City National Rochdale®
INVESTMENT MANAGEMENT

Special Bulletin

IMPLICATIONS OF DONALD TRUMP'S ELECTION NOVEMBER 9, 2016

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HIGHLIGHTS

- Uncertainty and complexity lead to low-confidence decision-making.
- Donald Trump's surprising win will precipitate a period of heightened volatility leading to declines in stocks and the U.S. dollar, while investment-grade bonds should benefit.
- No near-term resolution is likely as policy uncertainty will persist for months.
- Republicans' full sweep of Congress increases the risk of unknown policy dynamics.
- The initial reaction of the stock market has not proven to be a valid reason to sell good-quality companies or bonds.
- We own only high-quality companies' stocks and bonds. These companies' products and services are expected to continue leading to higher revenues and profits in the years ahead.
- Every historical circumstance of this magnitude is not immediately comprehensible. Uncertainty makes this a complex decision-making environment. No one, including President-elect Trump, really knows what policies will be enacted.
- The Fed may hold off on a December rate hike.
- We will not immediately be selling stocks or bonds. Our investment teams had previously mapped this outcome as a possibility. We will develop our action plan and communicate that in an update.

City National Rochdale has formed an initial assessment of the implications Donald Trump's victory may have. While this surprising election outcome will have a near-term adverse impact on market prices, we are not sure if it by itself represents a fundamental material change to our outlook for modest economic growth in the year ahead. We will likely make adjustments. The uncertainty associated with this surprise is substantial—not only due to policy dynamics, but also because of the impact consumer and business indecisiveness may have. This may lead us to lower our outlook.

Although Republicans now have control of the executive and legislative branches of government, the past decade-plus has shown how obstructionist Congress can be. Mr. Trump will likely achieve only a fraction of what he promised on the campaign trail. While the Trump victory brings forth political and economic uncertainty, the increased chances of a business-friendly political environment will likely offset volatility fears. Mr. Trump's Cabinet appointees will be critical for understanding his agenda.

GROWTH EQUITY – BLUE CHIP

The uncertainties associated with Mr. Trump's election win will lead to an overall near-term negative impact on economic activity. It may cause some slowing in business revenues and profits, though it is difficult to assess to what extent. It is possible that equities could decline by 10% in the near term. With a Republican Congress, the equity market will remain on edge until it has a better understanding of policy dynamics (which will likely not be known for months). While stocks prices may be declining, we believe the quality of our companies is high, and we have confidence in their management teams. As long-term investors, we find it reassuring to know that the businesses we own should continue to grow their revenues and profits despite political uncertainty, and these factors are the drivers of stock prices in the long-term.

HIGH-DIVIDEND STOCKS

High-dividend stocks have not priced in this surprise outcome. Like with core growth stocks, we would not be surprised to see high-dividend stocks decline by 10%. Mr. Trump has said that he would lower taxes and reduce regulations, which could help the economy. However, it will take time for actual policies to be determined. In addition, Mr. Trump's anti-trade proposals, if implemented, could potentially offset gains from such policies.

CORE FIXED INCOME

Market volatility is expected to pick up, but core fixed income will likely be the asset class of perceived safety. Given the nature of this surprise, this asset class is not priced into the market. The possible realization of Mr. Trump's proposed policies, including massive tax cuts and the disruption of free trade, presents a potential, but highly uncertain, risk to core fixed income. If enacted, these tax cuts and free trade policies could undermine the stability of the U.S. dollar and could potentially lead to higher interest rates and higher import inflation. This may cause the Fed to step up its tightening down the road. It is highly uncertain what tax and trade policies will be enacted.

OPPORTUNISTIC INCOME

Given the unexpected nature of Mr. Trump's win, we expect to see investors moving their capital away from riskier fixed income investments and into traditionally safer investment-grade bonds. Mr. Trump, as well as the Republican-controlled Congress, may push for protectionist policies, which would have a negative impact on exporters and lead to lower bond prices. Such policies, if enacted, could result in higher inflation over time, while anti-immigration policies could lead to a smaller workforce. Both of these outcomes would negatively impact economic growth, and slower growth could mean higher rates of default.

MUNICIPALS

Volatility is expected for municipals, which are not priced into the market. As a result of Mr. Trump's election, investors will likely move their assets into safer municipal bonds. We expect to see lower U.S. Treasury bond yields, with municipals broadly following the trend with a lagged effect.

Mr. Trump's proposed tax cuts, if implemented, would reduce the value of the municipal tax exemption and therefore would reduce the value relative to other asset classes. Longer term, his proposed policies lean toward inflationary, suggesting a higher inflation premium built into the yield curve. We expect a steeper curve as the gap between the yields on short-term and long-term bonds increases, with the long end outperforming.

In addition, Mr. Trump has indicated that he will repeal the Affordable Care Act, which would be a credit negative for much of the healthcare sector. We expect the uncertainty to be reflected in widening interest rate spreads.

TAXES

Mr. Trump has indicated that he would enact significant tax cuts, including eliminating the estate tax and lowering the corporate tax rate to 15%. With regard to capital gains, Mr. Trump has proposed to lower the top income tax rate to 33% for positions held under one year. In addition, his intended repeal of the Affordable Care Act would end its 3.8% tax on non-wage income, effectively lowering both the short- and long-term capital gains rates. However, it all depends on whether these proposed policies are enacted.

THE FEDERAL RESERVE

Mr. Trump has been critical of the Federal Reserve Bank, which concerns us, and if he decides to push for a change in Fed leadership, a resulting disruption in monetary policy would have unknown implications for interest rates. This is a fundamental concern for bond investors. Given the uncertainty, there are two competing forces—one that could lower rates in the near term as a flight to safety effect, while longer-term higher deficits could result in higher interest rates.

In light of policy uncertainty under Mr. Trump, the Fed may hold off on the expected December rate hike.

CONCLUSION

We believe that owning high-quality company stocks and bonds and modifying risk exposure where necessary are the appropriate strategies for the current environment. As we learn more about Mr. Trump's agenda, we will develop and communicate a comprehensive action plan.

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