MAERKI BAUMANN & CO. AG

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INVESTMENT COMMENT

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Words, not deeds

We have now had just over nine months to get used to the fact that the White House is occupied by a man who makes quite a noise. Inauguration took place on 21 January, but even in the ten weeks prior to the new President formally taking over the reins of power, the equity markets adopted their customary forward-running role and embarked on a course that they have remained true to ever since. Or should we say "...that they remained true to up to the end of July"?

The current slight weakness in global equity markets – or to be precise, the two-week hiatus in the upward movement, as there has been a decline of less than 3% in overall terms – has led many an observer to question whether "Trumphoria" has now run out of steam. When dividends are included, the global equity market (as measured by the MSCI All Country World Index) has risen by some 18% since Trump's electoral victory on 9 November 2016.

When the expectations of last November are set against the world's actual experiences of Mr Trump over the first three quarters of 2017, the term "congruence" would appear wildly out of place. Certain character features of "The Donald" – such as his tendency to feel affronted if anyone presumes to take a different view of the world to his own – remain glaringly apparent. At the same time, predictions that the White House would have a moderating effect even on a person of Mr Trump's calibre have not proved correct. His consistent refusal to show even a glimmer of goodwill toward the "fake" media has acquired an almost farcical character at times. And even when those close to him have succeeded in persuading him to make (scripted) statesmanlike comments, it is often barely 24 hours before he is once again "shooting from the hip" or being provoked by critical questions, thereby damaging his standing further. A good example of this came in mid-August, when the US President was almost imploring the press corps to ask "infrastructure questions"; instead the questioners chose to focus solely on his position on developments in Charlottesville, Virginia.

But let's not focus any more on Mr Trump's vulnerable areas, specifically those pertaining to his character. No, we want to look at the question of how things are progressing in respect of the much-vaunted intentions of the new Administration to initiate key reforms. Four key areas can be cited here: a comprehensive revision of tax law, an infrastructure investment programme, an adjustment to the healthcare system ("Obamacare") and the reform of immigration law. The first two aspects in particular fuelled plenty of hope among the investment community that economic growth would accelerate as a result. This in turn led to rising interest rate expectations, as can be seen by developments in the futures markets. On the day prior to the election, just under 18% of market participants expected key rates to be 1–1.25% or higher by mid-December 2017 (i.e. after the last FOMC meeting of the year). Two-and-a-half months later, on the day prior to Mr Trump's inauguration, this figure stood at more than 70%. Incidentally, US key interest rates have been at 1–1.25% since 14 June 2017, and in the middle of this month the futures markets implied (with a probability of at least 30%) that a further increase was on the cards.

The election of Donald Trump has resulted in much that is positive at an economic level, at least from a short-term perspective. The improvement in sentiment among both entrepreneurs and consumers remains beyond dispute. The intent to combat the jungle of regulation, which the Trump administration has voiced loud and clear, is clearly important in this context. The extent to which the axe has actually been wielded in this area is something we cannot say – but we assume that more has been said than has actually been done.

One area in which we do see dark clouds gathering, however, is in the relationship between Congress (Senate and House of Representatives) and the White House. In our view, the President has unnecessarily broken a considerable amount of porcelain here, primarily through his preferred communication form, Twitter. We believe the disputes over the reform of the US healthcare system ("Obamacare") speak volumes. In view of the multiple grand announcements trotted out by any number of different parties, not least by the President himself, the rejection of the House of Representatives' bill by the Senate at the end of July represented a bitter defeat for Trump. As recently as February, he was still amusing the world with his remark that "nobody knew healthcare could be so complicated". His temperament (which in the view of the UK's Economist magazine makes him unfit for office) once again could not be contained, and he fired off a number of Twitter broadsides against the Republican majority leader in the Senate, Mitch McConnell. We doubt this is the ideal strategy for achieving his goals.

But let's look forward: The process of agreeing the budget for the 2018 financial year (beginning on 1 October 2017) could trigger market dislocations, as it is very questionable how strong the President's negotiating position is. A number of groups in Congress – including the very conservative and influential "Freedom Caucus" in the House of Representatives, as well as the Democrats, who will close ranks to vote any bill down – could spring various negative surprises, most notably when it comes to the federal debt ceiling which will have to be increased before September if the Treasury Department is to remain liquid. The Republicans' majority position in the Senate is also precarious. While we do not think that the worst will happen, i.e. a government shutdown, hopes of an imminent tax reform could well go up in smoke. If that were to happen, one of the key pillars of Trump's reform agenda would have collapsed. Expectations of higher growth rates for the US economy in the medium term would also be dashed as a consequence, and it is precisely this scenario that could dampen the mood of investors.

Finally, mention should be made of the proposed infrastructure programme. While it is clear that there is a significant need for such a programme – given the many dilapidated US bridges and airports, as well as any number of roads in need of repair – it is questionable whether an ambitious federal government investment programme could be financed in the first place. The savings effect in respect of the Trump Administration's budget proposal submitted at the end of May, as calculated by the nonpartisan Congressional Budget Office, amounts to just a few tenths of a percentage point of GDP. Interestingly, the significant savings do not kick in until after 2020, while it is worth noting that the deficit (2017 budget) is already 3.6%. Quite how the money is to be found to finance substantial tax cuts – as proclaimed at regular intervals by the President – on top of existing expenditure commitments remains anyone's guess.

Conclusion:
There could be a fair amount of turbulence in the financial markets in September 2017, as the US budget and the increase in the federal debt ceiling are due to be put before Congress. This could also affect the foreign exchange market, in addition to the equity and bond markets. Any rapid agreement, including an increase in the debt ceiling, would strengthen the US dollar significantly in our view, whereas a prolonged tug-of-war fuelled by the colossal egos of the incumbent President and certain Senators would surely do little to assist the value of the greenback as the fourth quarter looms. Finally, there is at least one ray of light to cling on to: Time and again, Donald Trump has shown he is good value for surprises and U-turns. So even though we should be braced for a rough ride over the coming weeks, we should also not relinquish hopes of the bull market in equities persisting.

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