Big Picture

OCBC Bank

At Least It's Over?

When You-Know-Who Wins You-Know-What

Nov 9, 2016

- **Just how he did it will be fodder for reams of analysis for days and months to come, but the fact of the matter is this: Trump will be President of the U.S. of A. come January 20th, 2017.**
- **To say that market is shocked is an understatement. Here, what the man promised to be "Brexit plus, plus, plus" holds true indeed, in terms of the magnitude of initial damage to various asset classes.**
- **Here, we attempt to examine just what his presidency would entail for us here in Asia, by bringing back Mr. Q. Among other things, he is aghast at just how wrong the polls have been – again.**

When Brexit took place, you wrote about Monty Python. That was kind of funny. Can you humor us again please?
I wish I could come up with something like that, but now I think we are all just drained. What I was reminded the whole morning, weirdly enough, was this sign along a railway track in New Jersey that says, "What Trenton Makes, the World Takes", bragging about the area's long-gone manufacturing prowess. I cannot help but think it should now really read "What Mess America Makes, the World Takes." Global markets do not have a single vote in this, but are obviously reeling from the results.

That doesn't quite stick, but forget it. Tell me, what happened exactly? When did you start to really worry?
Hard to pinpoint, while getting bombarded with all the information. The fact that Florida was too close to call was expected, so that was okay.

However, I started to get antsy when the networks were hesitant about calling Virginia. A swing state, yes, but Clinton was supposed to lead by a good 4-5% there courtesy of her running mate, Tim Kaine, who hails from there and also the increasingly Democratic northern Virginia suburbs near D.C. She looks to win that state in the end, but it shouldn't have been that close to begin with.

On top of that, prior to today's actual vote, opinion polls showed that Clinton started to lead in North Carolina. As it turned out, wrong. Same story when it comes to another key swing state, Pennsylvania.

Because Trump went to Wharton?
Haha. He did, but I don't think that's that!

Anyway, why on earth are the polls so wrong?
Well, sorry to sound flippant but it doesn't matter anymore now. Still, some of the factors that we talked about just a few weeks before are proving to be substantial. Remember we spoke about how actual Trump supporters might have demurred from stating their preference towards pollsters? That might have been enough to tip the balance, given that the polls were showing a narrow lead of around 3% by Clinton anyway.

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Also, I won't be surprised if political pundits start to say how the third-party candidates 'stole' votes from Clinton that allow Trump to get the leads. On top of that, the turnout by white working class population – who feel most attracted to Trump's ideas of protectionism – appeared to be higher than expected. That is especially crucial to swing the key swing states along the rustbelt states, including Ohio and Pennsylvania, away from Clinton. There is also the element of just how low voters' trust towards Clinton appeared to be, perhaps strengthened even further by the FBI's re-investigation snafu so close to D-Day, even if ultimately pulled.

The truth is, we just don't know, and it has to be all of the above, but obviously this has come as a huge surprise, to say the least.

Yes, didn't we talk about how market was actually worried about Democrats making a clean sweep potentially?
Yes, we did. And for pollsters, the fact that not only is the Republican nominee moving into the White House, but the Republican Party is potentially retaining majority in both the House of Representatives and the Senate to boot, would be rubbing salt against the wound.

Okay. Enough after-the-fact diagnosis. Let's talk about what it really means to the markets.
I thought you'd never ask!

Look, let's state the obvious first: there is a surge towards safe-haven assets. Gold broke USD1300, up by more than 3% as we speak. Japanese Yen looked to be testing 101 against the USD at one point, and even Sterling with its own Brexit baggage was up by almost 1%. USD weakened by over 1% against its major partners going by the DXY basket. In and of itself, the last part on USD weakness has worked to limit at least the appearance of damage to Asian currencies at this point, with most currencies depreciating by around 0.5% against the dollar. Meanwhile, equity markets are down, with Nikkei suffering the brunt of it, down by more than 5%.

And Mexican Peso?
Ugly, very ugly. Down more than 10% at some point.

The wall and all. Is he going to really do this and more?
Well, one of the reasons why market has reacted the way it did is simply because it is not clear whether Trump the President would be the same as Trump the Candidate. While his campaign was said to be divisive and abrasive, his victory speech did talk about how it's time to come together as a country and that he will deal fairly with other people and other nations. Interestingly, market did rebound a bit from the depths after this.

Now, let's think about what's next. What are the key things to look out for?
Well, if he does act out on all the anti-trade bluster – including imposition of 45% tariffs on China – it would be the worst case from the perspective of Asian economies.

Even without a control of both houses of the Congress, there is already significant leeway for him to enact tariffs and barriers. In the name of national security, for instance, the US president can utilize a 1962 Act to impose tariffs. Trump could plausibly argue that job losses in the rust belt due to Mexican and Chinese imports amount to precisely such a national security threat.

And if you are asking about the worst case scenario, a 1917 Trading with the Enemy Act confers the president broad powers that include the right to not only impose tariffs but also to freeze and seize foreign assets. Technically, the tariffs and asset freeze can be applied not only to enemy nations, but any nation. Moreover, although only the Congress has the right to authorize a state of war, even periods whereby the US is engaged in military actions with no prior congressional authorization qualify for this presidential power. This last part is still contentious, and could potentially end up having to go to the Supreme Court for interpretation.

And, you told me before, the next President decides who controls the Supreme Court?
Yes. Just because the 9-member Supreme Court now has one vacancy that needs to be filled which also happens to carry the decisive vote in a 4-4 split case. If the Democrats have wrung control of the Senate, it could hinder President Trump's appointment, but that's no longer the case. Moreover, given that three of the existing justices are getting very old, he might well get to appoint their replacements too.

Okay, that's dark. And the President can change the Fed chief too?
Yes. I'm glad you recall our last conversation. Janet Yellen's term is ending in early 2018. Trump the Candidate has said some rather unhelpful things about the workings of the Federal Reserve, and may look to replace her with someone more pliable. This comes as the FOMC still has two vacancies that remain unfilled – which can now be filled by Trump and could affect rate decisions since they are voting members.

On that, it actually is not clear too whether he would prefer a dovish Fed – that would help growth – or return to his talks about how the Fed has kept rate too low for too long.

To complicate things further, now that the Senate remains in the hands of the Republicans, it is possible that Richard Shelby, who won re-election, may continue to head the Senate Banking Committee. Shelby has been a proponent of model-based process for the Federal Reserve to decide on its interest rate policy. Any renewed efforts to push for that approach may risk market's perception of Fed's independence.

In the near term though, the Fed is not going to hike right?
Given the market volatility, it does look like the Fed may put off hiking rate for now. Going by the OIS market, the probability of December rate hike has declined from 80% to just 51%. This has contributed to the USD weakness that we mentioned earlier.

Over the medium term, however, one way this could play out is that, because Trump may ramp up his fiscal spending considerably, the Fed may see the need to actually counter things and hike rate by more than otherwise anticipated.

My head is hurting. This thing is all over the place.
This situation is really fluid. Sorry if it sounds corny, but the only thing we can reasonably expect now is the unexpected. But to limit market fall out, after he is done celebrating, Trump will have a lot of things he needs to do. Appointing cabinet members that are seen as market-friendly or at least sane ranks highly on that. While he cannot say outright that "Let's forget about all the crazy things I say. You'll be crazy to expect me to do all that!", any measured policy platform that he can throw together now will go a long way in reassuring the global market. If he is honest about it, he himself is probably surprised at how far he has come. So this will take some time. Now the market has to acquaint itself with a new era of having someone who gets this far by talking big stuff to slowly, hopefully transform into someone who is doing reasonable stuff.

So, there is still hope?
Yes, there always is. And the best hope remains he really is not serious about doing all the things he said he wants to do. On that, maybe we can find some reassurance on a crazy day from Deng Xiaoping. The man apparently said, "US brags about its political system, but the President says one thing during the election, something else when he takes office, something else at midterm and something else when he leaves."