# Investment Insight

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## Donald Trump as the most powerful man in the world

Looking beyond the short-term

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### Outlook at a Glance

Capital markets have been jolted by the Trump victory resulting in increased volatility in some key markets. While such episodes always create opportunities for investors who are prepared to think independently and adopt a long-term, valuation-driven approach, they nevertheless contain dangers for investors too. Chief among these is the temptation to react too quickly or with too much confidence in the wake of the outcome of this significant event.

Let us be clear, while these are uncharted waters politically, volatility in capital markets is nothing new and on this occasion (as in the past) prudence and patience will win. For this reason, we favour research over reaction and urge other investors to do the same.

### Morningstar's View of the Election Implications

While many commentators are already likening this event to Brexit, we believe this is different in one key way: timeframe. Brexit is likely to be a permanent phenomenon, which could have a significant impact on long term economic growth and therefore be more likely to adversely affect our calculation of "fair" or "intrinsic" value. A Trump presidency is not permanent, which leads itself to sentimental change with less long-term significance.

As long-term investors, we need to appreciate and acknowledge this important difference, if we are to avoid the hype and focus on the real drivers of investment returns. On this note, we must come back to the two variables to successful investing: the current price and the long-term fair value.

Ultimately, the real risk to investors of a Trump government is that it results in an impairment of the fair value of assets. At this stage, our early judgement is that a significant impairment is unlikely due to the political cycle. As we view risk as the permanent loss of capital, as opposed to short-term volatility, a Trump government is unlikely to materially shift our already conservative positioning in this regard. As always, buying assets that have a wide margin of safety is the key to successful investing.

## Mispricing opportunities

With markets rallying strongly since Brexit, we have become increasingly concerned that global equity and fixed interest markets are expensive. As such, with our focus on the preservation of capital, we have been holding elevated levels of cash in portfolios in wait for more compelling investment opportunities. This has also seen us repositioning our portfolios further away from expensive asset classes such as domestic and global fixed income, in favour of inflation-linked bonds and cash, believing that the market was not correctly pricing in the likelihood of normal U.S. interest rates and inflation ahead. A dominant theme overnight as investors digest Trump's spending plans is an expectation for higher interest rates and greater inflation expectations.

We continue to see attractive opportunities, supported by a margin of safety, in select Emerging Market, Japanese and European equity markets, notwithstanding that these asset classes may get swept up in any near-term market hysteria. In this sense, turbulent markets can create great opportunities for value investors to purchase assets that will add meaningfully to returns in the future.

As we investigate this, it is important to remember that falls in asset prices often create their own momentum, pushing prices further from fair value in the short term. Investors may therefore get even better opportunities to buy assets in the coming days, weeks and months so should retain some ammunition available to buy more if asset prices fall further.

Said another way, "buying in the dips" can be a profitable exercise providing the investor buys the right assets and those with a margin of safety. We believe a framework to identify these assets is essential, as it may otherwise tempt investors to buy assets that do not have fundamental appeal. In this respect, we continue to believe U.S. equities are expensive relative to fair value and are therefore unlikely to advocate buying into any initial weakness in this market.

At a portfolio construction level, it is also important to differentiate between a cautious investor who is concerned about losing money versus an adventurous investor who is willing to take higher risk. Our exploitation of the valuation-driven opportunities that arise will seek to take account of these differences.

## Further downside risks

Of course, the spike in volatility is uncomfortable for many, and the change in the status-quo may have an impact in matters of global trade and domestic confidence. At a geopolitical level, it is easy to build an ugly bear case, and we are mindful that the media will take full advantage of this fear-driven sentiment (they want to sell newspapers). For instance, with the victory to Trump, and a realistic possibility for a "No" vote in the Italian constitutional vote on 5th December, we could see further political disharmony. The media will also be quick to point out the growing popularity of anti-elitist parties in Germany and France, with these countries each facing their own elections in 2017. We urge investors to keep a level head, and while these issues have substance, investors should look through media exaggeration as political risk is largely unpredictable.

**In summary**

We appreciate that the current period is very unsettling for investors and challenging for their advisers. We will do our utmost to support clients during this time. Whilst it is extremely difficult to predict when this period of volatility will end we believe that our portfolios are appropriately positioned to achieve their long term objectives, based on our unbiased assessment of valuations and fundamentals. Accordingly, we encourage clients to look through the fear and negativity knowing that Morningstar's valuation driven asset allocation approach is well positioned to take advantage of any opportunities that may materialise now or in the future.

For further information on investment management products and services, please contact our Investor Services Team on +61 2 9276 4550 or email AUDistribution@morningstar.com

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