



GLOBAL EQUITIES: HOPE TRUMPING REALITY?

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What a year 2016 was for investors. An early year bear market has given way to a full-on cyclical bull market that has powered through Brexit, Donald Trump's US presidential victory, as well as general weakness in economic growth and corporate earnings. At least for now, the market is choosing to look through a crescendo of macro and political noise (and change) and focus on the potential for cyclical recovery.

A year of Brexit and Trump, new political parties and populism in general begs the question as to whether the voter has had enough of stagnation and decided to do something about it. The results of democratic contests in the past year speak to a repudiation of quantitative easing and central banks even if voters might not describe it as such. Perhaps we are seeing voters accomplish what central banks could not; push us off stagnation – at least for a moment.

MAINTAINING CONVICTION IN UNCERTAIN TIMES

While there remain many uncertainties at the macro level, the first 100 days of Donald Trump's Presidency in 2017 will be watched with high intensity by markets. To state the obvious, this creates a set up for ongoing market volatility as well as likely stock and sector rotation. Knowing the stocks you want to buy and being confident enough to buy them during periods of weakness is going to be an ongoing necessity.

The question many are wrestling with is will Donald Trump's presidency be defined by a focus on the populist policies that carried him to victory, or by traditional republican policies that may help to stimulate the US economy. In general, the market has narrowed down its focus on traditional Republican policies, and so far, we have seen much more of Trump the Republican versus Trump the populist. This is a positive, but the key question is whether this reality holds, especially under the pressures that will follow. In the near term, we think it makes sense to hold at least enough dry powder to take advantage of the occasional presidential "Tweet Storm" that may rattle singular stocks or industries. We will certainly be aiming to pick up attractive long-term ideas when appropriate.

So, why the positive reaction to the election result, given the sell-off that was anticipated? Partly, it's because Republicans spend more than Democrats, at least Democrats that have been prevented from spending for eight years by Congressional deadlock. History and rhetoric would tell us that we should expect policies aimed at growth; growth which will theoretically offset lower taxes and any increase in spending. That has a number of consequences if, indeed, growth rhetoric turns into a growth reality.

Time will tell if this comes to pass but we can certainly expect lower headline corporate and individual tax rates. This will be important for US companies that pay high US tax rates, while foreign cash repatriation is also likely to happen. We would also expect a slowing and rolling back of some aspects of regulation. This may allow some pharmaceutical companies room to maintain or increase prices in the name of innovation and it has already taken some pressure off financial companies.

Given the upward trend that was already in motion, we should expect some further inflation, a modest interest rate increase cycle and a general shift in investor expectations around these factors. Expectations often dictate behaviour and it will be important to monitor this dimension in order to understand shifts in corporate policy (we're still awaiting any meaningful investment cycle given the prevailing caution of the past eight years, while the days of taking on debt to finance buybacks may be numbered), as well as in investor behaviour when expectations meet actual policy in 2017.

We would caution that it's important not to forget that there is an element of honeymoon around US politics at present. The best days to be buying stocks were in the first few days after the US election result, and even better, in the period before the result. We would emphasise that, today, there's a need to think longer-term and potentially trim some of the initial winners as policies become more distinct from the promises of an election campaign that became extreme by anyone's measure.

THE IMPORTANCE OF BEING CONTRARIAN

Consumer staples, emerging markets (EMs) and secular growth have all taken a meaningful hit in the weeks following the election. This makes sense in a world where interest rates in the US are likely to go higher and we may begin to see trade conflicts as we move forward into 2017. However, we believe some of these movements have already been overdone.

Our nature is always to be carefully contrarian and so we are looking for attractive assets in emerging markets where prices become unhinged from how the world will actually play out, but we are moving very slowly. Some growth Staples names may finally be cheap enough for us to pick at, but our conviction remains in growth firms on the right side of change where individual companies are taking market share and monetising this change and disruption. We find many of these companies in IT and Consumer Discretionary today, with the added benefit that the market has fallen mildly out of love with these sectors near term.

The clearest beneficiaries of the shifts we are seeing are Financials and some segments of Healthcare, but selectivity is now paramount. We also think that there are powerful deflationary forces at work which will still put downward pressure on interest rates, but Trump will put up a fight. Given the conditions in the US labour market, interest rate rises should remain slow, but the direction itself is more certain than under a Clinton presidency.

Elsewhere, there is too much energy in the world in our view (we've come a long way from peak oil theories) and there will still be too much energy if Trump "drills baby drills" in the US. This supply will only add to the downward fundamental pressure on global prices over the medium term and does not imply a broad-based headlong race into a sector of rising stock prices. We are also less enthused about Industrials and Commodities at higher prices. China has changed and cannot spend and consume infrastructure as it has for the past 20 years. The US may spend more, but many industrial and commodities companies are global, and the US is smaller than it used to be. We are generally cautious of Industrial valuations given many were already being chased before the election.

Ultimately, it remains important to go stock by stock and understand what policy changes will be real. This implies a watchful approach on policy, and an understanding of where the real impact may lead to improving economic returns. Avoiding disappointment over the next year will be crucial, especially with expectations at higher levels and earnings improvement for many cyclicals a 2018 event, if indeed the improvement actually transpires as a result of fiscal policy or a meaningful uptick in economic activity. The bottom line is we remain focused on picking stocks where we have an insight and can acquire unanticipated growth and improvement. Trump or no Trump, our stock picking and bottom-up work grinds on.

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