Donald Trump: The Elephant in the Room

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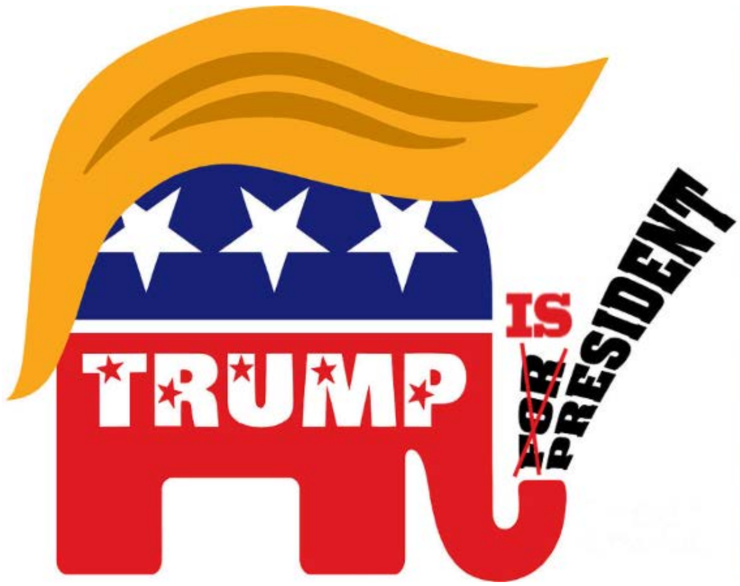

Depending on your point of view, either the unthinkable or the unlikely occurred on November 8. Donald Trump is to be the new American President against great odds.

To some, he is a misogynistic, racist, narcissistic businessman who inherited wealth and used influence to avoid serving in his country's armed forces. A man who is proud of the fact that he has paid no income taxes in the last 20 years and wants to increase the U.S. deficit by trillions over the next decade.

To others he is the anti-establishment leader who will take away the privileges long enjoyed by the Washington elite and the liberal media and return prosperity to middle class Americans who have seen their income stagnate for the last 30 years, while the 1% continues to amass the lion's share of the national wealth.

As with most things in life, the truth is likely to be found in the middle. Today we concern ourselves with how a Trump presidency might impact us and our clients; in particular our investments in the U.S.

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Trump's Potential Economic Impact

In elections, candidates make multiple promises they either cannot or will not keep and Trump is unlikely to be different in this regard. During the campaign he has suggested he will ban Muslim immigration, build a wall across the Mexican border (and have Mexico pay for it), tear up all trade agreements and repatriate manufacturing jobs to the U.S. from around the globe.

At the same time he has said he will reduce corporate taxes and tax rates for the wealthiest families. He plans on repealing Obamacare and investing billions into infrastructure throughout the U.S. He has Republican house and senate majorities (but arguably not many friends among them).

His overall agenda is very ambitious and even if a Republican Congress were to give him unqualified support it is hard to see how he would be more effective than Obama was in 2008 when he had a Democratic Congress.

Overall, Trump is basically pro-business and that may explain why equity markets were up on November 9 and why, the night before, Futures markets hit limit down territory (a sort of market downside "switch breaker" – almost 1000 points for the Dow Jones). Perhaps Wall Street is now thinking that the Donald may even be good for U.S. business.

If he were able to implement all of his policies, the deficits and national debt would rise and that seems to be reflected in the fact that 10-year government bonds have nudged over 2% for the first time since early 2016.

If global trade is reduced by new tariff walls and changes to existing global agreements, prices of goods will rise, as will inflation. That could easily lead to interest rates higher than 2%.

However the positive outcomes for business include lower taxes, less regulation (particularly for the financial services industry), and some repatriation of offshore retained earnings estimated to be about $2.5 trillion. He is in favour of the Keystone Pipeline project which will anger environmentalists but help the Alberta economy and his issues with NAFTA appear to be focused on Mexico.

Ironically, the Mexican Peso has fallen to just over 20 pesos to the U.S. dollar (vs. only 10 in 2008). Even if there were tariffs imposed, Mexico's cheaper currency would offset much, if not all of that. If the U.S. wants a trade war and at the same time sees its own interest rates rise, then its currency will also appreciate, making it easier for exporters to overcome the impact of tariffs. Trump may find this out the hard way.

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Overall, I do not have a lot of economic concerns about a Trump Presidency. However, I have more than a few concerns about where he takes the U.S. from a geo-political standpoint. For more on this, see the comments by George Friedman and Peter Zeihan:

- "Scared New World" by Peter Zeihan
- "President-Elect Donald Trump" by George Friedman

Impact on the NWM Portfolio

No one can say with certainty how this will play out in the markets. The only theme we have is that uncertainty and volatility will be higher.

Equities: Leading up to the election, equities were essentially correlated to politics. As Trump rose in the polls, the markets sold off. As Hillary was vindicated by the FBI, stocks went up. The day after the election, markets stabilized and were even positive. The fact of the matter is: companies have not invested and spent money because of the uncertainty. Based on Trump's declared tax and infrastructure measures, will companies spend again? There is a path that sees Trump making the economy great again.

Interest Rates: There is a risk from higher rates, which we've already started to see. As a firm, however, we've measured liquidity and credit risk, but have always mitigated interest rate risk in our portfolio. In the end, we do not see rates increasing much.

Gold: Another area to keep an eye on is gold. As we noted earlier, much depends on the success of Trump's policy agenda. If the new administration borrows money and the economy begins to see real growth again, it would be bad for gold. But if borrowing ensues, growth remains stagnant, rates get cut, and inflation increases, gold becomes a more attractive asset.

This is why we diversify. One of our investment philosophy strengths is *extensive diversification.* Including non-correlated assets such as private equity, private debt, real estate, farmland, and other illiquid sectors not marked-to-market affords us the ability to be patient with our asset mix changes. This is how we've been able to provide historically stable and consistent returns.

What's Next?

American Presidents are not particularly powerful politically and only a few have had major impacts on the economies they have presided over (such as FDR and Reagan). As with anything else, we will monitor events carefully.

In the end, Canada may well benefit from its position as a land of reason and a much

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fairer distribution of wealth, opportunity, and access to health care in comparison to our southern neighbour, as the Economist just recently wrote.

With that in mind, perhaps we could convince some of America's best and brightest to consider a change of address and call Canada home – we may not have Trump, but we do have Timbits and ice wine.

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