MACRO **MATTERS**

US election result

In a largely unexpected result, the US electorate has voted for Donald Trump to become the next President of the United States.

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Macro Matters represents the viewpoint of the Asset Allocation team at LGIM.

SIGNIFICANT VOLATILITY FOR RISK ASSETS

Although a number of polls had pointed to Donald Trump's chances of victory rising slightly in the final few weeks of the campaign, financial markets had been broadly positioned for a Clinton victory given her consistent overall lead in bookmakers' odds. As a result, the initial market response to the election result has been stark, with global equity markets moving sharply lower, bond yields receding and the Mexican peso weakening.

Looking further ahead, we expect to see above average levels of policy uncertainty, with the number of 'unknown unknowns' (as former US Secretary of Defence Donald Rumsfeld would have called them) staying unusually high. Uncertainty typically declines quickly after an election, but in this case the possibility of unexpected announcements, sudden policy changes and ill-advised comments is likely to be a feature for some time to come. It is a cliché that markets don't like uncertainty, but we would now expect a higher risk premium for US assets.

For equities, some of this effect should be offset by the prospect of higher earnings growth, driven by a significant fiscal stimulus package, although we still expect a net negative effect. For other assets the implications are less clear, with forces pulling prices in both directions. On the one hand investors may be put off holding US dollar denominated assets with greater domestic uncertainty, while on the other hand the dollar could benefit from Trump's proposal to encourage US corporates to repatriate some of their overseas cash holdings.

It's a similar story for fixed income assets. While an initial risk-off reaction has pushed bond yields down, it strikes us that many of Trump's policies could ultimately be inflationary. Protectionist policies could drive up

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import prices, anti-immigration policies could boost domestic wages and significant fiscal stimulus could add further to inflationary pressures. However, all of these are second-round effects that could take time to materialise. This divergence between short-term and medium-term risks is also reflected in Fed expectations. The increase in current uncertainty has reduced market pricing of a Fed rate hike in December, but the longer-term inflationary pressures could lead to a faster path of rate hikes once markets and circumstances settle down.

TRUMP'S POLICY PLANS

Much of the medium-term market impact hinges on the policy mix Donald Trump will ultimately implement. What will President Trump actually do? Unfortunately, the campaign has been a competition of personalities rather than policies. As Trump describes himself as 'totally flexible on very, very many issues' it will take some time until we know how much of the pre-election rhetoric will be transformed into actual policies.

Using the Donald Rumsfeld categories again, we see the policy stances Trump has taken during the campaign as 'known unknowns'. These include positions he has either been relatively consistent on during the campaign or those he has expressed more recently.

These policies fall broadly into three categories: capitalist, protectionist and anti-green. His capitalist policies include providing a significant boost to infrastructure spending, passing a bill to encourage companies to repatriate overseas cash and repealing and replacing 'Obamacare'. He has also pledged to dismantle the majority of the Dodd Frank Act, lower corporate and personal taxes across the board and increase the minimum wage.

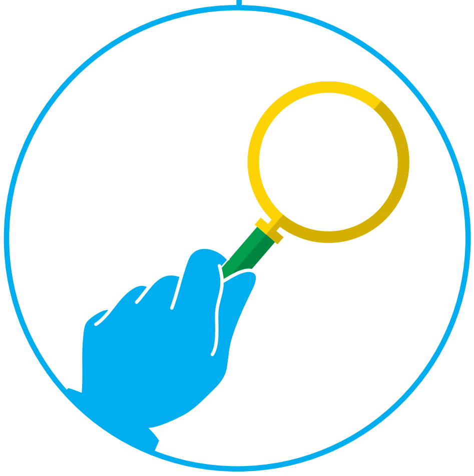
On the protectionist side, tighter immigration laws seem highly likely, as do higher import tariffs and increased domestic defence spending. It will also be interesting to see whether he follows through on his pledge to brand China a currency manipulator on day one. Trump has promised to oppose the Trans-Pacific Partnership, with a clear focus on protecting US jobs. Trump's anti-green policies, meanwhile, are focused on promoting fossil fuels and nuclear energy, cutting investment into green energy and being pro gun rights.

All of this makes for a surprising mix of views, from typically conservative positions, to right-wing positions (even by Republican standards) on immigration, all the way to quite left-wing positions. The main conclusion is that Trump is clearly not an ideologue with a firm set of core beliefs. One can view this as a negative because markets don't like uncertainty, or as a positive because it would also let us discount some of his more extreme positions as only the starting point in a negotiation.

It is also important to add constraints to the equation. The President of the United States may be the most powerful person on the planet, but he is far from omnipotent. The Constitution gives the President more leeway on foreign policy than on domestic affairs, but even on the former there are several checks and balances in place. The White House has some latitude to punish countries deemed to be engaged in currency manipulation or other free trade abuses, something to which Trump has alluded. Signing trade treaties, however, requires Senate approval, although it is seen as likely that the President has the authority to pull out of existing trade agreements. Also, Congress must approve all federal spending, which means it could stop many Trump proposals by refusing to fund them.

How much President Trump could change also depends on his self-professed deal-making ability. A broad range of outcomes is possible on this front. It's possible that he's not overpromising on his ability to compromise, and that his mix of traditionally liberal and conservative positions will allow him to draw support for some of his bills from both sides of the political spectrum; an outbreak of bipartisanship. At the same time it's not inconceivable that he alienates both Republicans and Democrats, resulting in even greater gridlock in Washington than in the past few years.

LOOKING FOR CLUES



Decisions made by Donald Trump over the coming days and weeks are likely to narrow down the many potential paths his policies could take. We will be keeping a close eye on his cabinet appointments. Should he surround himself with acknowledged experts of mainstream views it could reduce the probability of unorthodox and unpredictable policy choices going forward.

Comments clarifying his stance on the Fed and Janet Yellen's position will also be important to markets. Apart from undermining the Fed's independence, a sudden change in Fed leadership would create unwelcome uncertainty. Many investors would assume any replacement is unlikely to be more dovish than Janet Yellen.

Finally, we will look for signs of Donald Trump's learning curve. This is a process all new Heads of State go through. However, given Trump's lack of political experience and track record of ill-advised comments and unexpected policy announcements, the scope for initial errors seems greater and the speed of how he adapts to the role therefore becomes more important.

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