Q&A with Morningstar Investment Management

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Response to the U.S. Presidential Election

Morningstar Investment Management Australia Limited

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The news that Donald J. Trump will be the 45th President of the United States sent tremors through global financial markets as the election results trickled in on the evening of 8 November 2016. The following Q&A addresses our thoughts on what has happened, what we're doing about it, and how we believe investors should think about this development.

Q: What was the initial response to the news of Trump's win?

A: As Trump began gaining the upper hand on Hillary Clinton and the electoral map grew redder, global financial markets became volatile. U.S. stock futures sold off by 5%, the U.S. dollar fell in value versus the Japanese yen, and gold prices rose.

Q: Did the selling pressure continue when the U.S. stock market opened Wednesday morning?

A: Initial fears of a sharp morning selloff proved unfounded when U.S. markets opened on Wednesday. The major U.S. indices were flat, oil was off less than 1%, and gold rose 1%. Emerging markets traded lower by about 2.5%, with Mexico's market down about 8%.

Q: Why did the markets respond that way?

A: The initial bout of volatility showed, once again, that markets abhor uncertainty. Pundits had widely predicted a victory for Clinton, and markets were comforted in the days leading up to the election by expected continuity with current government policies. Trump's win upended that calculation and caused investors to ponder the potential impact of his policy goals.

Q: Did the election surprise catch Morningstar's portfolios off guard?

A: In short, the answer is no. We had not positioned the portfolio based on any guesses about the outcome of the election, and therefore had no positions to reverse when the surprise result occurred. Our portfolios are driven by long-term valuation-driven investing. Events like this make us glad we're not peering into a crystal ball and betting investors' portfolios on our predictions about the future.

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Q: What, if anything, is Morningstar doing to reposition portfolios?

A: Our investment process continues as it always has. We look to buy assets that are selling at a significant discount to their fair value. Negative sentiment and heavy selling, often driven by fears of what might happen, have historically created the best opportunities for value investors. While we never wish for markets to crumble, we stand ready to profit from any such opportunities that present themselves.

Q: What impact does Morningstar believe Trump will have on financial markets?

A: One significant concern is about the potential for a trade war that could upset the exchange of goods and services among our global trading powers. Trump has vociferously argued that the current trade deals – specifically with China and Mexico – are unfair to U.S. workers, and he has threatened to limit access to American consumer markets unless the deals are reworked. This feeds into an increasingly popular global narrative about the perceived costs of free trade. At minimum, those concerns are likely to limit the potential for any new free-trade deals to win approval, with a worst-case scenario being a major disruption in trade that has the potential to trigger a global recession. The optimists would point to Trump's plan to lower taxes and increase infrastructure spending as boosting GDP and corporate profits, which would be good for stocks.

Q: Does a Trump presidency have implications for stock prices?

A: We think it's far too early to buy into the worst-case scenario. Politicians often find they must transition from their campaign's talking points into the realm of reality and recognize that change can only occur through consensus with legislators in the Senate and House of Representatives. If the pro-growth policies get priority, stocks could get a near-term boost. Our more pressing concern is that we believe U.S. stocks are expensive compared to their fair value, and therefore we are underweight U.S. stocks in our multi-asset class portfolios. Our stock basket portfolios are focused on buying companies that have a margin of safety, which we believe is the best tool for minimising risk.

Q: What is the likely impact of Trump presidency on bond prices?

A: This is a tough question. The Federal Reserve has been inching toward a rate hike in December, but it has used any bouts of volatility as an excuse to avoid raising short-term rates. The long end of the yield curve is driven by investors, and the early move has been toward higher long-term rates because Trump has campaigned on lower taxes and higher infrastructure spending. Those policy goals, if achieved, would likely increase federal debt levels and put downward pressure on bond prices. Our view has been that there is little value in long-term bonds these days because historically low yields have depressed their return potential and created too much risk from rising rates. That thinking is not altered by Trump's victory.

Q: What should advisers and investors do with their portfolios?

A: Remain calm! Before making any decision in the heat of the moment, we recommend that investors consult their financial advisers. We appreciate that the current period is unsettling for many investors and challenging for advisers. We hope that investors keep their emotions in check and continue to focus on their long-term goals. Our portfolios are constructed based on our best estimates for potential reward versus potential downside risk. We will continue to opportunistically buy assets that we view as cheap and steer away from assets that are expensive.