

## Post US election lookout

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### Oliver's Insights



#### Key points

- > With the election over, investors will now likely look for a resolution to the significant policy decisions that need to be addressed in the United States.
- > President Obama's victory likely ensures the US Federal Reserve will remain very active in promoting US growth.
- > Beyond the near term uncertainties we see shares continuing their rising trend reflecting attractive valuations, a modest pick up in global growth next year and very easy monetary conditions globally.

#### Introduction

Given the US election outcome the following provides a summary of key issues post election and provides a snap shot of what you could likely hear about in the coming months.

With the election over, investors will now likely look for a resolution to key issues around the fiscal cliff, the US debt ceiling and long-term debt reduction.

#### Fed will remain active in promoting growth

President Obama's victory is likely to ensure that the US Federal Reserve will remain highly active in promoting US growth beyond the expiration of Chairman Bernanke's current term in January 2014, whereas Mitt Romney had committed to not re-appointing Bernanke and would have likely replaced him with a less dovish Chairman. This should be well received by markets as ongoing Fed action has been a driver of stability and growth in markets and the economy.

#### More of the same

The uncertainty regarding the Presidential election is out of the way. However, the US government remains divided with Democrats retaining the Senate and the Republicans retaining the House. This will likely mean negotiations surrounding necessary policy measures will be difficult and protracted. This may pose a risk for bouts of volatility in share markets in the near term.

#### What's now, later and down the track

While the US faces immediate fiscal challenges, the combination of continuing stimulus from the Fed and a responsible approach by policy makers should enable the gradual US recovery and rising share market trend to continue. To achieve this there is work to be done. There is no opportunity for the Obama administration to take a victory lap. Here is a list of key pressures facing US policy makers:

##### Immediate concerns – the 'fiscal cliff'

The start of 2013 will see the expiration of some key tax and spending measures that, if reduced or delayed, would cause a large fall in disposable household income and reduced spending in the US. These measures include tax cuts, unemployment

benefits and cuts to health and defence that flowed from last year's debt ceiling agreement.

Taken together, the simultaneous expiration of these tax and spending measures which are worth around 4.3% of US Gross Domestic Product (GDP) would likely plunge the US into recession given that the economy is growing around 2% pa. This is why this event is referred to as the 'fiscal cliff'.

Ultimately, I think a compromise will be reached as US politicians are unlikely to want to knowingly plunge the US economy into recession. This will likely see the fiscal austerity reduced to around 2% of US GDP, which would enable the US economic recovery to continue.

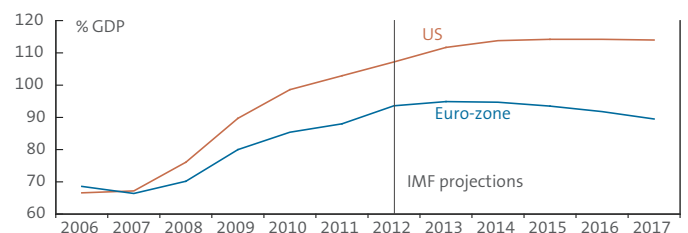
##### A little later – raising of the US debt ceiling

Soon after the fiscal cliff comes the need to again raise America's debt ceiling, which will be required by March at the latest. Any negotiations regarding the debt ceiling is likely to go hand in hand with negotiations over a long-term plan to reduce the deficit. The question is – how long will it take for policy makers to reach agreement? Memories are still fresh from the dysfunctional debt ceiling negotiations of August 2011, which dragged on and ultimately saw the United States lose its AAA rating from Standard & Pools.

##### Further down the track – long-term debt reduction plan

The US has a bigger public debt problem than Europe in aggregate, as shown by the IMF projections below. However, as yet the US hasn't had to deal with it. In brief, this means the US needs a long-term plan to reduce its budget deficit.

##### US and Euro-zone Gross Public Debt



Source: IMF, AMP Capital

The trouble is the 'fiscal cliff' cutbacks will occur too quickly. Expect Congress to largely implement agreements for short-term delays. The aim will likely be to provide time for the two parties to negotiate a more complete and long-term plan for debt reduction. Signs of a compromise and eventual agreement will be well received in share markets. It is worth noting that Republicans have recently shown more willingness to compromise. However, difficult and protracted negotiations may pose risks for bouts of exaggerated price movements in the short term.

As an interesting side note, it is worth bearing in mind that US shares in the post war period have performed better under Democratic presidents, with average returns of 15% pa, versus 10% pa under Republicans.

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