BlueBay investment response to Trump victory

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In line with our assessment going into the US presidential election that it was too close to call with high conviction, most portfolios were positioned to be less vulnerable to market volatility and drawdowns. Overnight in our London and Stamford CT offices, investment teams monitored portfolios and markets that have so far broadly performed in line with our expectations and prior risk and stress-test analysis.

Global financial markets have so far been relatively calm and we are able to execute transactions in an orderly manner. Macro hedges in currencies, interest rates and credit indices have been partially unwound across some strategies. In the very short-term, our focus is on the open of US financial markets and the reaction to Donald Trump as President-elect and a Republican 'clean sweep' of the Senate and House of Representatives.

The election of Donald Trump is consistent with our investment thesis that popular support for the status quo across 'Western' democracies is fracturing under the pressure of stagnant incomes, economic uncertainty and rising inequality. Rejection of the status quo implies a reversal of the long-standing economic policy mix of ultra-loose monetary policy and fiscal austerity. It also challenges the existing framework for global trade and investment that has boosted global wealth but also exacerbated inequalities within countries. Changes in the economic policy mix and framework for international economic relations need not be bad for risk assets if it leads to a more growth-friendly policy mix and global imbalances that are a continuing source of macro-financial fragility are addressed. But it could also lead to even more strident nationalism, greater state-intervention and protectionism with negative consequences for a swathe of financial and real assets.

Investment approach and themes

Our approach to the new investment regime of radical uncertainty is to fade 'knee-jerk' market reactions, adjusting portfolios in an efficient cost-effective manner using macro hedges and derivatives rather than incurring excessive transaction costs in cash securities. Moreover, we are dedicating more resources to understanding the implications of political and policy change for asset markets and especially for global fixed-income and credit, including emerging market debt.

While acknowledging the uncertainties associated with the election of an 'outsider' to the US Presidency who has no prior governance experience and detailed policy proposals, it nonetheless strengthens our existing bias in favour of steepening government bond yield curves. President-elect Donald Trump is committed to much more infrastructure spending as well as tax cuts. Looser fiscal policy that is growth-positive as well as the greater supply of Treasury securities and the requirement for more risk (term) premium will place upward pressure on longer-dated US bond yields.

Rising political risk in Europe, exacerbated in our opinion by the UK's vote to leave the European Union, will come under even greater scrutiny with the forthcoming Italian constitutional referendum as well as key votes next year in Austria, Netherlands and most importantly Germany and France. The prospect of a victory for the far-right and euro-sceptic Marine Le Pen in the French Presidential election next May should not be discounted. Greater political and policy uncertainty and an economy that is meaningfully weaker than the US implies that core European bond rates will remain extraordinarily low for the foreseeable future even as US rates drift higher.

A key uncertainty of a Trump presidency is the implications for global trade in light of his statements that existing trade arrangements, notably with China as well as the NAFTA with Canada and Mexico, are 'bad deals' for America that must change. Feedback from contacts in Beijing is that Chinese policy-makers were relatively sanguine that they could effectively negotiate with a President Trump and that geo-political tensions would be less under a Trump than Clinton presidency in light of his more isolationist stance on foreign policy. Nonetheless, in our opinion, a Trump election reinforces our expectation that the Chinese currency will continue to depreciate by more than implied by currency forwards even assuming a successful 're-set' of US-China relations.

In our opinion, it is far too early and too uncertain to reach definitive conclusions regarding the implications for emerging markets of Donald Trump's victory. Emerging market economies have been adjusting since the 'taper tantrum' of the summer of 2013 to tighter US dollar liquidity and the eventuality of higher US interest rates as well as stagnant global trade, developments that long precede the US election and prospect of a Donald Trump presidency. The uncertainty pertains whether a Trump presidency will result in a meaningful reversal in 'globalisation' in a manner that hurts emerging market economies. His policy appointments and pronouncements on trade and China will be very carefully monitored. In the short-term, we believe that relative valuations and a strong technical backdrop (significant cash holdings and neutral positioning) will forestall a meaningful sell-off in emerging market assets. Longer-term, much depends on the reality of a Trump presidency and the extent that economic policies in emerging markets adjust in a timely and appropriate manner. In the long as well as short-term, differentiation and using idiosyncratic risk to mitigate global macro shifts will be a key element of portfolio construction.

Shorter duration higher yielding assets more generally are a natural haven in a more reflationary as well as uncertain environment. The relative resilience of credit to the outcome of the election is very consistent with our perspective in this regard.

David Riley, Head of Credit Strategy

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