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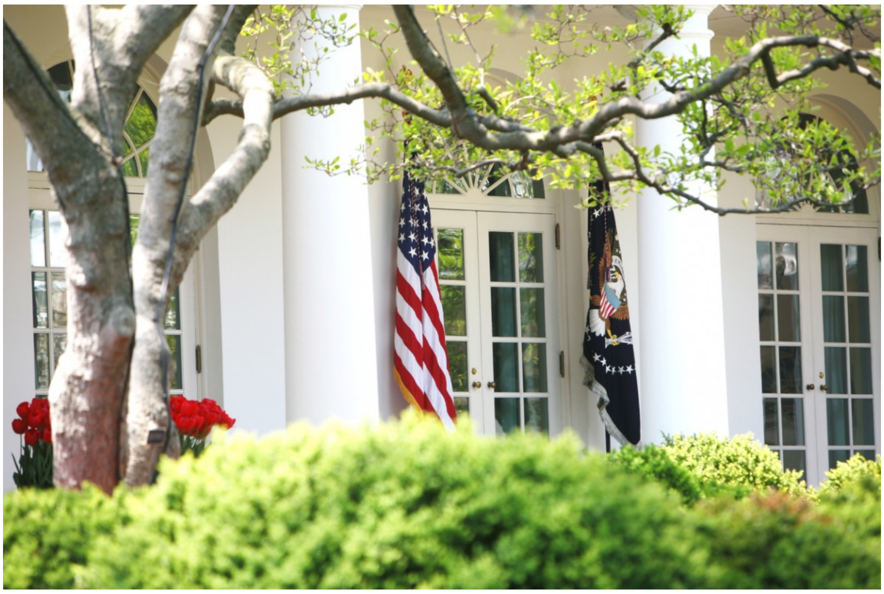
Four scenarios for markets over Trump's next 100 days

All Trump policy paradigms remain on the table, and our scenario analysis should serve as a useful framework for investors over the next 100 days



Source: iStock

There's four scenarios for the next 100 days

One of the major issues facing investors is determining which Trump policy paradigm will prevail over the next 100 days. The reality is that all possibilities remain on the table. To shed some clarity, here are 4 paths that we think global markets could take:

1. Muddling through: Markets adjust to a US economy at full capacity, while Trump stimulus hopes provide a buffer for US assets. Goldilocks environment for EM assets.
2. Reflation recovery: The administration's (watered-down) pro-growth policies gain the backing of Congress, prompting a positive re-pricing of US growth expectations.
3. Global monetary tightening: Simultaneous signals from the ECB and Fed over a change to their respective balance sheet policies sees a secular bearish steepening of global yield curves. A sharper bond market sell-off could dampen risk sentiment.
4. Geopolitical Armageddon: Trump's quest for a 'big' foreign policy win leads to an escalation

of geopolitical fears and risk-off behaviour in markets.

Four scenarios for global markets

	Reflationary assumptions					
	US 10Y yield (range)	Fed policy bias (relative)	Inflation & Term Premia	US equity markets	Risk aversion & volatility	FX Playbook
1 Muddling Through: Trump policy uncertainty prevails leaving global markets directionless	**2.3%-2.5%** Modest uplift as US inflation risks re-priced	**Neutral** Risk that Fed only hikes once more in 2017	**Small pickup in inflation premium** as US macro data rebounds	**Resilient** Tax hopes will underpin S&P 500 around 2350	**Low** Lower Trump tail risks should keep risk aversion low	Credit EM FX with a +ve local story given goldilocks market backdrop
2 Reflation Recovery: Trump tax reform plans pass Congress hurdle and provide modest stimulus	**2.8%-3.0%** Strong bearish steepening in US yield curve	**Hawkish tilt** Fed still tightens fairly gradually in reflation mode	**Both inflation & term premia rise** as global growth optimism rises	**More upside** Reality of stimulus lifts US earnings estimates	**Low** Orderly moves in a watered-down Trump world	USD/JPY optimal reflation vehicle; USD bid against EM high-yielders
3 Global Tightening: ECB QE exit & Fed balance sheet shrinking = a perfect storm for long-term yields	**2.6%-2.8%** US yields dragged higher by rising Bund yields	**Neutral** Tighter financial conditions keeps Fed cautious	**Global term premia rise** as access to 'easy money' falls	**Correction risks** Sharper sell-off in bonds may -vely affect equities	**High** Higher bond market volatility disrupts carry	EUR crosses see greater upside against typical carry currencies
4 Geopolitical Chaos: Trump foreign policy causes geopolitical fears to escalate in markets	**Below 2.0%** Investors seek safe assets & pile into Treasuries	**Dovish rethink** Fed on hold given uncertain global backdrop	**Term premia turns more –ve** as markets enter risk-off mode	**Sell-off** Global equities fall as investors rotate into bonds	**High** Spike in volatility as global risk aversion rises	USD falls versus safe-haven JPY but up against EM FX universe

Source: ING

Key takeaways

Our scenario analysis should serve as a useful framework for investors when it comes to navigating the next 100 days of Trump. Here are some key takeaways:

- The bond market implications are fairly intuitive: three out of the four scenarios point to a move higher in US 10-year yields (albeit to varying degrees).
- We have seen that global markets like a stronger US economy and can handle a bit of monetary normalisation pressures coming from a low base. So long as moves are orderly, we would expect this 'nirvana' market backdrop – where stocks and yields rise slowly in tandem – to continue. EM assets with a positive local story should stay resilient, though high-yielders remain vulnerable to a Trump-led rise in US yields.
- Geopolitics would be the only sting in the tail for a bearish US bond market outlook; our bell curve graphic shows that the probability of this is relatively low, but the consequences could be dire for markets that are positioned for a global recovery.

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