Bonds sold off after Donald Trump’s surprise election win. What could the election results mean for bond markets over the long term? Rick Rieder weighs in.

It’s hard to miss that Donald Trump’s surprise win in the presidential election, coupled with the Republicans gaining a majority in Congress, has already impacted bond markets. Bonds sold off in the days following the election, on expectations that higher growth—and inflation—are ahead. A key question on investors’ minds now: What could the election results mean for bond markets over the long term?

The outcome introduces many uncertainties regarding the future path of economic and monetary policy, legislation and international relations and trade policy. But there are some tentative points we can make about the implications of a President Trump and Republican Congress for fixed income markets.

Key trends already in place are likely to accelerate.

We are probably going to see a significant shift from monetary policy stimulus to fiscal policy initiatives, particularly in the area of infrastructure investment at the federal level. This may well aid in accelerating the pickup in inflation levels that already appeared underway before Nov. 8, and it likely will result in a steepening in the yield curve over time. We’ll be watching closely for signals of how added spending will be financed.

Rates won’t always rally when risk assets are hurt.

There are some common misconceptions that investors should guard against. Specifically, with bonds and equities more correlated today than in the past, investors must not assume that rates always rally when risk assets suffer. Moreover, while some believed that the U.S. dollar (USD) would ultimately decline on a Trump victory, we think this view is mistaken. The dollar is more likely to range-trade for a time, or even strengthen, depending on the direction legislation and policy take in 2017.
We are cautious about how the election result will impact emerging markets debt (EMD).

Trade policy uncertainty and a potentially higher USD could potentially weigh on the asset class. Still, as we’ve argued in recent months, the need for income isn’t going away, and the carry potential, particularly in the front to middle segments of select emerging market country rates curves, should remain attractive. What to watch: capital flows. A good amount of money has shifted in EMD, but it will be important to see if investors have the patience and wherewithal to stick out any near-term headline risks. In the meantime, we are cautiously optimistic on the carry prospects for shorter to intermediate EMD (as long as the USD remains contained and we do not descend into a trade war).

We think the election result should be, broadly speaking, positive for U.S. corporate credit sectors.

They may now operate in a more business-friendly environment. We could potentially see relaxed regulatory burdens, lowered corporate tax rates (and/or one-time overseas capital repatriation), and several industry-specific tailwinds that aid credit markets. In particular, we are still positive on long-end investment-grade corporates. Further, some high-cash-flow securitized asset markets continue to appear attractive.

We see a potential headwind for municipal bonds.

If personal income tax rates were to decline, and additional infrastructure spend were partly financed in municipal markets, this could be marginally negative for muni performance.

We continue to like rates markets ranging from the front end of the yield curve to its belly.

We think Treasury Inflation Protected Securities (TIPS) have an important place in portfolios today. And given that the U.S. is likely to continue to progress down a path of interest rate normalization, diversifying rates exposures globally also makes a great deal of sense.

Finally, over the short term, we believe a December Federal Reserve (Fed) hike is still likely. A lot can happen between now and then, but if markets remain stable, and labor markets don’t dramatically falter, the central bank will probably go ahead with a quarter-point hike.

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