DECALIA

INVESTMENT INSIGHTS

MONTHLY ISSUE #23

December 1st, 2016

THE RONALD VS. THE DONALD

Editorial View

The Ronald vs. The Donald

- There are many similarities between Trump and Reagan, but also some differences
- Ronald Reagan owed his success to a talented team and favorable factors
- Trump's early cabinet choices and economic context are less encouraging

Before going into politics, both Ronald and Donald had careers in entertainment, as an actor and reality-TV star respectively. Both were mocked by intellectuals and the establishment. Reagan, like Trump, was a charismatic speaker, who used simple words to appeal to Middle America with a message of America first, the world second. Both broke with consensus thinking and ran as Republicans in opposition to soft and "politically correct" Democratic presidents. Both overcame high odds to defeat their opponents first in the primaries and then in the general election. On the surface at least, Ronald Reagan and Donald Trump seem to have a lot in common.

Reagan's two-term presidency was widely acclaimed as an economic and political success: domestic unemployment fell, inflation dissipated, and America reclaimed its global leadership against the USSR, after a decade of military and geopolitical setbacks. For investors, too, it was one of the greatest periods ever, with double-digit annual returns in both fixed income and equities. From that perspective, a Trump presidency might seem promising.

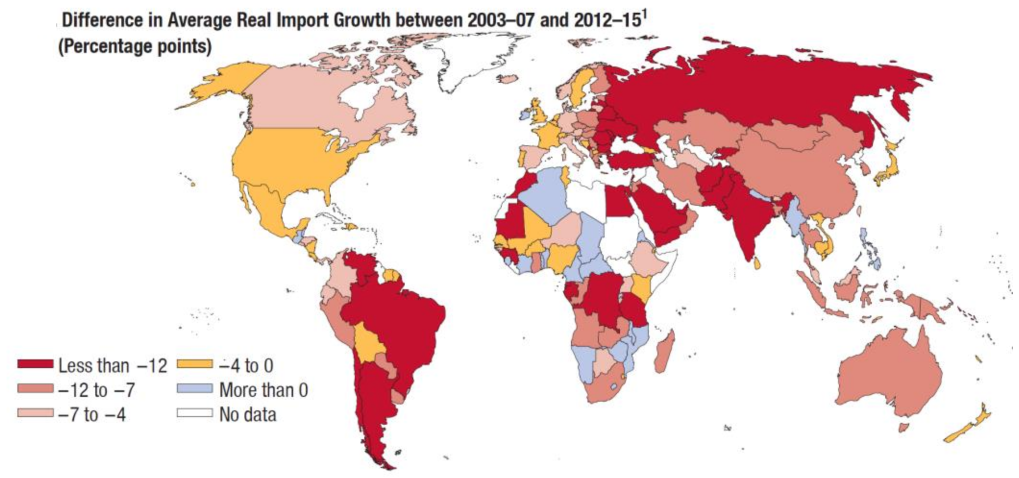
However, historians attribute the success of Reagan's presidency not so much to the man himself as to his team; by all accounts, the former president was a decisive leader and a remarkable judge of character, surrounding himself with highly capable people, such as James Baker, Georges Shultz, Caspar Weinberger, and Alan Greenspan, to whom he delegated to effectively.

He also benefited from a favorable global economic context: his presidency coincided with the collapse of oil prices, the crumbling of the Soviet Union, and the first positive effects of the globalization and deregulation started under Nixon, a decade earlier.

Trump's presidency is starting under very different auspices. The President-elect's early cabinet appointments indicate that he prizes loyalty over credentials and talent. Moreover, it is clear from the way he ran his campaign that he delegates very little outside of his inner circle. More crucially, the Donald faces far less favorable economic conditions, characterized by increasing regulation and de-globalization. Hence, investors should not get their hopes up!

Chart of the Month

Global trade



Global Strategy

ECONOMICS & ASSET ALLOCATION

Donald "trumped" the stock markets

- US elections delivered two surprises: a Trump victory and a stock market rally
- Investors were holding off on investing until after the elections
- Global cycle has been accelerating for months and tightening is clearly ahead

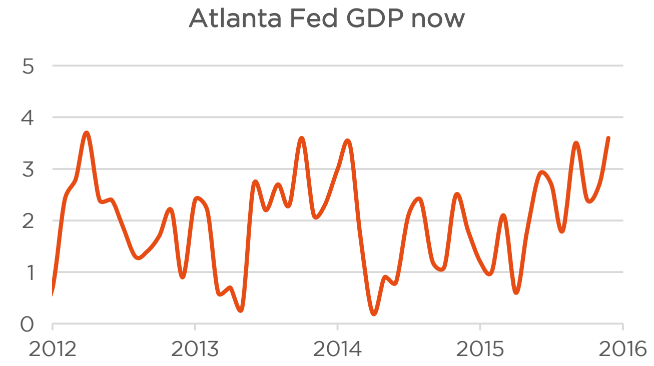
Our prediction last month that markets would re-price at business-as-usual levels was vindicated, though far more dramatically than we expected. Global activity had been accelerating for months. But before November 9th, asset prices reflected this fact only weakly. Little did we suspect that so many investors were waiting until after the US elections to enter the market, regardless of who won! This just goes to show that markets are influenced by economics more than politics, even when faced with candidates as fundamentally different as Clinton and Trump. In fact, perfect fore-knowledge of the latter's victory might have led most investors to make the wrong call, missing out on the 5% stock market rally, while taking a hit from the 50 bp increase in 10-year treasuries.

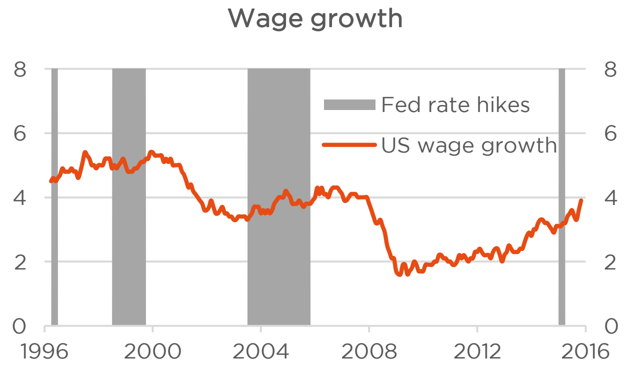
As we noted over the past months, economic conditions across the world are in fact quite positive, and global manufacturing activity is still expanding. In the Eurozone, recovery remains on track, despite the recent Brexit vote. Both France and Italy –the EMU laggards – are now catching up. In EM, China is showing signs of revival supported by sustained government stimuli, a further depreciation of its currency, and a rebound in commodity producers helped by gradually improving underlying price trends. Lastly, Japan just won some unexpected relief with a 10% currency depreciation that should boost its exports in 2017. The country of the rising sun ought to thank the US for unleashing the forces of "global reflation".

Both activity and inflation in the US have shown signs of strengthening, with Q4 GDP seemingly above 3%, and core CPI heading to 2% by mid-2017. Housing starts and wage increases have just recorded their highest level since 2007, for instance. The odds of a Fed tightening in December and beyond have significantly increased, suggesting a revival of the USD bullish trend.

All in all, recent and upcoming disruptive events (e.g. Italian referendum) notwithstanding, we remain comfortable with the global cyclical picture. Hence, we maintain our preference for risk assets over defensive ones in the near term, as Trump's policies are likely to support growth through large tax cuts, accelerated infrastructure spending, and a lightening of the regulatory burden in certain industries. However, looking beyond this short-term boon, risks remain, both in terms of strained international relations (protectionism) and side-effects of US policy (e.g. stronger USD). In this perspective, our portfolio is now better positioned to benefit from this "reflation theme":

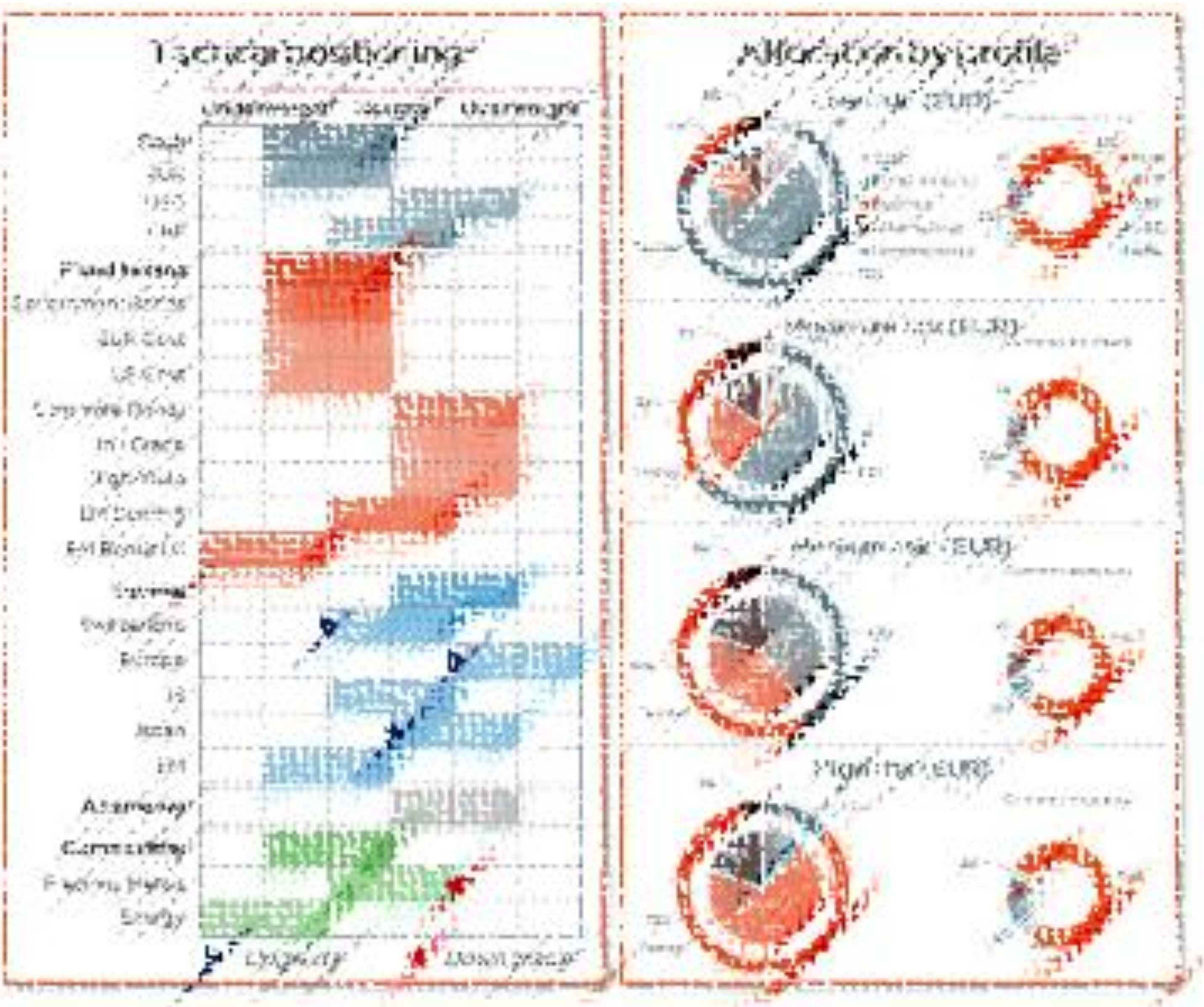
- Overweight US equities, favoring financials, materials, and IT
- Underweight government bonds, especially in Europe, and more cautious on EM Debt in local currency
- Overweight credit risk (inv. grade & high yield) vs. short duration (2-4 years)
- Continued preference for energy over gold in the commodities space





[1] Please learn more about it in our Educational series "Investing through the election cycle"[22]

Asset Allocation



- Unchanged Neutral stance on asset allocation with a constructive near-term bias
- Recently upgraded US equities and reinforced our reflation theme sector positioning
- Maintain a low duration across fixed income portfolios

Contacts

DECALIA Asset Management SA

31, rue du Rhône
Case postale 3182
CH – 1204 Genève

Tél. +41 22 989 89 89
Fax +41 22 310 44 27
info@decaliagroup.com

External sources include: Getty Image, Decalia, Bloomberg, Atlanta Federal Reserve, IMF Global Outlook, Morgan Stanley, Federal Reserve of Saint-Louis.

Finished drafting on December 1st 2016