# Another Win For Populism

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The U.S. election has brought Republican control of the House and Senate, and Mr. Trump to the White House. This was as much a surprise for financial markets as it was for the pollsters. Our surprise was that expectations going into the election were so biased towards the Democratic Party, even after seeing evidence of the voting trend against the "establishment" gaining momentum in the past few years. Populist agendas have resonated with voters who have felt that the establishment has favoured Wall Street over Main Street. An environment where income inequality is at historical highs, where globalization has benefitted multinational companies to the detriment of middle class households in developed economies and where wages have been close to stagnant, naturally feeds into populist sentiment. This narrative has been building ever since the politicians' bailouts in the 2008 financial crisis favoured large institutions over the average person. To be fair the politicians were told that if they fixed the financial system then the economy would fix itself. A look at the 1930s experience should have raised red flags, as it was clear then that the economy needed to be fixed first, and thereafter the financial system would fix itself.

Populist policies are typically inflationary. Monetary policy has not been effective in stimulating growth given the bias to reduce household debt burdens, especially outside of Canada. What can work is fiscal policy – essentially having the government increase its debt-financed spending. How it is spent is a political decision. With Mr. Trump, the focus will lean toward tax cuts and infrastructure spending. Combined with efforts to reduce the regulatory burden this should be more positive for economic growth prospects and stock markets than the Democratic Party's platform. Just the potential for Mr. Trump to make pro-business, pro-growth changes may be enough to generate the momentum that this economic expansion has been lacking.

In the short term, bond markets will be negatively impacted. As politicians ramp up their fiscal spending, the need for extremely easy monetary policy, which has helped suppress interest rates to historical lows, diminishes. The Canadian bond market, however, should outperform given our relatively weaker growth outlook. Corporate bonds, in general, should also outperform government bonds due to the expectation of better economic growth, which typically implies improved credit quality. The long term outlook, however, is that interest rates will remain relatively low as weak population growth, income inequality and central bank policy regimes will all be slow to turn.

Within the stock market, the U.S. bank stocks will be the clear winners. Higher interest rates, particularly with long term rates rising farther than short term rates, should help net interest margins. Mr. Trump's platform also called for less regulations, which may help reduce the increased capital burden. The impact, however, for Canadian bank stocks would be much more neutral given his anti-trade stance. Insurance companies will also benefit from a continued rise in rates. The pipeline companies will be beneficiaries of the Republican's more friendly approach towards energy development. On the losing side are regulated utilities as their steady income was viewed as a bond proxy, and their relative attractiveness diminishes with rising interest rates.

There is a significant amount of execution risk for the new Administration. Although it was a clean sweep for the Republicans, the election campaign made it clear that Mr. Trump is not perfectly aligned with the Party. His vice-president will have to mend that fence. We also do not know if it will be the pragmatic Mr. Trump or his populist alter ego that will take the reins. The populist agenda would include policies that stimulate growth but also those which would restrict growth such as limiting immigration and trade. Nonetheless, both will promote inflationary pressure. The only question is whether economic growth will be achieved with the expected inflation.

We believe that companies that have a superior quality of management, modestly-indebted balance sheets and strong business moats are unlikely to be destabilized by these types of political shocks. After more than 60 years practicing our craft of selecting these solid companies, we expect your portfolio to hold strong through this period.