US Election Commentary

Below please find some of our initial thoughts on the implications of Donald Trump's victory.

Key Economic Effects

It is still too early to speak with certainty about the economic effects of Trump's victory. However a Trump administration's economic policy should generally be business friendly. Based on policy proposals released during his campaign, there are likely to be several key effects, outlined below. Trump's ability to enact policies released during the campaign increases because of Republican control of both the House and Senate.

(1) Fiscal Policy. Most importantly, Trump has proposed a stimulatory fiscal policy. He has advocated tax policy of lower individual and corporate rates in order to spur economic growth. During the campaign he discussed trying to reach economic growth of 4%, based on over $4 trillion of tax cuts. This would be a large shift in US economic policy compared to the last 8 years, during which taxes have increased. It may be reminiscent of Reagan-era tax cuts. To complement this tax policy, Trump has also proposed to embark upon infrastructure spending. This will not be as meaningful a stimulus as tax policy, but will add to an overall stimulatory fiscal environment.

(2) Regulatory Policy. Trump has said he will reduce regulations which interfere with business growth. Regulatory reform is generally not thought of as having the same short-term economic impact as tax reform, but can nevertheless cause meaningful shifts in the US business climate. While Trump has not outlined many specifics, regulatory reform generally means eliminating regulations that increase the cost of doing business, or of starting a business. For instance, environmental and licensing regulations may decrease.

(3) Sector Effects. Uncertainty will increase for some specific sectors or types of business. Domestically oriented cyclical businesses should do relatively well in an environment of fiscal stimulation favouring US manufacturers. Export-heavy businesses will experience more uncertainty until Trump's trade agenda becomes more concrete. Additionally, healthcare businesses are likely to face uncertainty. Trump has said he would like to repeal and replace Obamacare, but a full plan has not yet emerged.

(4) Fed Policy. Trump has indicated that he may favour a Fed Chair who is more likely to increase interest rates.

Taking all of these together suggests that inflationary pressures may increase, as will interest rate risk. In addition, it will be important to monitor specific sectoral effects. Much will depend on the team that Trump puts in place.

Credit Market Considerations

Given a generally higher probability of interest rate increases and higher uncertainty, we believe both duration management and credit risk management will be increasingly important.

On the duration side, we would expect floating rate investment options such as bank loans and private debt to become increasingly attractive, as well as shorter-dated bond portfolios. We expect long-dated investment grade obligations to become less attractive. The high yield markets generally have constrained duration of around 4 years, so we would expect less volatility in these markets than investment grade.

On the credit risk side, we believe that credit fundamentals remain solid, and that overall default rates in the market will not change significantly. While leverage is slightly higher, interest coverage ratios remain above long-term averages. And companies have generally pushed out maturities, with only 10% of companies in the

US high yield market needing to refinance over the next two years (JP Morgan). We expect that fiscal stimulus will overall be constructive for company profitability.

The most important effects on credit risk will be at the sector level, as some sectors will benefit and some will face uncertainty from a change in policy. Therefore in-depth credit work will take on even more importance.

There will be much macroeconomic and political noise. What will matter to our portfolios is that companies can continue to pay interest and principal payments with a significant margin of safety. We have experienced many economic cycles before. We will continue to focus on in-depth, detailed credit work which is the key to long-term success. As long as we can avoid defaults and be paid back par at maturity, the macroeconomic noise will not matter to long-term investment returns.

Portfolio Positioning

Our portfolios are generally defensively positioned, both from a credit and a duration perspective. In our US high yield portfolio (Muzinich Americayield), our average credit quality is BB3 and our duration-to-worst is 3.93 years. In our European high yield strategy (Muzinich Europeyield) the figures are BB3 and 2.97 years, in Emerging Markets (Muzinich Emerging Markets Short Duration Bond Fund) BB1 and 2.27 years and in Muzinich Global Tactical Credit BBB3 and 3.22 years. Our absolute return portfolios are also conservatively positioned. Our hedge fund, LongShortCreditYield, has a net exposure of approximately 25% (ex-short maturity book). We are evaluating our specific sector positioning carefully, and generally will be looking to buy good quality companies that will be able to repay us at maturity if we are given the opportunity to do so at attractive prices.

Please do not hesitate to let us know if you have any questions. We will update you with further thoughts as developments warrant.

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All portfolio positioning data is ex-cash.

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