November 9, 2016

Trump Wins: FGP's Views

Early this morning, U.S. voters surprised the world by electing Republican party candidate Donald Trump as their president.

Markets in the Far East, which were open while the votes were being counted, reacted negatively as Mr. Trump's win turned from unlikely, to possible, to probable, and then to definite. U.S. equity futures also fell overnight, and circuit-breakers had to be implemented to slow the slide. Traders temporarily panicked as they were unsure about what a Trump presidency would bring.

As long-term investors, we look beyond today and tomorrow. Our focus is the foreseeable future, and how Mr. Trump's expected policies will affect our clients' investment portfolios.

While it is difficult to truly predict how Mr. Trump's presidency will unfold, we do believe there are some silver linings.

Energy

Mr. Trump has said he would approve the Keystone XL pipeline which would bring additional Alberta oil to U.S. refineries. How quickly he gives the go-ahead, and under what conditions, won't be known for awhile, but this pipeline would be positive for our Canadian oil-related investments.

The president-elect wants Americans' energy needs to be met without reliance on OPEC oil. According to his election platform, he plans to "unleash America's $50 trillion in untapped shale, oil, and natural gas reserves, plus hundreds of years in clean coal reserves." Several companies in our Canadian and U.S. portfolios which have expertise in drilling wells or providing other energy-related services are expected to benefit from Mr. Trump's plan.

Trade

During the election campaign, Mr. Trump reiterated that he would nullify or significantly amend trade agreements, particularly the North American Free Trade Agreement (NAFTA) and the yet-to-be ratified Trans-Pacific Partnership (TPP). Mexico has a huge trade surplus with the U.S. – almost $50 billion (U.S.) in 2015. On the other hand, Canada had a trade deficit with the U.S. of almost $12 billion (U.S.) in 2015. This means that more goods and services flowed northward into Canada from the U.S. than the other way around. We doubt the president-elect would wish to lose his country's trade advantage over Canada by canceling NAFTA without replacing it with a separate trade deal with Canada.

The Mexican peso dropped in early trading today over fears about the risks associated with the potential end of NAFTA. A lower peso would make companies in Mexico more attractive for our clients' emerging markets portfolios, which do not hold any Mexican companies because their valuations are currently unattractive.

FOYSTON, GORDON & PAYNE INC.
INVESTMENT COUNSEL

Taxes

Mr. Trump pledged to decrease the business tax rate from 35% to 15%. He also promised to change the corporate income tax code to allow companies with offshore profits to repatriate them to the U.S. and only pay a one-time tax of 10% on these revenues. We believe that more corporate money in the U.S. could improve the U.S. corporate financing and investment environment. A stronger U.S. economy should help Canadian and U.S. companies over the long term.

Interest rates

Inflationary expectations have been on the rise recently across parts of the developed world, causing longer term yields to slightly increase from record low levels reached earlier in the year. The Trump victory and the potential for a pro-growth mix of tax cuts and an increase in fiscal stimulus has only reinforced U.S. inflation expectations. This combination of measures has the potential to be bond unfriendly as it is ultimately inflationary in nature. The impact could clearly be seen earlier today when the yield on 30-year U.S. Treasury bonds increased by 20 basis points.

Furthermore, greater fiscal stimulus means more infrastructure spending which leads to higher budget deficits and, ultimately, to the issuance of more Treasury bonds which could have a negative effect on bond prices.

Given the interdependent nature of Canada and the U.S., higher interest rates in the U.S. should ultimately cross over into Canada and help the financial companies in our clients' equity portfolios. Additionally, our clients' fixed income portfolios would be buffered from the full effect of rising rates as the portfolios have a shorter-than-index duration.

On the flip side

The world has entered into another accelerated period of uncertainty and everything will not be rosy during a Trump presidency. What if Mr. Trump really does tear up NAFTA without thinking of all the consequences? What if other countries erect tariff barriers that would also hit Canadian goods and services? How will Canadians be affected by a U.S. pullout from the North Atlantic Treaty Organization (NATO)?

There are many unanswered questions at this point, but we continue to take the long term view that investing in solid, high-quality companies at attractive prices will benefit our clients. In fact, volatility can create investment opportunities as relative short-term mispricings emerge.

If you would like to discuss any of these issues, please do not hesitate to contact me or your client service team.

Sincerely,

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