Scotia Wealth Management™

Mailey Rogers Group

ScotiaMcLeod®, a division of Scotia Capital Inc.

Here's What We're Thinking

Global Portfolio Advisory Group – Scotia Wealth

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Investment Strategy: Markets react to Trump win

• **Strategy:** Defying expectations, the American people elected Donald Trump as the next President of the United States while keeping both the Senate and House of Representatives in the hands of the Republicans. Markets reacted in sharp fashion to this unexpected result but within hours retraced most of their losses as calm settled in during the first full day of trading. The policy leanings of the president-elect and the degree to which they materialize in his administration will have a wide-ranging impact across asset classes, markets and sectors over the medium-term. Our long-held investment strategy of remaining Overweight Equities / Underweight Fixed Income with a bias towards cyclical sectors continues to perform well. In particular, the possibility of a stimulative fiscal policy stance, improving near-term growth outlook and maintenance of Fed rate hikes over the coming year should continue to support cyclical/value segments (energy, financials, credit, commodities, etc.). However, our enthusiasm for international and emerging market assets has waned in light of protectionist trade risks looking ahead to next year. We expect market volatility to remain elevated though large cash holdings looking to be put to work on a dip should be an important support to the market in coming weeks. The next major events for investors to put on their calendars include OPEC's meeting aimed at freezing production (11/30), Italy's referendum (12/3), the European central bank's interest rate decision (12/8) and the Fed's expected December 25 basis point (0.25%) rate hike (12/14).

• **Equities:** Bottom line: Volatility indices are declining fast from the elevated levels which have historically been a good buy signal for equities. We believe there is ample cash on the sidelines that has been ear-marked for shoring up underweight equity allocations and awaiting a risk-off opportunity to deploy. In addition to cash over-weights, there was elevated pre-election protection buying and general inertia of investment decisions that will likely experience reversion in the near term - both tailwinds for equities. We believe although historically Presidential party changes have often led to indigestion periods of higher equity turbulence, we are open to the possibility that anxious investors might front-run historical tendencies and begin deploying cash quicker than usual – setting up a situation that if President-Trump is just as brash as Candidate-Trump, then markets will have to price in uncertainty risk premium at a later time. That being said, equity markets are currently implying Trump's pro-growth stance (tax-reform, fiscal spends) will overcome Trump's more anti-growth stance (immigration, protectionism). If that is the case, equities could enjoy a decent year-end rally. As such, we retain our cyclical/value bias of favoring Banks, Insurance, Energy and will add Industrials (Infrastructure and Defence) to the mix in relation to our underweights in defensive/yield names such as Utilities, Telcos and Reits. In addition, we will initiate our preference for US domestically-oriented sectors (Small Caps, Retailers etc.) as opposed to US Exporters and are moving to neutral on our view of the Rest of World over US.

• **Fixed income:** Despite the surprise result from the U.S. election our market view remains relatively intact (yields biased higher). We continue to believe the Fed is on track to raise the Fed Funds rate in December which will likely keep the Bank of Canada on hold for the next 12-18 months. The rationale is two-fold; 1) a Fed hike will likely maintain downward pressure on the Canadian dollar, removing the need for a cut, and; 2) a combined high household debt level and low economic growth (via non-energy exports) preclude the ability to raise. However, if risks to exports arise from potential renegotiation of NAFTA (as Trump has indicated) this would increase our rate cut bias. The potential renegotiation *could* result in one change to our outlook. We have long stated our bias toward Ontario/Quebec as the lower dollar would be beneficial to manufacturing in lieu of weak oil production. Now, with a Trump presidency and a lean toward energy infrastructure (notably Keystone XL) and away from trade agreements (notably NAFTA) we could see that tilt back in favour of Alberta (and other oil producing provinces) and away from Ontario and Quebec.

Economics: Clarity on Trump policy awaited; Fed remains on track for December hike

• Donald Trump was elected the 45th president of the United States on Tuesday night and the Republican party retained control of both the House and the Senate. Despite a lot of short-term volatility, the Fed is likely to remain on track to hike in December with the Fed Funds futures market continuing to assign a relatively high probability of a December hike at 82% as global market stability set in on Wednesday. As a result, a December Fed rate hike is unlikely to elicit a large reaction in the market. However, uncertainties remain over the path of the Fed rate hiking cycle for 2017 as risks are skewing towards more hikes than the two hikes we previously anticipated on the back of a possible overheating economy in the U.S. if Trump introduces sizeable fiscal stimulus. However, this could be partially offset by the drag on the economic outlook from possible protectionist trade policies in coming years.

Currencies and Commodities: Currency markets volatile post Trump victory

• There has been plenty of volatility post the U.S. Presidential Election results in currency and commodity markets. As expected, the clear currency loser from a Trump presidency has been the Mexican Peso, which has declined nearly 5% for the month of November. We do not expect much reprieve for the Peso given Trump's policy stance towards cross-border trade. The CAD has given up its month-to-date gains going into the vote, now trading about flat versus the USD for the month. Similar to Mexico, given the trade-related implications for Canada of a Trump win, the Canadian Dollar's response is appropriate. We also expect diverging monetary policy (rate hike in the U.S vs potential rate cut in Canada) to further pressure the CAD over the near-to-medium term.

Geopolitical: Trump Gets Triumph

• Markets were shocked overnight by Donald Trump's surprise victory. Mr. Trump succeeded by taking the swing states of Florida and Ohio but also the democratic strongholds of Pennsylvania and North Carolina. His victory was all but sealed with victories in Wisconsin and Michigan. There are plenty of questions about what policies the president-elect will implement at home, but his role internationally is also in question. He has spoken critically about NATO and warmly of Russian President Vladimir Putin. His foreign policy will dictate the level of involvement, or lack thereof, the U.S. has in the rest of the world which in turn will dictate the freedom other powers – China and Russia – have to maneuver in the new geopolitical landscape.

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