Eastern Bank
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ON OUR MINDS

The Presidential Election: Now What?

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To quote our President-elect, "Wrong!" Or, as our newest Nobel laureate said, "You don't need a weatherman to know the way the wind blows." Last night's election results defied the polls and made a shambles of most investors' economic and market forecasts. Now comes the hard part, as markets and people begin to sort out the implications of the Republican sweep. Today's wild market action suggests that there's a lot of sorting out ahead of us.

Yet the more things change, the more they stay the same. Investors overnight were focused on a GOP sweep, but awoke this morning to the realization that Democrats retained enough votes in the Senate to ensure that major legislation must carry a 60-vote supermajority to pass. In other words, the system of checks and balances is still intact.

For investors, the most important conclusion is simple: Don't panic! Although many aspects of Trump's platform would be harmful to the economy or to the federal budget if enacted as he originally proposed them, some aspects would ultimately be beneficial. The legislative process and the ever-present influence of lobbyists in Washington make it doubtful that the worst aspects will become law. A few initial thoughts come to mind:

- As an investor, my biggest concern is how Trump and Congress will handle trade policy. A wave of protectionist legislation would constrain global trade, and that could in turn send the U.S. into a recession. Similarly, a major clampdown on immigration would reduce aggregate demand in the U.S., and that too could send the U.S. into a recession.

- Trump's proposed tax cuts are heavily tilted toward the wealthy, but they would provide extra cash for Americans at every income level; this may help to offset the contractionary effects of his trade and immigration policies.

- Trump has promised a massive investment in infrastructure, which may be the only major point on which Democrats and Republicans agree. He might be wise to focus his initial legislative agenda on this topic, hoping for an early success on which to build the more controversial aspects of his Presidency. A big infrastructure bill would likely be welcomed by securities markets.

- Trump's promises to maintain entitlements (mainly Social Security and Medicare) and to cut taxes have led non-partisan analysts to conclude that the federal budget deficit will balloon upward, leading to inflation and higher interest rates as long-term investors worry about the creditworthiness of the United States.

- The hidden costs of the regulatory state probably dampened economic growth during the Obama years; a partial rollback of rules stemming from the Affordable Care Act and Dodd-Frank could unleash significant upside in health care and finance.

- The yield curve will probably get somewhat steeper in the next few months. Depending on the tone of rhetoric over the next few weeks, the Fed may hold off on raising rates at its December meeting (following the playbook of the Bank of England after Brexit), which would hold the short-end of the yield curve down. Longer-term rates may rise if investors begin to question the safety of Treasury debt in the wake of wider deficits and higher inflation.

For now, we are staying the course. We have built client portfolios designed to stand the test of time, and we firmly believe that patience is a great virtue. Let others sort out more of the details; the underlying resilience of the U.S. economy will ultimately support both earnings and valuations for American companies and for government debt.

One final thought: Trump's victory speech last night included praise for Clinton, and Clinton's concession was an important reminder to her supporters that the time has come for healing. Whether these initial olive branches can lead to a sustained effort to rebuild constructive dialogue remains to be seen, but Presidents in the past have sometimes governed with more wisdom and generosity than their campaigns would have led observers to believe. Perhaps the office elevates the man.

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I don't normally distribute material from Wall Street pundits, but the extraordinary nature of the day leads me to include a couple of commentaries that I found to be worth reading. I don't necessarily endorse the writers' points of view, but I do think they offer some interesting insights.

CAPITAL DAILY

Global economic and market analysis from Capital Economics

Why were markets so quick to shrug off Trump's victory?

- ***We are sticking to our core views on the markets for now***
- ***What next for the Mexican peso? (see Chart of the Day)***
- ***The Reserve Bank of New Zealand is likely to cut rates (20.00 GMT, Wednesday)***

Key Market Themes

While the initial reactions to Donald **Trump**'s victory in the US presidential elections were largely predictable – the **dollar** slid against other major currencies, the prices of **equities** and **emerging market assets** fell, while those of safe havens including government bonds, **gold** and the **yen** rose – these moves were typically both smaller and shorter-lived than might have been anticipated. Indeed, at time of writing, **Treasury yields** are actually higher than before the polls closed.

We suspect that the muted responses can be explained by some combination of five factors. The first is the precedents set by **Brexit**. The shock of the UK's vote in favour of leaving the EU meant that investors may have been better prepared for a surprise outcome this time and also quicker to re-position for a swift recovery.

Second, Trump's gracious acceptance speech has encouraged hopes that he will moderate his more extreme positions when actually in office. We argued in the wake of the EU referendum that nothing had changed immediately as a result of the Brexit vote and wouldn't for a while. That line is arguably stronger in this case. Brexit means Brexit at some point. Trump doesn't inevitably change anything. Indeed, it is fair to ask "**does Trump mean Trump**?".

Third, there are hopes that the checks and balances in the US political system (including opposition from more **fiscally-conservative Republicans**) will prevent him from doing that much too radical anyway in terms of domestic policy, especially fiscal policy.

Fourth, worries about a **trade war** may have been tempered by the belief that the tide had turned against globalisation anyway and that a Trump presidency may not make much difference. Admittedly, the chances of the US signing any new trade deals are now even smaller (except perhaps for a bilateral agreement with the UK). But we doubt that Trump will follow through fully on his threats to impose large trade tariffs on **Mexico** or **China**, or to withdraw from existing deals (even though he does have a lot of leeway to do so without congressional approval).

Fifth and finally, the economic backdrop for asset markets is generally improving. Markets seem confident that underlying **fundamentals** are sound, helped by recent better economic news from the US and elsewhere, especially China.

As a result, we are sticking to our core views on the markets. In particular, we expect US **Treasury** yields to continue to grind higher. (Our long-standing forecasts for the 10-year are 2.0% at end-2016 and 2.75% at end-2017.) Indeed, expectations that fiscal policy might be somewhat looser under President Trump might add to the upward pressure on yields from rising **inflation**. What's more, the relatively muted market responses to the election mean that a December **Fed** hike is probably back on the agenda again.

Nonetheless, it is also too soon to sound the "all clear" on political risks. The continuity candidate has just lost the US election and there are now many more policy unknowns. (See our *US Economics Update*, "Trump victory to bring lasting uncertainty and volatility", published on Wednesday.) The risk of further contagion to Europe has also increased. (See our *European Economics Update*, "Trump win could heighten euro-zone political risks", also published on Wednesday.)

This uncertainty is likely to ensure continued strong underlying support for safe havens. We have therefore revised up our forecast for the price of **gold** to $1,400 per ounce for end-2016 (previously $1,300) and the **yen** against the dollar to 100 (previously 110). (**Julian Jessop**)

What to watch for today: US

No major data or events scheduled today.

SELECTED DATA AND EVENTS

				GMT	Previous*	Median*	CE Forecasts*
9th Nov		**NZ**	RBNZ Policy Announcement	20.00	2.00%	1.75%	1.75%
		Jpn	Machinery Orders (Sep)	23.50	-2.2%(+11.6%)	-2.0%(+3.7%)	-3.0%(+4.5%)
10th Nov		**Php**	Interest Rate Announcement	08.00	3.00%	3.00%	3.00%

*m/m(y/y) unless otherwise stated; p = provisional

BLACKROCK

BLACKROCK BULLETIN

NOV. 9, 2016

VIEWS FROM OUR STRATEGISTS AND PORTFOLIO TEAMS

U.S. election: Trump win

Key views

Republican nominee Donald Trump's unexpected election win points to increased market and policy uncertainty ahead.

We expect an initial sell-off in risk assets and flight to perceived safe havens. We see emerging markets as particularly vulnerable due to their reliance on exports and investor sentiment.

We expect steeper yield curves and see health care stocks outperforming due to likely reduced regulation under Trump.

We see Republican presidential nominee Donald Trump's unexpected election victory bringing market and policy uncertainty in the short run. Trump's agenda lacks detail and departs from the Republican Party tradition on trade, security and entitlements. Tapping into a backlash against the Washington status quo, he has often appeared at war with his own party and has surrounded himself with less known advisors.

Trump has said he may withdraw from or renegotiate trade deals as well as label China a "currency manipulator." This raises the specter of retaliatory protectionist moves by other nations. Any such tensions, coupled with general uncertainty over the Trump administration's goals, would likely initially result in "risk-off" sentiment hitting stocks and corporate bonds – and a flight to perceived safety havens such as gold and the Japanese yen.

U.S. Treasuries may initially benefit, but long-term bonds could come under pressure if markets perceive Trump's policies to widen the budget deficit. Emerging market (EM) assets could sell off in the short run due to their reliance on trade and investor sentiment, with Mexico looking vulnerable because of its dependence on exports to the U.S. We see many EMs supported by improving economies, easing monetary policies and a global focus on fiscal spending, but Trump's victory poses a challenge.

We see any market turmoil potentially leading the Federal Reserve to hold off on a widely expected rate increase in December, but the path thereafter looks less clear. Trump's planned income tax cuts could initially boost consumer spending, but might soon lead to a deterioration in the U.S. budget and rising rates, in our view. Similarly, plans to deport undocumented immigrants could cause labor shortages and rising wages over time. This might lift inflation, leading to a faster pace of rate increases. Also, the Fed's board could change significantly over the next four years, given that Trump has criticized the current low-for-longer monetary stance.

A balancing factor is that Trump's ability to carry out his stated goals looks restricted. Even though Republicans now maintain control of both the Senate and the House of Representatives, Trump may have to compromise with the party leadership. We could see gridlock on the legislative agenda as a result. Corporate tax reform and increased spending on infrastructure appear to have limited bipartisan support, however, and could be a ripe area for negotiation. Any infrastructure spending would come with a lag but should boost growth more than usual amid rock-bottom rates, in our view.

Steeper yield curves could pressure "bond proxies" such as utility stocks, and we see cyclical and value stocks outperforming. Health care stocks may rebound from recent losses on perceptions that a Trump administration would exert less pressure to lower drug prices. Yet we see drug pricing under pressure amid media and political scrutiny. We also expect rising uncertainty over potential attempts to repeal or shake up the Affordable Care Act.

We could see relative outperformance by financial stocks in the medium term amid higher inflation and steeper yield curves. Republicans also have proposed paring back post-crisis Dodd-Frank regulations. Yet uncertainty surrounding potential changes may unsettle investors, and any Fed delay in raising rates is a near-term negative. We generally see U.S. regional banks as a bright spot. Proposals to reduce their regulatory burden could help them grow faster and return capital to shareholders.

BLACKROCK INVESTMENT INSTITUTE

Goldman Sachs Asset Management

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Observations on the US Elections

Overview

On November 9, Donald J. Trump became the US President-Elect and the Republican Party has secured both houses of Congress. Though many polls reflected a tight race, the result was a surprise for markets and the initial reaction has been turbulent as investors adjust positioning. Among the sharpest moves were a drop in the S&P futures index, and weakening in the Mexican peso versus the US dollar and rallies in currencies that have traditionally performed well in periods of volatility, such as the yen and Swiss franc.

We expect volatility to remain elevated over the near- to medium term, and we are well placed to leverage opportunities as they arise.

Market Outlook

We think the market reaction to the election is likely to be similar to the UK referendum scenario: 1) a volatile, risk-off response, followed by 2) a gradual reversal as investors recognize that changes under a Trump administration will take time to play out and the US Federal Reserve (Fed) is likely to remain in wait-and-see mode, and then 3) isolated bouts of volatility as the administration's policy priorities, and ability to execute them, become clearer.

Investment Implications

The election has not been a dominant theme in our portfolio positioning, and details of policies under a Trump administration are yet to be determined. That said, below are some of the issues we are watching as part of the broader investment strategies across our platforms. In particular, we see increased risks stemming from a more protectionist stance on trade. However, we are watching for a potential softening in tone in the coming months as senior Republican officials weigh in and the administration takes shape.

- **Broadly speaking, our fundamental economic outlook is unchanged.** We expect healthy but unexceptional growth in the US of around 2% for the next couple of years, with continued strengthening in inflation.
- **We think the chances of the Fed raising rates in December have diminished.** Policymakers are likely to delay any further tightening in a period of uncertainty, until the impact on financial conditions becomes clearer. However, we believe monetary policy bias is likely to skew more

hawkish over the longer term, as the process for selecting Fed Chair Janet Yellen's replacement starts next year.

- **We see near-term pressure on the dollar versus core markets and downward pressure on Treasury yields,** consistent with more defensive positioning in a volatile market environment. While the dollar may weaken against the euro, Swiss franc and Japanese yen, we see potential for outperformance versus some emerging market currencies due to concerns over the trade outlook. Over the longer term, we favor equities over credit over government bonds.
- **Risk appetite may suffer at least an initial setback from the election result, due in part to uncertainty over domestic policy and concerns about the stability of existing international trade and security arrangements.** Volatility across global markets should subside, but we see potential for continued pressures in markets most exposed to US policy uncertainty. We are looking for opportunities in any dislocations.
- **Trade policy uncertainty is likely to weigh on markets that are levered to US trade channels.** We see potential for markets to further discount protectionist policies under a Trump administration. This concern could be a source of renewed pressure on emerging markets most exposed to the US and, to a lesser extent, countries dependent on global export growth. Mexico and Canada appear particularly vulnerable, as Trump has expressed opposition to the North American Free Trade Agreement (NAFTA) trade deal. We will follow the new administration's foreign policy agenda closely as it evolves.
- **Heavy fiscal stimulus may support growth and inflation, and benefit targeted infrastructure sectors, but may face considerable opposition** from within the Republican Party ranks. Trump's infrastructure package is yet to be detailed, but he has pledged to commit far more than Clinton's proposed $275 bn. His proposed combination of increased defense spending and tax cuts would likely amount to significant fiscal expansion.
- **Trump's proposed tax cuts may support growth.** Trump has pledged income tax cuts, along with a drop in the headline corporate tax rate from 35% to 15%. The Committee for a Responsible Federal Budget has estimated that these initiatives, which amount to around $5 trillion over the next decade, could push the debt-to-gross domestic product ratio well over 100%, which could add to upward pressure on US government yields.
- **Healthcare policies could be positive for insurers and pose a modest risk to pharmaceuticals.** Details on a replacement for the Affordable Care Act are unclear. Insurers may benefit from the ability to compete across state lines, and particularly from proposed block grants for Medicaid. Trump's proposed "free market for drug providers" could negatively impact the pharmaceuticals industry.
- **Energy sector deregulation and growth policies should benefit the pipeline and mining sectors.**