

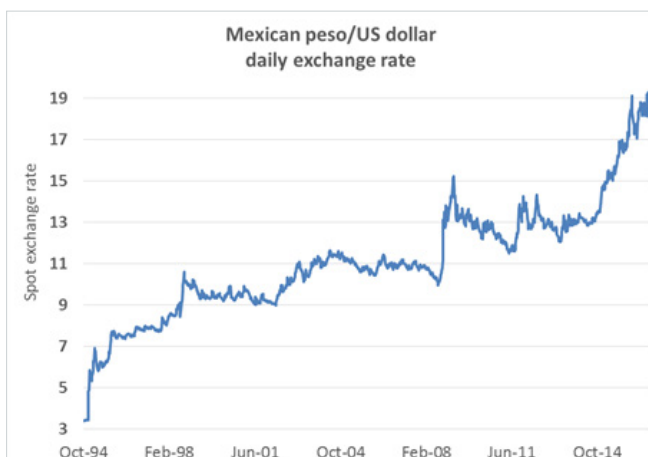


FEARS AROUND TRUMP'S VICTORY COULD PROVE TO BE A 'STORM IN A TEA CUP'

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NOVEMBER 2016

It is not often the effects of an election can be directly observable in financial markets. This time around, however, the US election and the related ascent of Donald Trump to US President-elect was punctuated by a noticeable persistent depreciation of the Mexican peso, the currency of neighbouring Mexico. Leading up to the election result, the peso had become a proxy for the possible effects of a Trump presidency on emerging market (EMs) countries.



Source: Bloomberg

Since Trump hit the campaign trail 18 months ago, the peso has depreciated about 35% against the US dollar on expectations of possible trade deal renegotiations such as the North American Free Trade Agreement (NAFTA), which has benefited Mexico over the past few decades. At the moment, the peso is at an all-time low against the dollar after 'that which has been feared has come true'.

What this means for emerging markets

Is this an ominous sign of things to come for emerging countries under President Donald Trump? What is the likely effect on South Africa?

The outcome is dependent on whether the Trump on the campaign trail will be the same Trump in the White House. The Republican Party now controls the House and Senate, which has removed the historic gridlock in the US Congress. As a result Trump should have a relatively easier platform to implement policies.

His intention to expand fiscal policy through infrastructure spending could prove to have a positive effect on US growth with positive spill-overs to emerging market countries. The Organisation for Economic Co-operation and Development (OECD) has modelled that 0.5% of GDP spent on public investment could increase US GDP by less than one-percentage point within the first year of implementation. Commodity-producing EMs might benefit from this.



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Relative to how financial markets responded to the Brexit vote a few months ago, the outcome in the markets following the announcement Trump had won were more sanguine. After surging to around 25 index points prior to the election, the CBOE Volatility Index (VIX) has moderated. Although equity markets sold off in Asia, Europe and South Africa, the declines are not commensurate to what was seen following the Brexit vote.

Before the Trump announcement, asset markets exhibited a decline in risk premiums. Bank shares are often a good proxy of sovereign risk – whether emanating internally or externally. The performance of South African bank shares has been spectacular year-to-date, unwinding, inter alia, risks relating to domestic factors and they remain little changed on the Trump news. Similarly, spreads in credit default markets have declined to levels much lower than before ‘Nenagate’ while bonds have rallied 168 basis points from the peak during the heightened domestic risk event. The rand is stronger from a year ago and was little moved.

Response of South African asset markets

	Banks		Credit default swaps (CDS)		10-year bond ZAR		ZAR/\$
	Index	Return %	Premium (bsp)	Basis Points	%	Basis Points	Spot
Before Nenagate	6461.3	-	278	-	8.65	-	14.4
Peak	7508.7	16	369	91	10.36	171	16.8
YTD	7395.7	-1.5*	240	-129	8.68	-168	13.6

*Denotes return between year-to-date and peak levels. The index used excludes dividend reinvestments.
Source: Bloomberg

The election of Trump as the next US president will not materially alter the strong global trend favouring EM assets. The seemingly insatiable demand for EM debt and equities might remain intact as the world continues to battle negative yielding bonds in developed markets.

The real test will be whether Trump makes radical changes which affect the independence of the US Federal Reserve. Even with a 25 basis point increase in the Fed fund rate expected in December 2016, interest rates remain well below historic ‘neutral’ levels. It remains to be seen whether the Fed will deviate from its planned normalisation of the interest rate path or not.

The official term of Janet Yellen, the Chair of the Board of Governors at the Fed, expires in February 2018. There is a risk an alternative name might be put forward by President-elect Trump and this will remain a source of speculation in the period ahead, which could add to uncertainty.

Bottom line

Despite the Trump electoral victory, equity markets have been expensive on valuation measures suggesting that, over the medium term, lower returns ought to be expected. At this stage, the response in markets has been relatively sanguine. Although volatility will remain, risk measures observed in the markets are not indicating a catastrophic outcome.

Noise in the markets can often induce unwarranted angst. Investors should look through the noise and remain focused on long-term investing.

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