Implications of the Trump election win

A Canadian perspective

A special report by Portfolio Advisory Group

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All values in Canadian dollars and priced as of November 8, 2016, market close unless otherwise noted.

Wealth Management
Dominion Securities

Implications of the Trump election win – A Canadian perspective

Donald Trump defied the polls and pundits to be elected the 45th president of the United States. Global equity markets initially greeted the news with a broad-based sell-off, yet most of the losses were quickly recovered. This report takes a closer look at the proposed policies of President-elect Trump, their likely economic impact, and what we believe are the implications for equity and fixed income markets.

Our key conclusions

- Trump's proposed stimulus measures, including tax cuts and infrastructure spending, are likely to provide a boost to short-term economic growth. We believe he may find some support for these measures in a Republican-led Congress.
- Trade and immigration reforms represent key risks, in our view. We regard protectionist trade policy as a risk to global growth. More extreme scenarios, such as trade wars with China and/or Mexico or the elimination of NAFTA are risks but do not represent our base case.
- Government spending and tax cuts may result in a material increase in U.S. debt over the long term.
- From an asset allocation perspective, we recommend staying the course. While risks have increased, the outlook for equities remains favourable, in our view.

A closer look at Donald Trump's policy proposals

Policy categories	Details and likelihood of implementation	Impact on U.S. economy	Impact on Canadian economy
Tax cuts, infrastructure spending, and other fiscal stimulus	Trump's plan includes reductions to personal and corporate tax rates and a significant increase in infrastructure spending. A Republican-led Congress appears likely to support some form of tax cuts but may push back on infrastructure spending.	These measures are likely to provide a boost to short-term U.S. economic growth. The magnitude of tax cuts and other fiscal stimulus will have to be considered alongside the projected increase in U.S. debt.	Stronger U.S. growth would have positive short-term implications for the Canadian economy. Longer term, the erosion of Canada's corporate tax rate advantage relative to the U.S. could diminish Canadian competitiveness.
Trade reforms	He has proposed tariffs on Chinese imports and renegotiating NAFTA. Congressional support is likely to be limited, yet Trump could use executive powers to impose some measures.	While unlikely at this point, a full-blown trade war with China and Mexico could have a significant negative impact on U.S. and global growth.	The potential elimination of NAFTA is a key risk for Canada. It is unclear whether he could unilaterally achieve this outcome without congressional support and whether a pre-existing U.S.-Canada trade pact would come back into force.
Immigration reform	Trump's proposals on the immigration front include the deportation of illegal immigrants and measures to restrict illegal immigration.	Access to skilled labour may become more challenging, which could pose a challenge to U.S. growth over time.	Less hospitable U.S. immigration policy could enhance Canada's appeal in the eyes of skilled immigrant workers.
Energy policies	He has proposed plans that would encourage the use of coal and natural gas over renewable sources of energy. A lenient approach to environmental matters could spark an increase in U.S. oil & gas activity in environmentally-sensitive areas. Opposition to the Iran nuclear deal could result in renewed export sanctions.	On balance, Trump's policies should have a positive short-term impact on the Energy sector. Longer term, increased activity in U.S. shale could add additional low-cost supply to the crude oil market.	Support for the Keystone XL pipeline would help resolve some of Canada's accessibility issues and could improve price realizations. Longer term, increased activity in U.S. shale could add additional low-cost supply to the crude oil market.

Source - RBC Dominion Securities, Inc.

Impact on the Canadian equity market

We believe **Canadian banks and life insurance companies** are well-positioned to benefit from higher long-term interest rates tied to the potential for accelerated U.S. economic growth and increased budget deficits. Higher long-term rates and a consequently steeper yield curve would provide a welcome boost to bank net interest margins, which have stagnated amid the protracted low interest rate environment. Life insurance companies would benefit not only from enhanced profitability but also from an implied reduction in long-duration liabilities.

Other rate-sensitive sectors may be negatively impacted by higher rates over time. While these typically defensive sectors of the market could experience relative outperformance on a short-term flight to safety, higher interest rates over time could present a headwind to valuations in the REIT, Utilities, and Telecommunications sectors.

We see mixed implications for the **Industrials sector**. On one hand, tax cuts and infrastructure spending in isolation present a potential boon to companies involved in the North American supply chain and cross-border flow of goods. However, protectionist rhetoric on the campaign trail presents considerable uncertainty with respect to free trade policies and border security.

The **Energy sector** appears to be a winner from a policy standpoint, but the commodity price implications are more difficult to ascertain. Approval of new pipelines such as Keystone XL could provide additional takeaway capacity for Canadian crude oil, leading to improved realized pricing and increased activity levels. However, the implications for oil prices are more difficult to unpack. Reinstatement of Iranian sanctions could remove barrels from the crude export market, which would accelerate the market's rebalancing and lead to higher prices. However, a more-accommodative policy stance towards U.S. oil & gas activity in environmentally-sensitive areas could lead to higher future U.S. production levels and lower crude oil prices.

Gold stocks appear set to be amongst the biggest beneficiaries of a Trump presidency. As the world debates the extent to which some of his more ground-shifting policy proposals will be put into action, the related uncertainty should provide a tailwind to bullion prices.

Elsewhere in the Materials sector, a potential acceleration in U.S. economic growth and infrastructure spending could provide a tailwind to base metals and bulk commodity prices. However, we continue to question the sustainability of Chinese government stimulus efforts, which have underpinned the significant recovery in commodity prices in 2016. Moreover, any tariffs imposed on Chinese exports into the U.S. or otherwise anti-free trade policies would pose a headwind to commodity demand. With that, the outlook for base metals and bulk commodities remains uncertain, in our opinion.

Impact on the U.S. equity market

Financials are generally expected to mildly benefit from Trump's victory. Regional banks are particularly well positioned to benefit from potential changes to the Dodd-Frank Act and an improved M&A outlook. A steeper yield curve combined with a continuation of the rate hike cycle would also support the outlook for the sector.

The implications for **Health Care** are mixed and vary by sub-sector. The **healthcare services and managed care** segment may come under pressure given the Republican opposition to the Obama administration's landmark Affordable Care Act (Obamacare). Similarly, a repeal of healthcare reforms could lead to a decline in elective surgical procedures, which would be negative for the **medical technology** sector. In contrast, **U.S. pharmaceutical and biotech** stocks are likely poised for a reversal of the negative sentiment that has been pervasive leading into the election as drug pricing was never a key tenet of Trump's platform. We note that many companies in this segment have cash-rich balance sheets that should support future growth and healthy capital returns over the long term, and their stocks trade at attractive valuations.

Trump has expressed intent to curtail Obama's climate change plans and promote oil and gas drilling on federal lands. He is also in favor of more construction of oil and gas pipelines. Overall, the Trump win should represent an incremental positive for frac service companies and land drillers. A potentially more-favorable regulatory environment coupled with more tax incentives for the industry would be a positive for the **refiners** and the **E&P** players.

With respect to **defense**, Trump has expressed a desire to grow the defense budget and boost spending above the current sequester caps. Although these caps are in place through 2021, the Republican-led Congress may push through amendments that would remove them earlier. Still, we believe a Trump administration introduces greater uncertainty with respect to personnel, actual policies, and execution.

Trump's intent to boost infrastructure spending (by some US$1T in new spending), repairing the aging U.S. infrastructure and funding new projects, should have a favourable impact on **multi-industrial** stocks, particularly those exposed to non-residential construction and water projects. In **transportation**, the deepest impact will likely be felt by the U.S. rails, particularly those with exposure to cross-border trade with Mexico. A Trump presidency that would foster greater U.S. protectionism, a re-negotiation of NAFTA, or broad isolationist policies would likely disrupt cross-border traffic and discourage foreign direct investment in Mexico. We believe such factors would have negative implications for volumes and weigh on valuations.

Implications for fixed income markets

The initial post-election reaction in Canadian fixed income markets has been fairly muted compared to what has occurred in the U.S. market. Canadian government bond yields are flat to 7 basis points (bps) higher, with a steeper yield curve resulting as a function of increases occurring in longer-dated maturities. Moves along the Canadian curve pale in comparison to those in the U.S. For example, while 2-year yields in both countries are essentially unchanged at midday, the yield on the U.S. 10-year is up 11bps (1.97%) versus only 3bps in Canada (1.30%). Similarly, the yield on the U.S. 30-year Treasury is up 15bps (2.77%) concurrent with just a 7 basis point move in Canada (1.98%). The election results are unlikely to change the bias of central bank policy in either country, with the market still pricing in a 70%+ chance of a hike by the Federal Reserve by the end of the year, while the Bank of Canada (BoC) is almost certainly on hold over that same period of time. The combination of a wider yield differential between the U.S. and Canada, and a looming rate hike by the Fed as the BoC remains on hold, is likely to serve as a headwind for the Canadian dollar. Activity in the corporate bond market has been fairly orderly with movements in spreads thus far described as being muted.

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