Månedskommentar af
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Inceased uncertainty about the US election

On October 28, FBI Director James Comey announced that the FBI will re-open the investigation of Hillary Clinton's emails and email server. This has spurred renewed focus on Hillary Clinton's poor handling of top-secret information, and there is also a possibility that, this time, the FBI will find reason to prosecute, since the bureau gained access to about 300.000 emails that Hillary Clinton deleted before the server and other hardware was handed over to the FBI.

This unusual development has increased support for Donald Trump's candidacy, but in most opinion polls Clinton still holds a narrow majority. Bookmakers' odds also indicate a closer race, but converted into probabilities, they give Hillary Clinton an 86% chance (down from 90%) and Trump 14%.

With Wikileaks on the sidelines, almost daily leaking hundreds of emails from leading politicians in the Democratic Party and continually claiming that the leaked information will result in police investigations., there is still some uncertainty up to the election. It is my assessment that Clinton will be elected - not least because her voters and the media gradually almost have become immune to the ongoing revelations. However, I believe that the outcome can be significantly narrower than the market expects, and it is my assessment that Trump has a significantly higher probability of being selected than 14%.

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Expectations to the election

It is my opinion that the election between Clinton and Trump is characterized by the same dynamics as the referendum on Britain's membership of the EU. In other words, a vote for Clinton (equivalent to Remain) expresses better taste than a vote for Trump (equivalent to Brexit). So far, it also seems that Trump can bring many disgruntled voters to the polls, and he is more a vote against the system – of which Hillary Clinton is seen as the most prominent representative - than he is an active choice.

As the market appears to have priced in a Clinton victory with high probabilities, an election of Trump and the uncertainty it causes can surprise the market massively at this time.

To predict a market reaction to a surprising Trump win is of course associated with great uncertainty, but based on a number of analyses, it is my overall assessment that the market reaction will be relatively negative for risky assets (especially US equities), but not as negative as other analyses show (in some cases expecting a reduction of 10-15%). The reason is that the market here in early November has dropped and already priced in a higher probability of a Trump victory.

In the event that Trump becomes president, I expect the following reactions

- MSCI USA falls by 8% (in USD)
- MSCI World falling by 6% (in local currency)
- MSCI Emerging Markets fall by 8% (in local currency)
- EUR / USD increases by 4%
- European government bond yields (for durations over 5 years) fall by 0.10 percentage points.
- European government bond yields (for durations less than 5 years) fall by 0.5 percentage points
- Most EM currencies fall by 3-10% (peso falls the most)

With regard to specific sectors of the stock market - and judging by the correlation between the Trump / Clinton spread in the polls and the various equity sectors - Utilities, Consumer Staples and Health Care will perform the best. Financials, Energy and Industrials seem to perform worst.

Similar to the Brexit referendum, I expect that the market just days after the result will calm down, and normalize back to the levels from before the election – all within in 5-10 business days.

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Strong momentum in China

Over the summer, I expected a reversal and then an increase in the leading indicators in China - mainly due to a large increase in money supply and fiscal stimulus. This is now beginning to pay off, and the last fears of a hard landing in China in the near future should therefore be buried.

The massive stimulus that Chinese authorities have put into the economy in recent quarters now seems to bear fruit, as a very large share of economic indicators point up for the Chinese economy for the next 12 months. National and Caixin PMI is above 50 (expansion), which is supported by SpaceKnows satellite measurements of economic activity in China.

Bloomberg's monthly GDP indicator for China is well above 7%, and monetary policy has been strongly stimulating the whole year. In addition, Chinese companies again reported healthy earnings growth, and container freight out of Chinese ports is rising again (with a growth rate of around 5%). The Australian dollar in real and trade-weighted terms is also at its highest level in almost two years, which is significant because the Australian economy is considered to be quite dependent on how the Chinese economy develops.

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Stronger European figures - higher interest rates

October saw stronger macroeconomic data in the Eurozone. We have to go back to the spring of 2015 to see so many great, positive surprises in the data. As I have warned repeatedly here in the monthly report, a combination of stronger macro data and higher energy prices could lead to higher inflation expectations and thus higher long-term rates.

Long-term rates have already risen significantly over the past two months - in virtually all regions. In the US, 10-year government bond yields increased by more than 40 bps. since July. In Germany they increased by almost 40 bps. Approximately half of this increase comes from higher long-term (5Y5Y) inflation expectations. My assessment is that this trend can continue - because data is still surprising, and because we have not seen the full impact on the overall inflation from the sharp increase in energy prices since the beginning of the 2016.

The macroeconomic situation may to some extent be compared with the development until April 2015, when long-term interest rates were in a persistent downward trend until mid-April, although macro data had improved and far more positive than market expectations in February and March.

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British Supreme Court insists on parliamentary vote on Brexit

In early November, the British High Court ruled that the British government - as a result of the referendum on the British connection to the EU – does not have the right to activate the so-called Article 50 of the Lisbon Treaty, which will affect the exit.

The British pound immediately rose almost 2% on the news. The reason is that, in the British Parliament, there has been a majority against Brexit, and the market now imagines that the parliament can block such a decision. My assessment is that Parliament - now apparently been given the right to veto the resolution - will follow Prime Minister Mays recommendation to exit. May herself recommended that the British people should vote to remain in the EU, but she has since then insisted that politicians must follow the outcome of the referendum. One could fear that the British Supreme Court decision will contribute to enhancing the already great uncertainty, but so far I expect May's line will rule and that Parliament thus also will vote in favour of activating Article 50.

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MomVol indicator - close to sell

At the end of October, our MomVol-indicator, which aims to gauge how attractive equity market exposure will be for coming month, had a value of 0.69 (it can take values between 0 and 1). The threshold under which it most likely will be unattractive to be in the stock market is 0.6 - so we are close to "risk-off".

In the beginning of November, the market has already dropped as Trump's polls have improved, but if he were to be elected, the likelihood of a sale signal will increase. However, much can happen over the election. As described above, I see a drop in the stock market due to the fact that Trump would be elected president as a buying opportunity.

The bottom line is - investors should not do anything they would not have done otherwise

Editorial deadline: November 4, 2016