Heartwood Investment Management

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Investment Insight

Weekly Insight

What to think as the Trump administration takes shape

It is going to be an unpredictable journey over the next four years if this week's events in the United States are anything to go by. Next week Donald Trump is inaugurated as the 45th President. What can investors expect?

The 'Trump-trade', where equity markets have rallied in hopes of stronger growth and reflation, started to unwind this week, as investors reacted to unverified reports of links between President-elect Trump and the Kremlin. Equity moves, though, have not been too dramatic and we expect this softer tone to be a pause rather than anything more serious. Nonetheless, investors will have to get used to a 'new normal' for politics and attune themselves to distinguishing between bombastic headlines and what actually happens in practice.

With this in mind, our key takeaways are:

- **US protectionism is coming and Trump appears to be targeting Mexico and China.** Several times during his press conference, Trump praised the decisions of several US companies to keep operations in the rustbelt states of America rather than transfer workforces to Mexico. The President-elect has also nominated a renowned China critic, Robert Lighthizer, as US Trade Representative. None of this seems to be good news for emerging market (EM) equities, which will likely contend with a stronger US dollar and higher US interest rates. However, we should remember that many EM economies have much improved external financing positions, lower inflation and room to ease monetary policy, helping them to withstand an event risk. An 'America-first' policy probably benefits domestically-exposed smaller companies and their rising optimism has clearly showed in recent sentiment surveys.

- **Corporate tax reform is likely to be skewed to the benefit of exporters.** Corporate tax reform forms part of a quid pro quo of keeping corporate operations onshore, with exporters likely to receive more favourable tax treatment than importers. However, not all of corporate America is happy; retailers, in particular, are expected to fiercely oppose any tax burdens imposed on payments to foreign suppliers. We will also probably see a one-off tax cut to repatriate US corporate earnings in overseas operations, which will provide a short-term boost to the US dollar.

- **More volatility is likely among healthcare stocks.** While it is highly likely that the Affordable Care Act is repealed, it is not yet known what it will be replaced with and how this will impact insurers. Pharmaceutical companies are also under a Trump administration's radar, with proposals to introduce competitive bidding for drug companies seeking government contracts. Nevertheless, looking through the headlines, we continue to believe in the longer-term drivers of growth in the diversified health care sector: advancing medical techniques and technologies, genomics and growing consumer demand arising from an ageing demographics and longer life expectancy.

- **A more corporate friendly environment…particularly for financials and energy stocks.** Despite being 'Main Street's' champion during the election campaign, the nomination of a former Wall Street banker and hedge fund investor as US Treasury Secretary indicates that the new administration will encourage a friendly environment towards the banks. The key proposal is to reduce restrictions around investment banking activities which have been criticised for reducing market liquidity. Trump has also pledged to ease

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emissions and mining, as well as facilitate the restarting of several energy projects, which stalled under President Obama.

We have not changed our view that the reshaping of the political environment in the US will boost confidence, at least in the near term, and support US growth and corporate profitability. Even before Trump takes office, the global economy was already starting to show improvement after a prolonged period of deleveraging and corporate saving. A reflationary and higher growth environment is likely to favour economically-sensitive stocks and those with a domestic US focus. Of course, this more positive outlook is not without risk. Investors need to be prepared for potential price swings, as the Trump administration looks to deliver a mandate acceptable to an electorate that brought him to the White House in the hope of a better standard of living.

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