Does political analysis matter when investing?

Jonathan Pain | The Pain Report | 28 January 2017

Does political analysis matter when investing? Should we just keep our heads down and treat political events as nothing more than noise?

The investment management world is populated by a broad range of investment approaches or styles. You have your hard core valuation types who only ever look at earnings, price and various ratios and multiples. Then you have those who blend both qualitative and quantitative measures, top-down, bottom-up, et al. Short- term, long-term, and ultra-long-term investors, 10 years. Value, growth, GARP, momentum. Indexation, closet indexation, relative value, benchmark unaware. And the list goes on and on. And let's be frank this is all getting seriously boring.

What's the point, you ask impatiently?

2016 was a year of significant political change. The consensus view was that Brexit would be bad and that Trump would be even worse. But don't worry, neither were going to occur. Both happened and both were good for markets. How can this be? There's your proof if you needed any that politics are irrelevant.

Not so fast...

I have long believed that investing is all about identifying catalysts that are likely to change the prevailing environment, mood and/or sentiment. For a long time, Japan was seen as a busted flush. Then along came Shinzo Abe in December 2012 and the Nikkei surged 65% in the next five months. Why? Because Abe won an overwhelming majority and he spoke of reforms and had the mandate to do so. He changed perceptions and gave hope of a new dawn. In reality, not much changed - not in economic terms, anyway. What really changed was that the Yen weakened dramatically once turbo-charged Kuroda took the helm at the BOJ.

In May 2014, Narendra Modi won in a landslide and the SENSEX surged 30%. He spoke of pro-business reforms and cutting red tape.

It's worth, perhaps, also mentioning that both Abe and Modi have strongly nationalistic tendencies. Surely these two examples suggest that politics and policy do in fact matter.

And if we are being completely honest and open minded on this subject and non-dogmatic, surely Trump's arrival in the White House demonstrates that politics and policy do very much matter to markets. All we have done, since that fateful day on Tuesday 8 November, is talk about Trump and what his policies are going to be. And, so far, we have a pretty good idea

what he's going to do. Yes, he's going to build a wall, cut taxes, cut regulation and make America's airports, bridges and highways great again. What is so hard about that? In Trump's world, the end justifies the means. And the end game is all about making America great again. So, let's stop trying to interpret and second guess him and take him at face value. It doesn't matter whether you like him or dislike him - he is what he is and that's President of The United States of America. I'm sure you've read his Inauguration Speech - it was pretty straight forward. And, my understanding of the history of populists and nationalists is that they usually do what they say they're going to do. Trump, in my view, is no different.

Yes, there are checks and balances built into the judicial and legislative branches, but a Republican-controlled Congress will, in my opinion, pass most of his domestic policy agenda.

The great unknown, in my eyes, is the foreign policy domain and how Trump deals with China. The omens here, so far anyway, are not good. He has surrounded himself with China hawks who have long desired to take China down a notch or two. Only time will tell - but I just cannot see the Chinese responding well to Trump's megaphone style of diplomacy. And after centuries of colonial humiliation, China is in no mood to be humiliated by Trump.

Which brings me to my key point for the day.

2016 was a year when investors and the markets dodged two big bullets - Brexit and Trump. But - and this bit is the important bit - most investors were underweight their benchmarks and so used any pull back to get closer to benchmark.

Similarly, as I have discussed before, most of us were sick to death with the Alice in Wonderland level of global bond yields and didn't need too much of an excuse to sell uber-expensive bonds. The New Trumpian Reflationary Reality gave us all the perfect excuse, and opportunity, to sell bonds.

In my Weekly of 14 January, I suggested that it was time for the reflationary trade to take a pause and I said that I had bought gold, and sold $/YEN, CBA and ANZ. I closed all these trades last week and currently have no positions... Yes, I have every intention to be nimble and flexible this year and non-dogmatic.

So, let me be both brutal and brief. 2017 is going to be a year when politics does matter. In fact, it always has.

This year, however, we are witnessing a tectonic shift in the global political and geo-political landscape, perhaps the most profound since the fall of the Berlin Wall. Trump heralds the return of a more populist and nationalistic strain of politics. That's the easy bit. The difficult bit is to predict how the rest of the world will respond - in particular, how the Chinese will respond.

Jonathan Pain is Author of The Pain Report, an independent and global perspective of financial markets and world economy, free of Wall Street spin. A self- confessed market and economic data junkie who spends far too many hours thinking about what the world will look like in the years ahead, JP is a regular presenter at PortfolioConstruction Forum's continuing education programs. Over the years, he has debuted new investment theses and challenged delegates about how to build better quality investor portfolios.

Jonathan will be presenting as a member of the Faculty at our upcoming PortfolioConstruction Forum Markets Summit (14 February 2017).