

Gundlach: Trump Will Win

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by Robert Huebscher

Donald Trump will be our next president, according to Jeffrey Gundlach, because Hillary Clinton is such an ineffective campaigner. Gundlach did not endorse Trump or say whether he would vote for him. But he said a Trump victory is inevitable – and offered some insight into how markets will react.



Gundlach spoke to investors on May 12 to provide updates on the DoubleLine closed-end funds, DBL and DSL. He is the founder and chief investment officer of Los Angeles-based DoubleLine Capital, known for its fixed-income mutual funds and ETFs.

Trump will win, Gundlach said, because “Hillary Clinton has her hands full with this cranky socialist from Vermont who has now won 19 states. If she is such a great candidate, why is she losing to this fringe guy from Vermont? Why couldn’t she beat a community organizer, junior senator eight years ago if she is such a great candidate?”

“It’s clear,” he said, “that everyone has underestimated Trump from the beginning.”

Gundlach said he initially predicted a Trump victory on January 11, when the *Barron’s* “roundtable” was published and that he has reaffirmed his prediction over the last several months.

When Trump wins, Gundlach said, investors should expect higher deficits. Trump has advocated higher spending on the military and a willingness to take on debt. The impact, Gundlach said, would be that inflation would be more likely.

Gundlach commented on a number of other topics related to the economy and the capital markets.

Monetary policy and the debt markets

Don’t expect a Fed rate hike, according to Gundlach.

He discounted the Fed’s forecast of two rate hikes and said that one hike “would be challenging enough.” The futures markets are forecasting a 50% chance of one rate hike, he said. Fed Chairwoman Yellen is the most dovish Fed member, he said, and at the other extreme are two “rebellious” members who are calling for rate hikes.

The idea that the Fed would pursue a “helicopter money” policy, where it would distribute funds directly to Americans, is now a “reasonable possibility,” Gundlach said, unlike six or eight years ago when such talk was dismissed as coming from the “lunatic fringe.” Gundlach said that policy is one way to produce inflation, and it is “just a question of how much is enough and not too much.”

In Sweden, he said, there is a proposal to distribute \$10,000 to all its citizens, although this is not truly helicopter money, because there would be a simultaneous reduction in safety nets.

For the next couple of years, investors should expect a “quiescent” rate environment, he said.

But Gundlach predicted that debt markets will face problems in a couple of years. Between 2018 and 2020, he predicted, a lot of corporate and government debt will mature and need to be rolled over. This won’t affect Fed policy now, he said.

Beyond that time frame, Gundlach forecast that the 30-year interest rate would be greater than 6% in 10 years. By that time, he said, there will be “a lot more clarity about entitlements.” He noted that the present value of federal government unfunded liabilities is \$120 trillion.

The 10-year interest rate will hit 2% before it hits 1.5%, he predicted. It closed at 1.75% on the day he spoke. Reaching 1.5%, he said, would require “taking out the lows” of 2014, 2015 and 2016. He reiterated his call that interest rates hit a secular bottom in 2012.

The central issue facing the Fed is to have rates “well north of zero” when the next recession occurs, but doing so will put pressure on the economy, he said.

The high-yield sector – and energy bonds in particular – should be avoided. Gundlach reiterated his warning from his previous **webcast** that, unless there is a significant increase in commodity prices, junk bonds will fare poorly. He said that issuers will default, recovery rates on debt will drop and “it’s hard to see a high-yield market rally under those conditions.”

Gundlach said he did not have a strong view on the future price of oil, which was at \$46/barrel when he spoke. Oil prices might push to \$60/barrel, Gundlach said, but that is “about it” for the rest of the year. Even if it hits \$60, though, that would not be enough to forestall defaults in the energy sector.

The performance of commodities, emerging-market economies and emerging-market equities are generally highly correlated, Gundlach noted, except that the latter of those three are not rising along with the recent increase in commodity prices. “One has to give,” he said. He advised investors to follow those asset classes, because “at some point they have to get into sync.”

Gundlach remarked on comments he had made at the Ira Sohn conference in New York on May 4. He said that he recommended selling a utility ETF (XLU) and buying a REIT ETF (REM). Both, he said, are “bond surrogates” and have had a correlation of approximately 0.6 with interest rates for the last 10-15 years. Investors who acted on that recommendation, Gundlach said, would have already profited.

The flagship REIT, Annaly (NLY), would suffer if interest rates rose, Gundlach said, but it would take a significant Fed rate hike for it to have a problem. REITs will soon be added to the S&P as a sector, he said, which will help their performance.

Negative interest rates, Puerto Rico and the muni market

Globally, the central issue is negative interest rates, according to Gundlach. Those policies aren’t working, he said, and instead are causing stronger currencies and poor stock market performance for those countries that have followed that path. The reason is that negative interest rates are the “definition of deflation,” he said.

“Maybe it will take more evidence before the markets realize this,” he said. “Trying to fight deflation with deflation is like putting out a fire with gasoline.”

Gundlach said a British exit from the European Union – “Brexit – will not happen. He was so certain that he refused to answer hypothetical questions about the ramifications of such a move. He told investors “don’t bother with protection” against a Brexit.

Thirty-year AAA-rated municipal bonds are at all-time historically low yields, Gundlach said, due to “incredible” demand. Puerto Rican bonds are appropriately priced for the default risk they carry, he said. He said the DSL fund has 1% of its holdings in Puerto Rican general-obligation (GO) bonds. The municipal bonds investors should worry about, according to Gundlach, are from issuers like the state of Illinois, “which are not priced for a Puerto Rico scenario or anything close to it.”

He had similar warnings for low-volatility equity funds and ETFs, which he said are riskier than their prices reflect. “No equity has low volatility,” Gundlach said.

“Avoid risky investments that are not priced as if they are risky,” he said, “like Illinois bonds.”

Election predictions

Most pundits carefully avoid attaching a time frame or a specific level to their predictions. They’ll predict a 20% change in the price of an asset, but omit the date when it will happen.

But Gundlach’s 2016 will be easily and objectively measurable on the evening of November 8.

I’ll posit that the outcome is far less certain than Gundlach thinks. If, for example, Clinton were to choose a Republican (from among those who have repudiated Trump’s candidacy) as her running mate, she would likely win in a landslide.

If you think the Trump-Clinton faceoff isn’t providing enough excitement, Gundlach said the 2020 elections will be “even crazier” because the deficit issues will be more central to the political debate – especially if, as he predicted, Trump becomes the next president.