

# U.S. FIXED INCOME POST-ELECTION: CERTAIN UNCERTAINTY

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If the [Brexit](#) vote has taught fixed income investors anything, it's that the actual vote, and the days leading up to it, offered a snapshot of how the money and bond markets would respond in a knee-jerk fashion to potential event risk. This script has been, and will most likely continue to be, adapted to the outcome of the U.S. presidential election. Financial markets, specifically risk markets, do not like uncertainty, while bond markets, such as [sovereign debt](#) arenas like [U.S. Treasuries \(UST\)](#) tend to thrive on uncertainty. Heading into the voting booths, conventional wisdom broke down into two distinctive camps: a Clinton victory would fall under the certainty banner; a Trump victory would fall under the uncertainty banner.

In the days leading up to election day, the tightening in the polls had created a sense of uncertainty, and we did see a bit of a risk-off trade. As of this writing, [high-yield spreads](#) widened by 47 [basis points \(bps\)](#) from their October lows, with 33 bps of that increase occurring within a single week. Investment-grade spreads were better behaved, rising a more modest 6 bps from their October lows. Meanwhile, the [UST 10-Year](#) rallied during this time frame. After hitting an intraday high of 1.87%, the 10-Year yield fell, at one point, by nearly 10 bps.

Thus, with Republican nominee Donald Trump now set to become the 45th president of the United States, investors should more than likely witness scenario #2 play out in a knee-jerk fashion. In other words, we could see a risk-off trade in arenas such as equities and high yield, while the UST market will benefit from safe-haven demand.

Another important aspect we have learned from the Brexit experience was that it is important to consider the investment backdrop going into the vote. For Brexit, conventional wisdom assumed a soft, if not outright weak, economic setting for both the [eurozone](#) and the UK. However, recent data have revealed that the landscape was not as weak as expected, and the markets have responded accordingly. This should hold true here in the U.S. as well.

Let's take a look at the domestic fundamental backdrop. Following a tepid first half of 2016, growth has rebounded thus far in the second half, with real [GDP](#) coming in at +2.9% in Q3 versus only +1.1% in 1H2016. As last week's jobs data revealed, the employment backdrop remained on relatively solid footing to begin Q4 as well. In October, nonfarm payrolls rose a less-than-expected +161,000, but this was offset by an upward revision of +44,000 workers in the prior two months. In addition, the unemployment rate came in at 4.9% for the fourth time in the last five months. Perhaps the most important facet of the report was wages: average hourly earnings posted a +2.8% year-over-year gain, the best showing since June 2009. This increase was widespread and reflected essentially across-the-board gains in both the goods- and service-producing groupings.

This brings us to the other part of the Washington, D.C., equation—the Federal Reserve (Fed). The policy makers did not necessarily break any new ground at last week's Federal Open Market Committee (FOMC) meeting, but they still seemed to be heading in the direction of a [rate hike](#) at their December convocation, as long as economic data does not soften from current readings. According to the November FOMC policy statement, "the case for an increase in the Federal Funds Rate has continued to strengthen..." In fact, the aforementioned jobs report would seemingly offer the Fed [hawks](#) ammunition to make such a move.

## Conclusion

After important events such as this U.S. presidential election, it is important to remember that knee-jerk reactions do not necessarily translate into longer-lasting effects. The post-Grexit and Brexit experiences are two perfect examples. In each case, the UST 10-Year yield rallied to new lows in the near term, only to reverse course and rise by some 40 to 50 bps in the period that followed. So stay tuned—the only thing that may be certain is more uncertainty.

***Unless otherwise noted, data source is Bloomberg, as of November 4, 2016.***

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**Brexit** : an abbreviation of “British exit” that mirrors the term Grexit. It refers to the possibility that Britain will withdraw from the European Union.

**Sovereign Debt** : Bonds issued by a national government in a foreign currency, in order to finance the issuing country’s growth.

**Treasury** : Debt obligation issued by the U.S. government with payments of principal and interest backed by the full faith and credit of the U.S. government.

**High Yield** : Sometimes referred to as “junk bonds,” these securities have a higher risk of default than investment-grade securities.

**Spread** : Typically refers to a difference between a measure of yield for one asset class and a measure of yield for either a different subset of that asset class or a different asset class entirely.

**Basis point** : 1/100th of 1 percent.

**10- Year Treasury** : a debt obligation of the U.S. government with an original maturity of ten years.

**Eurozone (EZ)** : Consists of the following 18 countries that have adopted the euro as their currency: Austria, Belgium, Cyprus, Estonia, Finland, France, Germany, Greece, Ireland, Italy, Latvia, Luxembourg, Malta, the Netherlands, Portugal, Slovakia, Slovenia and Spain (source: European Central Bank, 2014).

**Gross domestic product (GDP)** : The sum total of all goods and services produced across an economy.

**Rate Hike** : refers to an increase in the policy rate set by a central bank. In the U.S., this generally refers to the Federal Funds Target Rate.

**Hawkish** : Description used when worries about inflation are the primary concerns in setting monetary policy decisions.