

It is not about Trump

10 November 2016



- *It is not about Trump. Trump's victory highlights the rising discontent over status-quo and outcry for change.*
- *On the positive side, higher infrastructure spending in the US incrementally positive for global growth.*
- *On the negative side, the trend of protectionism and de-globalization is clear.*
- *Changes are happening in Asia too, on balance for the better. Latest example being India's fight against black money.*
- *Lower taxes, larger deficits and higher infrastructure spending under Trump → positive for equities.*
- *Asia's externally-oriented economies, particularly low-end manufacturing sectors, are most at risk.*
- *Under this new global economic paradigm of rising protectionism, focus on countries / sectors / companies with internal structural drivers that are relatively isolated from the global macro environment.*

What a day! Mr. Trump wins the US Presidential election against all odds and previous polls. While the outcome may have surprised many, this is by no means an isolated event. Weak global recovery, poor job creation, meager wage growth, widening wealth inequality – people are crying out for change. The American public cried out with their votes by electing Mr. Trump, a political outsider who has run a very unconventional campaign, to say the least. In the UK, Britons voted to exit the European Union over the summer. This is happening in Asia too, where unconventional leaders have come out of nowhere with strong public support and a clear mandate for change – Duterte in the Philippines, Jokowi in Indonesia and Modi in India.

Change for the better, or for the worse?

It is very understandable that when status-quo is not working, **people want change. Any change.** The important question is whether the change is for the better or for the worse.

In the case of the US election, we would say that the jury is still out. **On the positive side, we should see greater support through much-needed fiscal spending on the country's ailing infrastructure.** Infrastructure spending has been discussed for years by the Obama administration but not implemented due to resistance on the legislative level. Now that Republicans control both executive and legislative arms, Mr. Trump will have the support to implement his plans. His plan to bring manufacturing jobs back to the US means greater adoption of advanced technologies such as automation, which will result in long-term productivity gains for the country. In addition, Mr. Trump's campaign proposal to slash taxes on cash which US companies have stashed overseas will also be beneficial. **After six years of Quantitative Easing, people are increasingly questioning the efficacy of monetary policy alone.** Mr. Trump's plans when implemented may very well provide the much-needed catalyst to "make America great again". With the US economy on a better footing, the rest of the world would certainly benefit.

On the other hand, rising protectionism is clearly negative for the fragile global recovery. This was not only a key message in Mr. Trump's campaign, but also a common theme elsewhere globally. Having said that, we expect political maturity to prevail after the election where some of the more aggressive campaign rhetoric gives way to pragmatism. Notwithstanding this, however, **the seed of rising protectionism and de-globalization is planted on fertile soil**, well set to germinate and sprout in coming years.

In Asia, change has so far been for the better, particularly in India, Indonesia and Philippines where strong leadership has resulted in on-the-ground productivity improvements, such as reduction in government bureaucracy, plugging subsidy leakages, fighting corruption and enhancing long-term competitiveness through better infrastructure. In India, we have seen great progress by Prime Minister Modi on financial inclusion and rural electrification. In Indonesia, President Jokowi has tackled corruption head on. In the Philippines, President Duterte has toned down his previously aggressive rhetoric and shown a more cooperative stance with its neighbors in the region.

India's fight against black money

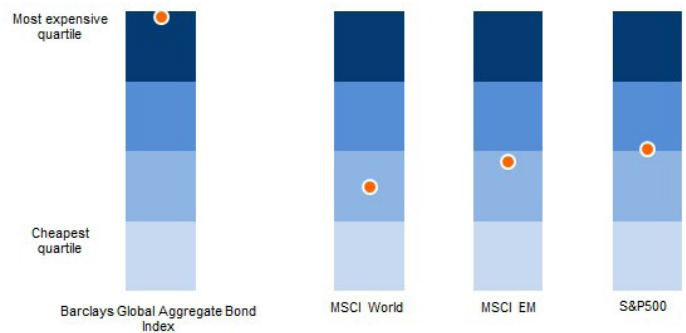
As an example of positive changes in Asia, an important change for India came yesterday – a move to tackle India's black money and black market, which no doubt has been overshadowed by Mr. Trump's victory. India has a highly cash-based economy with one of the highest level of currencies in circulation at 12.1% of GDP¹. **In an attempt to fight black money and counterfeit notes, the Indian government has decided to scrap high-denomination (Rs500 and Rs1,000) currency notes**. These two notes account for about 85% of currency in circulation². The existing notes can be exchanged for new notes (in small amounts) or deposited into banks (in any amount), with the aim to bring black money, and the people generating the black money through illicit means, into the light.

This is undoubtedly a very bold move – one that requires significant political courage and capital. While there is certainly a near-term impact on consumption, it is a long-term positive for the economy. Firstly, **this effectively tackles black money and corruption** in one clean stroke. Secondly, **this accelerates the shift towards formal organized economy**. India has already made significant progress in promoting financial inclusion by issuing unique IDs and opening bank accounts. Along with the recently-passed Goods and Services Tax bill, this is a catalyst to move India's black market into the organized economy. Lastly, more deposits into the banking system will help ease India's chronically tight monetary condition, leading to **lower funding cost and inflation** – conditions conducive to future rate cuts.

Implications

Trump's surprise victory would likely come with higher volatility in financial markets as investors gauge the balance between the changes that are for the better and those that are for the worse, as discussed earlier. While his actual policies remain to be seen, the overall direction appears clear – **lower taxes, larger deficits and higher infrastructure spending. This should bode well for equities**. We expect to see a shift from bonds to equities on the back of higher inflationary expectations and relative valuation (Exhibit 1).

Exhibit 1: Valuation-Bond vs. Equities (since 1995)



Source: Bloomberg, Mirae Asset, November 2016

Note: Fixed income valuation = Yield-To-Maturity; equity valuation = Price-to-Book ratio

Asia's externally-oriented economies such as Taiwan, Korea and China's export sector may face headwinds as Trump ran a more protectionist campaign. In particular, low- and mid-end manufacturing in Asia is most at risk to move back to the US as Trump won an overwhelming voter share of those without a college degree. **Our portfolios are well-positioned favoring domestic-oriented economies / companies**.

Higher infrastructure spending in the US will be incrementally positive for commodities. To what extent this affects commodity prices and the sustainability of the cyclical rally seen year-to-date will depend on the eventual size of Mr. Trump's infrastructure package, and how that compares with the likely moderation in infrastructure spending in China.

From the geopolitical standpoint, much will depend on how much of his campaign rhetoric gets materialized. Incrementally, we will likely see the US exerting less influence in Asia, which will be more conducive to greater cooperation within the region.

However, to emphasize again, **it is not about Trump**.

The world is facing structural issues that are giving rise to people's outcry for change and de-globalization. **This trend started before Trump – with Arab Spring and Brexit – and will surely continue after Trump.** Trump's win merely brought to light the gravity and breadth of these issues.

We have long held the view that these structural issues are difficult to correct. Under this scenario, **Asia stands out globally with its consumption-driven domestically-oriented economies.** Countries like India, Indonesia and Philippines benefit from positive structural tailwinds such as attractive demographics and low household debt, with strong leaders taking bold steps to improve productivity and competitiveness. China, notwithstanding its own issues of overcapacity and corporate leverage, has a healthy consumption economy that is led companies at the leading edge of innovation, particularly in the internet / e-commerce space. **Under this new global economic paradigm of rising protectionism, our preference is in countries / sectors / companies with internal structural drivers that are relatively isolated from the global macro environment.**

Source:

¹ CLSA

² Credit Suisse

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