Discovery Invest

The formula for successful investing

Impact of the US elections on South Africa

US election result impact on markets and our portfolios

Overview

A Trump victory has been declared, with both the House and the Senate set to remain under Republican control. The markets have put a relatively low probability on a Donald Trump victory with the majority of reputable polls having indicated a win for Hillary Clinton. As a result, we are not surprised by an initial shock reaction hitting most risk assets such as equities as well as the currencies of areas at risk from Trump's policies such as Mexico, Asia and Canada.

We believe, similar to Brexit, that the initial panic may be followed by a recovery as the market tries to price in the uncertainty around how much Trump will follow through on his campaign promises and the extent to which he can expect support from a Republican Congress. It is encouraging that his initial message was positive and focused on unity, with Trump stating that he wants to be the president for all Americans and engage with global partners on a fair basis. Whether that's just rhetoric, will remain to be seen.

Whatever happens, it is going to take time for the new administration's agenda to become clear, let alone be implemented. He is the first US President to be elected who has never held formal political office nor a position in the military, so there are a lot of unknowns in how he will take decisions, and how he will fill his transition team.

In the medium term, his protectionist agenda may weigh on global growth if pursued, with looser fiscal policy providing some offset. In combination, these measures could also lead to higher inflation. For now, we believe that the global economy will continue on its current path of a synchronised pick-up in growth, which should help market sentiment. However, this election result reinforces the sense that populism is on the rise globally and concerns are now likely to focus on how this phenomenon will impact other forthcoming elections.

Impact on markets

Following Donald Trump's victory to become the 45th US President, the markets experienced a sharp initial "flight to safety" which saw gold, the yen and US bonds rally while equities, the rand and especially the Mexican Peso came under significant pressure.

Trump's acceptance speech, however, was measured and could even be considered reconciliatory (both at a national and an international level). He emphasised a presidential term where the focus will be on growth through infrastructure spending. This provided some support to markets with most asset classes reversing the sharp sell-off (or rally) following the initial reaction. For example, the ALSI opened 2.5% lower this morning (Wednesday, 09 November 2016), but by midday had recovered all the losses and traded flat compared to yesterday's close.

While the recovery on most asset classes is pleasing, there are a number of questions and risks that have to be assessed and answered in coming weeks which should provide more clarity on the potential longer-term impact on markets and economies following this significant event. Some of the key questions include:

- Clarity and more detail on Trump's policies and the ability to implement these policies
- The impact on fiscal and monetary policies in the US going forward. Some immediate questions relate to what the FED will do in the upcoming monetary meeting in early December. While market expectations for a rate hike have immediately declined earlier today, these expectations are moderating (back to levels where they price in a strong likelihood for a rate cut (again).

These questions are definitely a concern for markets and this uncertainty is best reflected in the sharp rise in US Government Bond yields that has risen to 1.95% (its highest level since January) during the course of the day.

As we have seen earlier this year with Brexit, the outcome of political events are becoming increasingly more difficult to predict. We have not positioned the funds in favour of a specific outcome. However, we will not hesitate to make changes to the funds should conditions which could impact the longer-term market and economic environment change.

Impact on Discovery funds

Discovery Balanced Fund range

We have not made any material changes to the portfolios in anticipation of a specific outcome of the US election. While we remain fairly conservatively positioned in terms of our allocation to riskier assets (domestic and international equities), exposure to these asset classes could result in short-term volatility as markets digest potential changes in US economic policies.

Some of the key positions currently reflected in the Discovery Balanced Fund range include:

- We have a fairly conservative allocation to domestic equities, however, the increased allocation to resources shares (gold, platinum and diversified miners such as BHP Billiton and Anglo American) is positively contributing to returns. That said, 'SA Inc' counters such as banks and retailers are somewhat softer on the back of a modestly weaker rand.
- We remain close to the maximum offshore allocation which should benefit from a weaker rand. We have however no exposure to offshore bonds where the markets are under some pressure.
- We have a fairly high allocation to cash (both domestic and offshore) which we could employ if opportunities present themselves.

Discovery Diversified Income Fund

Our portfolios have generally been conservatively positioned for some months given the significant local and offshore political risks.

There are very real cross- winds at play at the moment and we are watching developments closely. For fixed income assets there is every chance that the "fiscal policy taking over the baton from monetary policy" narrative gathers momentum as the Republicans now hold the presidency, congress and senate. The prospect of political deadlock has decreased, and we believe that traditional conservative policies such as tax cuts could very well follow. This expansion would put pressure on longer-dated US bonds, and provide a negative impulse for longer-dated bonds across the globe.

Furthermore, the economic uncertainty this type of political upset creates could very well delay the Fed from hiking interest rates in December, providing support for shorter-dated bonds.

Discovery Equity & Dynamic Equity Funds

An integral part of our portfolio construction process is to avoid being over-exposed to a specific macroeconomic theme or view. We construct a diversified portfolio of shares where performance is not dependent on a specific event/view.

Discovery Equity Fund

Looking forward, we remain very optimistic on the outlook for our key overweight holdings where resources shares such as BHP Billiton, Anglo American and Sibanye Gold are trading at cheap valuations and are receiving positive earnings revisions. While domestic property counters came under some pressure today on the back of a mildly weaker rand, we remain optimistic about SA Corporate, for example. Despite the short-term noise, the company offers an exceptional yield to investors and have a high level of earnings certainty. The fund remains close to its maximum allowable offshore allocation which should benefit from a weaker rand.

Discovery Dynamic Equity Fund

We remain very optimistic on the outlook for our key overweight holdings where resources shares such as African Rainbow Minerals and Sibanye Gold are trading at cheap valuations and are receiving positive earnings revisions. While holdings in domestic banks such as FirstRand for example are came under some pressure today on the back a mildly weaker rand, we remain optimistic on the outlook for these counters. Despite the short-term noise, the company offers decent value with reasonable earnings growth expectations. The fund remains close to its maximum allowable offshore allocation which should benefit from a weaker rand.

Discovery Flexible Property

While the domestic listed property market has come under some initial pressure, returns are moderating with declines only around 0.8% towards the afternoon's session. We do not believe that the outcome of the US election will have a material long-term impact on the domestic real estate market and have therefore not made any material changes to the portfolio.

Considering a fairly muted domestic growth environment, our preference remains for domestic real estate companies with a high degree of distribution growth certainty. We are not actively chasing higher yields currently on offer from lower quality counters where sustainable distribution growth is less certain. In a "low return world", the outlook for listed property however looks very decent. Yields on domestic counters around 5% to 7% and distribution growth expectations around 7% to 10% could see the sector deliver (low) double digit returns (if we don't have any additional major shocks on the rand and a significant rise in domestic bond yields).

Discovery Global Equity Fund

As with the aftermath of the UK's EU referendum in June, it is fair to expect a degree of short-term market reaction to what was broadly believed to be the less favourable election outcome for the markets.

In the lead-up to the election the team worked closely with our investment risk team to conduct stress tests of our portfolios, based on a variety of potential market impacts. The scenarios modelled centred on wider-market expectations which include a possible dip in global equity markets, depreciation of certain emerging market currencies, and strengthening of other developed currencies such as the yen and euro. We have already seen evidence of these shifts in the immediate market reaction.
Given our current positioning and risk characteristics, our analysis suggests these scenarios would cause minimal impact to the relative performance of the portfolio versus the benchmark.

The Discovery Global Equity process focuses on the bottom-up analysis of stocks in our portfolio and our investable universe. In the event of any significant market reaction to Trump's victory, our approach will be to follow our process: to understand where investment cases have been fundamentally impacted and therefore advisable to sell, but also to search out new opportunities created in the market.