.

Consider the overwhelming evidence! Leading up to the election the S&P 500 index experienced nine straight down days. A sell-off directly related to FBI Director James Comey's letter re-opening the Clinton email probe citing possible new evidence that came to light in an unrelated investigation. As the polls tightened, the market sell-off continued.

On the week-end prior to the election, Director Comey sent a follow-up letter to Congress in which he closed the investigation having found nothing in the subsequent email review. Following the election driven script, markets perked up on Monday November 7th and by the close of trading, had erased most of the losses from the previous nine-day swoon.

Then came the shockwave! By midnight Tuesday it became clear that Trump would win. Dow futures fell 800 points in Asian trading. They would have fallen further had circuit breakers not kicked in. Surprisingly, by the time US and Canadian markets opened Wednesday morning, they had recovered most of the overnight losses.

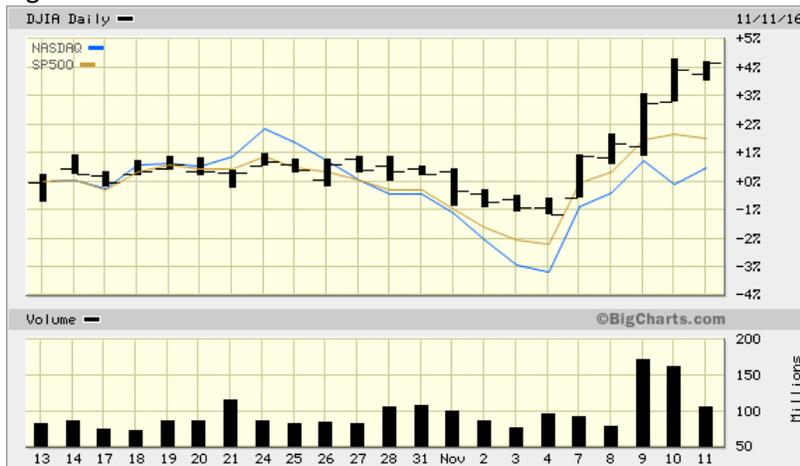
All of which raises so many questions. How could the polls have been so wrong? What caused such a striking recovery in the markets, given the negativity that besieged Trump in the run-up to the election? And of course, what will a Trump Presidency look like?

The question about the failure of polls to accurately gauge sentiment among the US electorate is up for debate. What we know is social media had a much better handle on the pulse of the electorate, which means that the alternative media will play a critical role in future polling. We suspect this trend will be good for Facebook, Twitter and Google; all companies that have not fared well since the election.

In fact, the post-election underperformance of tech companies tells us something about what to expect in the future. For one thing, the so-called Trump upswing looks more like a sector rotation than a broad rally.

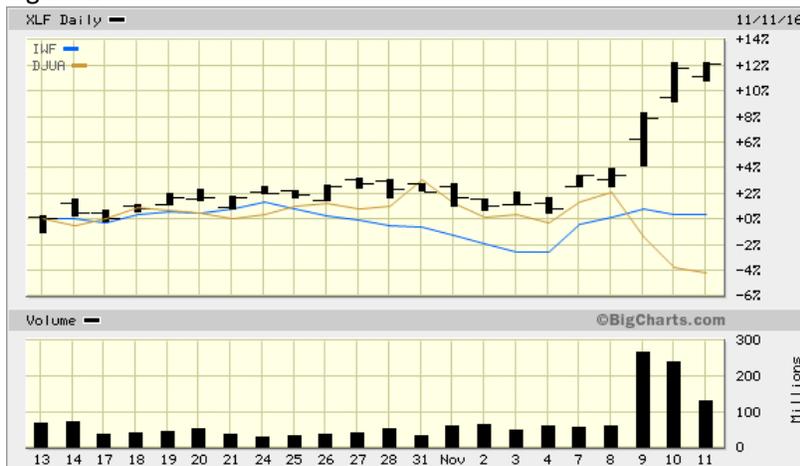
Evidence of this can be found in Figure 1, which compares the performance of the price-weighted Dow Industrial Average, with substantial exposure to financials and health care, to the broader cap-weighted S&P 500 and, more importantly, the tech heavy Nasdaq 100 index.

Figure 1



Further evidence can be found in Figure 2, which compares the US Financial ETF (XLF) to the Technology ETF (IWF) and the Dow Utilities Index (DJUA). The latter has been one of the stronger performers over the past two years as investors focused on dividend paying stocks that played to investors seeking income in a low interest rate environment.

Figure 2



TO THE FUTURE

Having reviewed the activity immediately following the election, what about the future? For insight into that, we need to leave aside for a moment the political backdrop around immigration and international affairs to examine Trump's economic and fiscal policies more closely.

What we know is that Trump intends to repeal much of Obamacare, which should stimulate small business. That would be good for small cap companies that have been hampered by the costs related to the program. More importantly, with Republicans controlling both Congress and the Senate he has the support to make the requisite changes.

In terms of fiscal policy, we know that Trump intends to embark on a mandate to cut taxes, upgrade infrastructure and pare back the harsh regulatory environment. Positions that have widespread support among Republicans.

These initiatives also play directly into the Federal Reserve's playbook. On numerous occasions in testimony before Congress, Fed Chairman Janet Yellen has advocated fiscal stimulus maintaining that the Fed had few remaining tools to invigorate the economy with monetary measures. The infrastructure spending plays directly into that wheelhouse and all but assures a Fed rate hike in December.

Deregulation has implications for a broad swath of corporate America from the environmental impact on the energy sector – notably clean coal and the Keystone pipeline – to pharmaceutical companies which have been weighed down by Obamacare and Congressional oversight.

Most importantly deregulation is relevant to the banking sector which by all accounts has been hampered by excess regulation since the financial crisis. Talk about a perfect storm for US banks. Higher interest rates will improve margins less regulation will make it easier to lend and fiscal stimulus will create more demand for loans.

The reaction in the financial sector has been swift. To the point that some analysts think US banks have already priced in much of the potential upside. We don't agree. While there may be some short-term pullback, we think longer term, there is more to come – particularly if the fiscal stimulus has the intended impact to loan demand.

Initially tech companies and the auto industry have been weighed down under the perception that US jobs have been lost because production has been moved off-shore. That's true to a point. However, we think lower corporate taxes and a proposed one-time tax holiday for companies who repatriate off-shore capital will be a net benefit to both industries. In time the market will recognize the benefits and reward these companies with higher share prices.

THE DOWNSIDE

A Trump Presidency is not without risk. Not the least of which is the President Elect's view on trade pacts like NAFTA and the Trans Pacific Partnership Agreement, which is not likely to be approved.

NAFTA is particularly disconcerting for Canada although we think most of the impact will be felt in Mexico. Trump has always said that he is not against free trade; he simply wants fair trade. Given that Canadian costs are in line with those in the US, we suspect that Canada will feel much less impact from any proposed changes, which probably explains the relative stability of the Canadian dollar vis-à-vis the US Greenback.

The wildcard is Trump's personality and how that will play on the world stage. Much depends on whether the personality of President Trump differs from Candidate Trump. On that front we can only hope that he is the man his family says he is rather than the man whose caustic observations and social media rants took center stage during the campaign. We can only hope that Trump's handlers convince him to keep his twitter finger in his pocket.