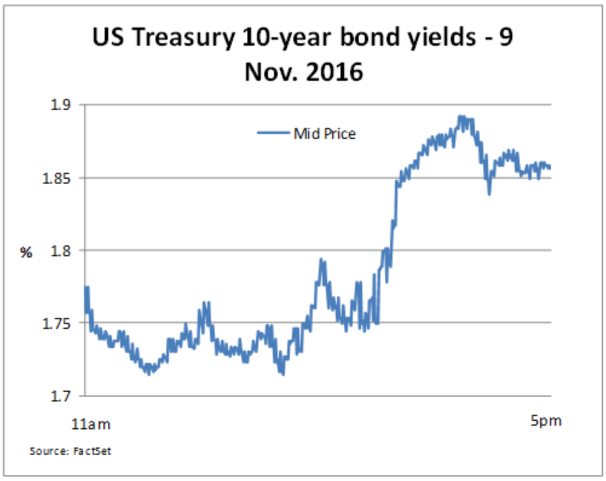
Play the ball, not the man

Paul Moore
Chairman and CIO, PM Capital

11 November 2016

Donald Trump has sprung an upset and markets in the short term did not react well to the uncertainty this result will undoubtedly bring. When I say the short term, I mean the *very* short term – a few hours, to be more explicit.



While the Brexit vote decision took days for the markets to shake off and resume expecting higher interest rates and an improvement in future economic activity, it took less than a day for market participants to get over their shock of a Trump victory and consider the meaning of having President Trump, rather than 'The Apprentice' Trump. Again we are shown that attempting to time markets or predict macro events is not a worthwhile bet.

On the day of the election US Treasury bond yields ended the day higher, sending the yield on the 10-year US Treasury note to its biggest one-day increase since July 2013. It is further evidence of what we suggested in our last quarterly report that we may be at an inflection point in long term interest rates. This is despite the fact, that If you include February's scare about Chinese economy, we have had three events in 2016 (+ Brexit, + Trump) that have created considerable fear over the sustainability of economic growth.

When considering this election result's effect on markets, play the ball, not the man. Trump, the personality, is not the same as Trump the policy maker. Avoid making an investment on what you think of Trump, but after reflecting on the implications of his policies on longer term trends. This result is likely to accelerate the trends already in play. The underlying principles of the Trump campaign have been pro-growth, most particularly in the promise to lower corporate tax rates. This is pro-growth in the usual ways, but will also encourage those US corporates who are booking revenues offshore to return more of their capital home, either in the form of increased investment or increased shareholder returns. Those shareholders, in turn, will spend.

Although this may be proven to be incorrect over time, Mr Trump has also campaigned – even mentioning it in his acceptance speech – on an increased spend on urban infrastructure which will boost growth.

The size of the protest vote in both the US presidential election and Brexit is a reflection of the economic stagnation the electorate has seen and what are thought to be the negative effects of globalisation. People want change. They may not be sure what type of change, but change nonetheless. It could be said to be a reverse of the old proverb: it's how fast we go, not what direction we travel, that matters.

The longer term fundamentals that were in play a week ago remain in play today. The US is on a recovery path and the Federal Reserve has indicated that it is looking to raise rates before the end of the year. We would be surprised if this changes.

At a stock level, the extreme valuation differentials between defensives with perceived low earnings risks and cyclicals that are leveraged to an economic recovery continue to reverse and the election of Trump will in all likelihood reinforce this trend. The tide has truly changed. Immediately, post-election, this has seen strong moves in our domestic banking, exchanges and alternative investment themes.

Stepping away from the noise, the most important question remains: Where can you invest your capital at acceptable rates of return? Return expectations are for cash to return between 0-2%, bonds 0-2% and property 3-5% pa. So at best, excluding equities, investors should expect 2-3% pa returns – not enough to satisfy many people's ongoing requirements. Equities are therefore required to achieve long term objectives. But not any equities; market returns mean that added value through truly active managers will become even more important.

We invest for long term returns with a portfolio built stock by stock. While seeing the macro political and economic environments, we look through them to discover the true value in each company in which we invest our capital.