US election outcome favors US credit markets

Examining the sectors most likely to be affected by the Trump administration

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The next few months should provide greater clarity on President-elect Donald Trump's policies and details on key appointments in his administration. We at Invesco Fixed Income expect some volatility in risk assets as markets assess his likely policy direction. (Please see our recent blog: What will drive markets after Trump's victory?) But over the medium term, we believe that the likely tone of the Trump administration is likely to be, on the margin, positive for US credit fundamentals and market dynamics.

Our initial view is that a Trump policy framework is likely to entail:

- A less activist approach to regulation by agencies such as the Federal Trade Commission, Federal Communications Commission and financial regulators.
- A more flexible Department of Justice approach toward mergers and acquisitions.
- Potential for a tax holiday or reduced tax rates for foreign-held cash of US companies, potentially leading to greater share buybacks, dividends and capital expenditures. Cash repatriation could also potentially reduce corporate debt issuance needs and, therefore, be supportive of credit spreads.

The following US credit sectors could be particularly affected by Trump administration policies:

Health care

We believe market pricing pressures on drug producers will remain, but we see an easier path for pharmaceutical companies than we would have expected under a potentially more stringent reform scenario under Hillary Clinton – especially for specialty pharmaceutical companies, which develop innovative therapies. We also see this as an incremental positive for insurers in terms of their ability to adjust pricing and make the current components of the Affordable Care Act (ACA, also known as Obamacare) more structurally sustainable. However, changes in health care policy could be potentially negative for acute-care hospitals, which had benefitted under the expansion of Medicaid and the ACA's insurance of previously uninsured patients.

Financials

Potentially less regulation coupled with potentially pro-growth macroeconomic policies (possibly leading to higher interest rates and a steeper yield curve) would likely be supportive of the business models of banks and insurance companies. However, substantial repeal of the Dodd-Frank Act could hamper the strong fundamental credit profile of the US banking sector over time.

Telecommunications, media and technology

We believe a less-activist approach to regulation in this sector would likely pave the way for more mergers in the media space between distribution providers and content providers. We would also expect greater consolidation in the telecommunications sector. While individual company outcomes would likely differ, we believe consolidation would support industry fundamentals broadly over the medium term and would be a positive response to rapid and uncertain shifts in industry dynamics triggered by changes in technology and consumer preferences.

Metals and mining

We would expect the metals and mining sector to perform well in a Trump policy environment given a potentially more protectionist tone toward tariffs and other trade arrangements. This would potentially benefit US-focused metals and mining firms.

Energy

We believe a more relaxed regulatory environment, especially as it relates to fracking and coal production, would likely benefit the energy sector. In particular, we see support for oil exploration activity, which would benefit oil field service providers. Higher oil production may lead to lower sustained oil prices, especially in the face of a stronger US dollar (which is traditionally negative for commodity prices) driven by potentially higher interest rates, as mentioned above. We favor pipeline operators based on potentially less environmental oversight and a higher rate of pipeline approvals.

Industrials

The industrial sector may be more vulnerable to policy shifts that negatively impact global trade, especially for those firms that derive a significant portion of their revenues outside the US. We, therefore, prefer industrials that are focused on domestic infrastructure, although positive sentiment has been partly priced in given the rhetoric of both candidates leading up to the election. One sector that could be supported under new administration policies may be defense, which may see greater government spending activity.

Consumer

Consumption comprises around 70% of the US economy. A greater level of uncertainty could cause a consumer pull-back in the near term, with potentially serious implications going into the critical holiday season. A divided electorate means that, post-election, a portion of US voters may feel less confident going forward under the new administration. That said, a lower tax regime under Trump could ultimately benefit consumers over the medium term though higher disposable incomes. We favor domestically focused sectors that are less reliant on foreign sources of revenue. Large multinationals focusing on tourism – such as hotels, airlines and cruise operators – could face headwinds in the near term.

These are admittedly early days in the transition to a new policy environment, and we expect market volatility to be a near-term issue. We at Invesco Fixed Income believe that active management centered on rigorous research and careful security selection is paramount as details of the new administration's policy regime unfold.

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