INVESTING IN THE AGE OF DONALD TRUMP

The first signs following the U.S. election have been positive for financial markets, but what do the president's policies mean for the future?

By ***Jennifer Paterson***

The whole world is watching to see what President Donald Trump will say or do next — and Canada's institutional investors are no exception.

When the Caisse de dépôt et placement du Québec reported its annual results in February, its president and chief executive officer, Michael Sabia, said the world was experiencing an unprecedented level of geopolitical risk that the markets had yet to account for.

But he also acknowledged that, despite the noise around the election, the U.S. economy remains quite stable. So what should pension plans and other large institutional investors be considering when it comes to navigating their way through the age of Trump?

It's impossible to predict what's going to happen, so rather than trying to guess, institutional investors should be thinking about how to bridge the move from President Barack Obama's administration to the next four years — or longer — of Trump's presidency, says Kurt Reiman, chief investment strategist at BlackRock Asset Management Canada Ltd.

"It's how to think about all the things that matter when you make an investment decision — economic fundamentals, valuation, correlations, structural changes — and how you blend that all with the change in the status quo of this new administration," he says.

'Tweaking' trade agreements

During Trump's presidential campaign, a key promise was to renegotiate the North American Free Trade Agreement. His primary target appears to be Mexico, since Canada, despite recent issues around dairy and softwood lumber, has a more balanced trade relationship with the United States. Indeed, when Trump met with Prime Minister Justin Trudeau in February, he said the United States was in favour of "tweaking" NAFTA, rather than dramatically changing it.

While any changes to NAFTA would be a major issue for Canadian institutional investors, broader trade agreements should be the bigger focus, particularly from the perspective of the equity markets, says Bruce Cooper, chief executive officer and chief investment officer at TD Asset Management Inc. "There's this whole notion of the world we've been living in for the last 30 years, governed by the World Trade Organization, tariffs coming down, trade barriers coming down. That has been an enormously positive environment for corporations on a global basis.

"So, to the extent you get that unwinding — meaning instead of a more global world, we get a less global world — I think, from an equity market perspective, the potential double whammy is earnings could be impacted. And secondly, the multiple could be impacted, meaning the multiple that the equity market trades on could go lower. . . . That's the risk if the market focuses on the idea that Trump is going to be successful in his fair-trade versus free-trade approach."

Tim Bray, managing partner and co-chief investment officer at global equity manager NS Partners Ltd. in London, England, says a move to abolish NAFTA may not be a big problem for Canada if it's able to replace the free-trade deal with a bilateral agreement with the United States. "I wouldn't be too bearish on NAFTA; he's not after you," he says, acknowledging the issue isn't necessarily positive for globalization.

As for the impact of any trade changes on investments in China and Mexico, Erik Weisman, chief economist and fixed-income portfolio manager at MFS Investment Management in Boston, says the risks look manageable so far. "On the margin, investments in China and Mexico may be just a touch riskier today because of the Trump administration's rhetoric. But at this stage, it is just rhetoric and, on many issues, Trump has chosen a less aggressive stance on trade than was anticipated."

While it may sound trite, says Cooper, diversification is an investor's best friend in the current environment. "Given that the range of possible outcomes is quite wide, diversification is even more important than ever. For a Canadian investor, particularly, there's certain scenarios that could unfold that could be quite positive for the U.S. dollar and quite negative for the Canadian dollar. For institutional investors in Canada, having some U.S. dollar exposure in that environment could be quite helpful."

Bond yields, interest rates and inflation

While interest rates had hit bottom in July 2016 following the British vote to leave the European Union, Trump's policy announcements led forecasters to increase expectations for growth, which filtered through to the stock market, a stronger U.S. dollar and a rise in bond yields, says Robert Head, senior vice-president and portfolio manager for fixed income at Foyston Gordon & Payne Inc.

"From the bottom in July to the election in November, rates rose about 40 basis points," he says. "From the time of the election to mid-December, it rose another 50 basis points. In total, that's nearly 100 basis points from the low in July. It was a pretty substantial move."

But while bond yields have been increasing since the election, they're still at the same historically low levels they were at around the beginning of 2016, says Yvan Breton, head of fiduciary management for Canada at Mercer Investment Management. And Weisman notes there are many trends that will make it difficult for the increases to continue. "Higher yields and a stronger dollar have

TOP 5 | FASTEST GROWING (%) - LESS THAN $1 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2016

	Company	2016 CPA	2015 CPA	Variance
1	Highstreet Asset Management Inc.	$26.2	$7.3	258.9%
2	Galibier Capital Management	$312.0	$165.4	88.6%
3	Canadian Urban Ltd.	$582.0	$381.0	52.8%
4	Global Alpha Capital Management Ltd. (a Connor Clark & Lunn Financial Group company)	$38.5	$25.7	49.8%
5	Hillsdale Investment Management Inc.	$612.6	$438.0	39.9%

TOP 5 | FASTEST GROWING (%) - $1 BILLION TO $10 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2016

	Company	2016 CPA	2015 CPA	Variance
1	Neuberger Berman LLC	$4,353.0	$2,899.2	50.1%
2	Sun Life Institutional Investments (Canada) Inc.*	$2,443.3	$1,671.6	46.2%
3	Picton Mahoney Asset Management	$1,767.0	$1,270.0	39.1%
4	Unigestion SA	$1,630.0	$1,175.3	38.7%
5	Crestpoint Real Estate Investment Ltd. (a Connor Clark & Lunn Financial Group company)	$1,710.5	$1,251.8	36.6%

Notes: *2015 figure restated

TOP 5 | FASTEST GROWING (%) - GREATER THAN $10 BILLION

CPA = CANADIAN PENSION ASSETS / ASSETS (MILLIONS) AS OF DEC. 31, 2016

	Company	2016 CPA	2015 CPA	Variance
1	Burgundy Asset Management Ltd.	$10,649.5	$8,502.9	25.2%
2	Fidelity Investments Canada ULC	$21,762.8	$18,675.5	16.53%
3	Brookfield Asset Management	$22,954.0	$19,707.0	16.48%
4	Manulife Asset Management	$38,986.9	$33,862.5	15.1%
5	Sun Life Global Investments	$10,574.8	$9,335.4	13.3%

Source: Firms participating in the Canadian Institutional Investment Network's spring 2017 top 40 money managers survey

TOP 40 MONEY MANAGERS

CANADIAN ASSETS (MILLIONS) UNDER MANAGEMENT AS OF DEC. 31, 2016
CPA = CANADIAN PENSION ASSETS
▲▼ Indicates an increase or decrease in assets from 2015 to 2016

Rank	Manager	Rank 2016	Change	2016 CPA	2015 CPA	Total Assets 2016
1	TD ASSET MANAGEMENT	1	▲4.1%	$91,924.6	$88,306.6	$272,620.6
2	BLACKROCK ASSET MANAGEMENT CANADA LTD.	2	▲0.4%	$82,695.8	$82,354.8	$155,181.4
3	PHILLIPS HAGER & NORTH INVESTMENT MANAGEMENT (RBC GLOBAL ASSET MANAGEMENT)	3	▲0.0%	$56,871.6	$56,869.2	$284,097.3
4	MANULIFE ASSET MANAGEMENT	4	▲15.1%	$38,986.9	$33,862.5	$113,034.3
5	BEUTEL GOODMAN & COMPANY LTD.	5	▼2.6%	$30,083.0	$30,890.0	$37,764.0
6	FIERA CAPITAL CORP.	6	▼0.4%	$29,392.4	$29,512.3	$74,638.0
7	CONNOR CLARK & LUNN FINANCIAL GROUP	7	▲6.4%	$29,203.6	$27,458.5	$65,379.2
8	STATE STREET GLOBAL ADVISORS, LTD.	8	▲4.0%	$25,969.0	$24,967.9	$48,608.0
9	BROOKFIELD ASSET MANAGEMENT	12	▲16.5%	$22,954.0	$19,707.0	$71,990.0
10	FIDELITY INVESTMENTS CANADA ULC	13	▲16.5%	$21,762.8	$18,675.5	$129,523.3
11	CIBC ASSET MANAGEMENT INC.[1]	9	▼3.7%	$21,484.8	$22,302.2	$141,373.9
12	GREYSTONE MANAGED INVESTMENTS INC.	11	▲2.9%	$21,112.7	$20,518.2	$31,970.8
13	GLC ASSET MANAGEMENT GROUP LTD.[2]	22	▲64.5%	$21,015.3	$12,773.1	$51,314.6
14	J.P. MORGAN ASSET MANAGEMENT (CANADA) INC.	10	▼0.2%	$20,539.0	$20,580.3	$24,368.0
15	LETKO BROSSEAU & ASSOCIATES INC.	15	▲4.8%	$17,785.7	$16,975.7	$29,374.1
16	MFS INVESTMENT MANAGEMENT CANADA LTD.	14	▼6.3%	$16,262.4	$17,357.5	$27,285.4
17	BNY/MELLON ASSET MANAGEMENT LTD.	18	▲6.7%	$16,138.0	$15,131.0	$23,917.0
18	FRANKLIN TEMPLETON INSTITUTIONAL	16	▼9.5%	$15,133.6	$16,714.1	$40,720.0
19	WELLINGTON MANAGEMENT GROUP LLP	17	▼5.9%	$15,075.0	$16,013.0	$21,480.0
20	PIMCO CANADA CORP.	21	▲10.9%	$14,313.0	$12,908.0	$31,900.0
21	JARISLOWSKY FRASER LTD.	20	▲3.4%	$13,430.0	$12,983.0	$36,357.0
22	LEITH WHEELER INVESTMENT COUNSEL LTD.	23	▼1.7%	$11,676.2	$11,880.4	$17,961.0
23	BURGUNDY ASSET MANAGEMENT LTD.[3]	28	▲25.2%	$10,649.5	$8,502.9	$24,209.9
24	SUN LIFE GLOBAL INVESTMENTS	25	▲13.3%	$10,574.8	$9,335.4	$15,601.5
25	ADDENDA CAPITAL INC.	24	▲2.2%	$9,732.2	$9,527.3	$27,056.8
26	GOLDMAN SACHS ASSET MANAGEMENT LP	27	▲11.2%	$9,730.9	$8,750.3	$12,944.9
27	MAWER INVESTMENT MANAGEMENT LTD.	33	▲19.6%	$9,532.2	$7,970.9	$39,461.6
28	MERCER GLOBAL INVESTMENTS CANADA LTD.	29	▲8.1%	$9,020.7	$8,344.6	$10,919.7
29	INDUSTRIAL ALLIANCE GROUP	34	▲13.3%	$8,474.5	$7,481.8	$84,847.0
30	MORGUARD INVESTMENTS LTD.	32	▼1.6%	$7,933.3	$8,062.5	$13,197.9
31	BAILLIE GIFFORD OVERSEAS LTD.	26	▼16.3%	$7,499.0	$8,958.8	$12,951.0
32	GUARDIAN CAPITAL LP	36	▲12.4%	$7,415.7	$6,595.7	$24,351.8
33	ABERDEEN ASSET MANAGEMENT PLC	30	▼11.8%	$7,214.8	$8,183.1	$10,600.2
34	HEXAVEST INC.	35	▲0.4%	$6,967.4	$6,937.5	$8,004.5
35	ALLIANCEBERNSTEIN	39	▲21.9%	$6,812.8	$5,587.9	$14,246.5
36	CANSO INVESTMENT COUNSEL LTD.	43	▲16.8%	$6,284.6	$5,381.0	$19,855.5
37	ARROWSTREET CAPITAL LP	40	▲10.5%	$5,984.0	$5,416.0	$7,191.0
38	SPRUCEGROVE INVESTMENT MANAGEMENT LTD.[4]	31	▼30.0%	$5,665.5	$8,096.6	$7,965.6
39	ACADIAN ASSET MANAGEMENT LLC	41	▲10.4%	$5,640.0	$5,106.8	$6,973.1
40	INVESCO	37	▼7.7%	$5,480.5	$5,937.1	$32,808.0

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Notes: 1. Total assets include $29 billion in third-party sub-advised assets and $28.1 billion in notional currency overlay assets. Of the $28.1 billion, CIBC manages $6 billion of the underlying assets. 2016 pension assets include $5.5 billion and 2015 pension assets include $5.4 billion in currency overlay assets. **2.** The increase is due to Portfolio Solutions Group moving under the GLC umbrella as a distinctive investment division, effective Jan. 1, 2016. **3.** The increase in variance is due to a combination of new mandates won and market growth. **4.** The decline was mainly due to terminations and existing client cash flows/rebalancing. ***Figures in this report are based on responses provided by the survey participants.* Benefits Canada *assumes no responsibility for the accuracy of the data provided. All totals are subject to a +/- variance due to rounding.***

2016 top 40 total:	$774,421.8
2015 top 40 total:	$742,917.0
Variance:	▲4.2%

POWERED BY CANADIAN Institutional Investment NETWORK

Source: Firms participating in the Canadian Institutional Investment Network's spring 2017 top 40 money managers survey consistently upended any momentum we have seen in this eight-year business cycle, and I think if we were to see a rapid rise in rates and another step up in the dollar, we would see some of those issues return," he says.

While U.S. interest rates are on the rise, Cooper says those in Canada are unlikely to go up. "We do not anticipate really rapid growth in the Canadian economy, which should keep inflationary pressures at bay, which in turn should keep interest rates from running away on us."

In light of all of those trends, what strategies should investors be considering? "If you don't think yields or the dollar are going a heck of a lot higher and you think commodities will hang in, then [emerging markets] actually look like a pretty good trade in individual countries, relative to high yield," says Head.

Also, corporate credit has continued to perform well, notes Reiman. "A lot of large institutional investors have been overweight corporate bonds for some time, and that's been a great trade," he says. "We've been scaling back on the lesser quality and investing in higher-quality corporate credits because the spread differential is relatively small. . . ."

During the Caisse's presentation of its annual results, Sabia said the pension fund is restructuring its fixed-income portfolio in order to reduce exposure to traditional bonds and increase its investment in corporate credit. "We're breaking that apart into two portfolios, one of which will essentially be traditional fixed income. . . . We're creating another portfolio and putting the investments we have made so far in . . . corporate credit into that portfolio. It's in that portfolio that we're going to put more priority, because we think that can offer us a relatively low level of risk but somewhat higher returns."

Infrastructure spending and tax reform

U.S. interest rates could rise if Trump is successful in implementing some of his policies on deregulation, tax cuts and infrastructure, says Cooper. "But if they muck around with trade too much, arguably that would tend to depress growth. So we need a bit more clarity on which of these policies are going to unfold."

Sabia, echoing that sentiment when asked about the potential for infrastructure investment and tax cuts during the Caisse presentation, noted Trump would have to work with Congress to implement any new policies. And Jonathan Simmons, chief financial officer at the Ontario Municipal Employees Retirement System, said during the pension fund's announcement of its annual results in February that it would look at all infrastructure investment opportunities. "About half of our infrastructure book and 60 per cent of our real estate is in North America," he said. "All of the economic indicators are quite strong right now, and we think Canada will benefit from the strength in the United States."

Again, institutional investors should be wary that Trump may not get much done, says Bray. "The U.S. political system . . . has all those checks and balances . . . so there might be real problems getting some of this stuff through for Trump."

Indeed, Trump is likely to prioritize his plans for tax reform before he gets to infrastructure spending, says Cooper. "People whose job it is to read the tea leaves, which is not easy with Mr. Trump, would say infrastructure could be down the road a little bit because he's clearly led with Obamacare. Most people think tax reform is extremely high on the agenda — [and it] might come next — and, probably, they don't have capacity to do more than two big things this year."

From an equity perspective, U.S. tax reform — in particular, changes to corporate taxes — could be promising for investors, adds Cooper. "If companies pay fewer taxes, their earnings will go up and that will be positive for the equity market. I think it's very important to watch tax reform and how that unfolds. It's a potentially much bigger impact to the equity market and, therefore, to institutional investors than, say, infrastructure."

Ultimately, any new policies are likely to take longer than anticipated, so investors should be careful not to chase the excitement of some of those investment prospects, says Reiman. "We started with immediate euphoria; I think what we've learned is that it's a bit trickier. I don't think we get protectionist measures, until there really is a reason to do so. . . . So some of the things we're talking about today may not be real investment opportunities or risks until several years in."

Twitter risk

On the other hand, Trump's penchant for using Twitter to criticize or praise individual companies for their perceived opposition to or support for his policies has introduced a new, short-term dynamic to the market, according to Jim Elder, director of risk services at S&P Global Market Intelligence.

Elder looked at a collection of firms that Trump had targeted via Twitter, examining the days before and after the tweet, and how the perceived credit risk changed as a result. "What I found was that, in most of the cases, there was a corresponding increase or decrease in credit risk with the sentiment of this tweet," he says. "You can view it just like in the stock market. It's a bit harder to know who's going to be the target, I guess, but it's definitely an interesting phenomenon."

Reiman, however, doesn't put a lot of stock in Trump's Twitter rants. "I'm not dismissing the importance of a regulation or Twitter feeds in the investment outcomes but I'm just saying there's a lot of other factors — fundamentals, valuation, sentiment, structural trends — that can influence outcomes over the time frame, this age of Trump, rather than the day in and day out of Trump."

Indeed, if Trump's tweets do manage to rustle the markets, the effect is very temporary, notes Bray. He points to the example of Lockheed Martin Corp. in December 2016, when Trump tweeted that, because of the "cost overruns" involving the company's F-35 aircraft, he was asking Boeing Co. to price out a comparable design.

"The fundamental impact on Lockheed Martin was pretty much close to zero," says Bray. "There was an initial shock, the shares initially sold off, but then the market makes a more measured assessment of what's actually possible to achieve and the share prices are back." BC

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