Manulife Investments

INVESTMENT NOTE

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U.S. Election impact

As we were approaching "Election Day" in the United States, the closer we got, the more questions there were as investors expressed concerns about the potential outcome and the eventual impact on the markets and economies. While we believe the election of Donald Trump to President of the United States, will have an impact, it is important to remember two things about the U.S.:

1. Within a diversified portfolio, an allocation to the U.S. stock markets should be viewed as a strategic allocation, not a short term tactical trade, given the depth and breadth of the market and the number of quality companies.
2. The founders of the Constitution thought it was best that there be checks and balances in place within the U.S. political system (Congress, the Senate, the Supreme Court, etc.) in order to prevent the abuse of power by any individual executive branch.

This Investment Note represents the views of **Philip Petursson** of Manulife Investments

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The following is by no means a complete analysis of the impact of President Trump's policies, we do attempt to cover the major issues facing the capital markets given the stated views during the campaign.

Energy

Trump supports "*Frack now and Frack fast*"[1]. He supports offshore drilling and exploration, as his goal is to be "*totally independent of any need to import energy from the OPEC cartel or any nations hostile to our interests*". Trump plans to achieve energy independence by 2022 by removing regulations on oil and gas companies and lifting moratoriums on energy production which would increase US shale production. Donald Trump has also said that he would reverse President Obama's rejection of the Keystone XL pipeline deal. However, he said that he would only reverse it after negotiating a better deal.

[1] Twitter, May 30, 2013

Looking at the oil market from a supply/demand dynamic, Trump's plan would likely increase supply, while not necessarily impacting demand, thus potentially having a negative impact on price. However, his policy to reduce regulation on the energy industry would improve the competitiveness of energy drillers and coal companies. This could help employment and profits in the sector.

Sell side Bay Street analysts estimate that the Keystone XL pipeline would contribute approximately $4 billion per year for the Canadian economy. The approval of Keystone will be a byproduct of Donald Trump's larger vision for the industry.

Taxation

Trump tax plan lowers the business tax rate from 35% to 15%. At 35%, the U.S. has the third highest general top marginal corporate income tax rate in the world. The worldwide average top corporate income tax rate is 22.9%. According to his campaign, the current business rate is preventing U.S companies from making domestic investment unattractive. The plan also includes a 10% tax on repatriation, which could bring trillions of dollars back into the U.S.; American companies are holding $2.5 trillion abroad, which has increased 20 percent over the past two years. This is equivalent to nearly 14 percent of the total U.S. GDP.

Trump's plan is targeted at stimulating the economy. Trump's plan assumes that companies and individuals would use tax savings to invest back into the economy. Under the plan, the tax cuts should lead to stronger economic growth if corporations and households spend their excess income. This may lead to an increase in sales growth and will likely lead add to the bottom line of U.S. corporations.

The proposed repatriation tax would be similar in nature to the 2004-2005 Homeland Investment Act (HIA) which created a window in which corporations could repatriate foreign income at a rate of 5.25%. The HIA had a limited economic and market impact, however it did repatriate of upwards of $350 billion from overseas and a significant rally in the U.S. dollar. In passing the act, Congress argued the tax holiday would result in creating more than 500,000 jobs in two years, while JPMorgan Securities estimated businesses would increase capital spending by 2 percent to 3 percent during that time, the National Bureau of Economic Research reported. However, the actual results were different. The research organization, in its study, concluded that "the decreased costs of accessing earnings retained abroad under the (Homeland Investment Act) did not increase domestic employment, investment, or R&D." According to its analysis, each $1 of earnings from abroad repatriated under the act resulted in an increased domestic investment of less than 1 cent. However, each $1 increase in repatriations did result in a 79-cent increase in share repurchases and a 15-cent increase in dividends, the research organization reported.

Trump's plan could lead to less competiveness for Canadian domiciled U.S. companies as corporate Canada has lower tax rates. For manufacturing, the US manufacturing combined corporate tax rate is ~30% whereas it is ~20% in Canada.

Trade

Trade will be an important driver of economic growth along with other key structural reforms. It is not within the President's power to impose new tariffs; however, the president could change pre-existing tariffs if certain conditions are met. The president through the US Treasury and the Commerce Department might have a free hand in cases where industries are allegedly suffering *'market disruptions*'. For example, President Bush in 2002 imposed tariffs on steel imports in order to protect the industry. The WTO ruled those tariffs were in violation of the WTO Treaty and allowed Europe to impose tariffs. In the end, President Bush decided to end the tariffs but by that time, he had given the US steel Industry roughly 5 years to adjust. Ultimately, imposing a tariff will be sanctioned *'illegal'* by some Trade Organization - however, if the Softwood Lumber Issue is an example, these disputes can spend years in court while tariffs are imposed.

Trump's plan will be to ensure that all U.S. trade agreements increase the GDP growth rate, reduce the trade deficit, and strengthen the domestic manufacturing base. He plans to stop the Trans-Pacific Partnership (countries within TPP account for 40 percent of global economic output) at almost any cost. He also plans to renegotiate the North American Free-Trade Agreement ("NAFTA") as he believes it is harmful to American workers. Manufacturing has actually increased tremendously since NAFTA, as the US produces approximately 60% more than it did before the deal came into effect. As well, Canada, Mexico and the US have become increasingly more intertwined over the years. For example, 35% of US exports go to Canada and Mexico. His plan has a clear focus on protectionism and will focus his sights on China on many fronts.

As the world has experienced an increasing amount of globalization, trade among countries is becoming more important as companies look to grow their customer base. Any uncertainty regarding trade deals could be harmful to companies that have a greater focus on foreign business. This uncertainty would further complicate global trade on the back of the issues created by the "Brexit" vote earlier this summer. At the same time, a protectionist policy could benefit companies that have seen increasing competition from foreign companies and have subsequently lost market share to them.

Monique Moreau, director of national affairs at the Canadian Federation of Independent Business, which represents more than 109,000 small businesses in Canada: "*About 50 per cent of our members import from the U.S., and about 25 per cent export, so that's a significant amount, and if there is a decrease in access to the U.S., that will certainly have an impact on our members. But we're still very much in wait-and-see mode at this time.*" Canada and Mexico are important trade partners for the U.S. and therefore, it is unlikely that policies geared negatively towards Canada will be implemented. For example, 35% of US exports go to Canada and Mexico. Exchange between Mexico/US and Canada/US tend to part of the manufacturing value chain. Unwinding these contracts could prove extremely difficult.

In general we believe markets may experience higher volatility given the uncertainty of the Trump proposed policies. If the Obama presidency is any indication however, a President's ability to implement policy can be influenced by the willingness for compromise or lack thereof, between the two executive branches. Also, what promises will be implemented? Michael Krukones, author of Promises and Performance has analyzed 70 years of presidential campaign promises and found that approximately 75% of promises on the campaign trail are kept to some degree. Therefore, the efficacy of Trump's policies is dependent on whether congress is willing to cooperate and whether the proposals are legitimate or simply 'election promises' to win votes. Markets would also likely prefer a split Congress to provide balance, despite the risk of gridlock. Overall, investments decisions based on geopolitical or political issues have historically resulted in poor outcomes. Following the presidential election, we should remind ourselves that portfolio returns will ultimately be driven by company specifics fundamentals and valuations.

A rise in interest rates typically causes bond prices to fall. The longer the average maturity of the bonds held by a fund, the more sensitive a fund is likely to be to interest-rate changes. The yield earned by a fund will vary with changes in interest rates.

Global events have resulted, and may continue to result, in an unusually high degree of volatility in the financial markets, both domestic and foreign.

Currency risk is the risk that fluctuations in exchange rates may adversely affect the value of a fund's investments.

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