Market Note

2024 Election: Where to From Here?

11/6/2024

Summary

- In the early hours of Wednesday, November 6, with 277 of the 270 electoral college votes needed, Trump was declared the winner of the 2024 U.S. Presidential Election. The Republican party has also gained control of the Senate.
- A Republican sweep of Congress would make it much easier for Trump to push through his agenda; however, it may take several days to determine which party has secured control of the House.
- In light of this, we want to echo the guidance we shared leading up to the election: diversification should include healthy exposures to risk while minimizing exposure to longer-term bonds. We also still like profitable small caps.
- This market note provides further insights on the expected policy response and market implications.

Overview

With 277 electoral votes, Trump was declared the winner early this morning

On Wednesday, November 6, with 277 of the 270 electoral college votes needed, Trump was declared the winner of the 2024 U.S. Presidential Election. Trump will be sworn in at the inauguration on Monday, January 20, 2025, and the new members of Congress will assemble on January 3, 2025. The Republican party has also gained control of the Senate, and according to betting markets, there is currently an 89% chance of a Republican sweep.

Trump won majority in each of the seven swing states, with the race in Pennsylvania—anticipated to be the key determinant of the presidential winner—being called in the early hours of Wednesday morning. Exit polls show that, for the first time in at least twenty years, self-identified independents accounted for a larger share of voters (at 34%) than Democrats (at 32%) and tied with Republicans (at 34%).[1] Trump is also the first Republican president to win the popular vote (at 51%) in twenty years.

Policy & Market Implications

Below are our views on the expected policy response and market implications of a Trump win.

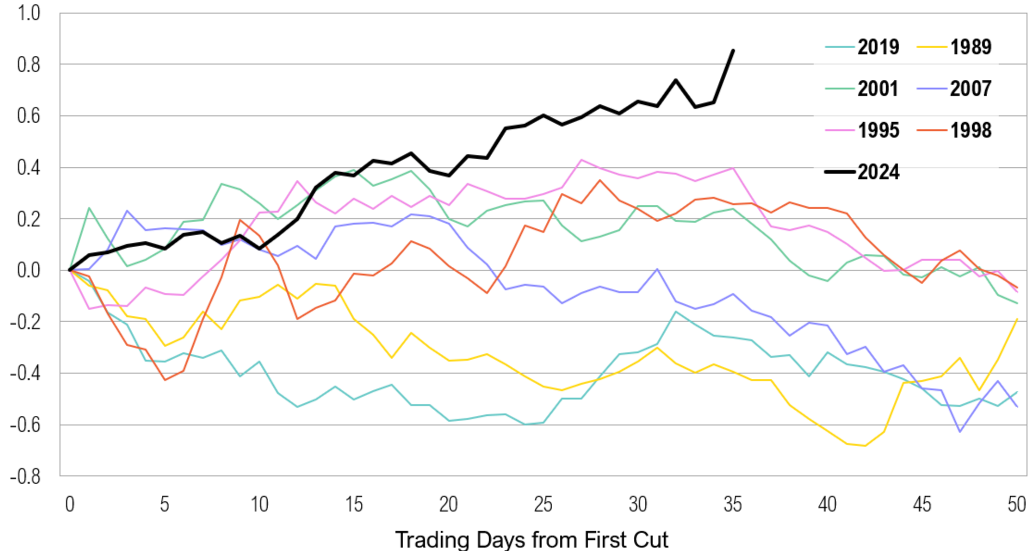
While supportive of growth, Trump's policies could lead to higher inflation and interest rates

- Monetary policy implications: Trump's proposed policies—tax cuts, global tariffs, and border control—are likely to be inflationary in the near term. However, there are potential offsets, such as the proposed deportation of undocumented immigrants, which could alleviate housing pressure. On balance, we believe that Trump's policies would support nominal growth but also lead to higher long-term inflation expectations and bond yields. The Federal Reserve's response may be harder to call given its recent tolerance for higher inflation. Trump has stated that he would not reappoint Powell but would allow him to complete his term, which runs until May 2026. The market currently anticipates the equivalent of two additional 25-basis-point rate cuts before year-end, which we believe are on track, as the Fed aims to maintain a nonpolitical stance. However, the likelihood of rate cuts in 2025 has now come into question, with markets now anticipating the equivalent of around 0.7% in reductions next year, compared to nearly 1.0% last week.[2] Any increase in inflation between now and year-end could be managed through forward guidance, potentially moderating rate cut expectations for 2025.

Treasury yields have been rising on anticipation of another Fed rate cut and the Trump win

Bond Market Jitters on Fed Rate Cuts and Trump Win

Absolute Change in 10-Year Yield During Major Cutting Cycles, %

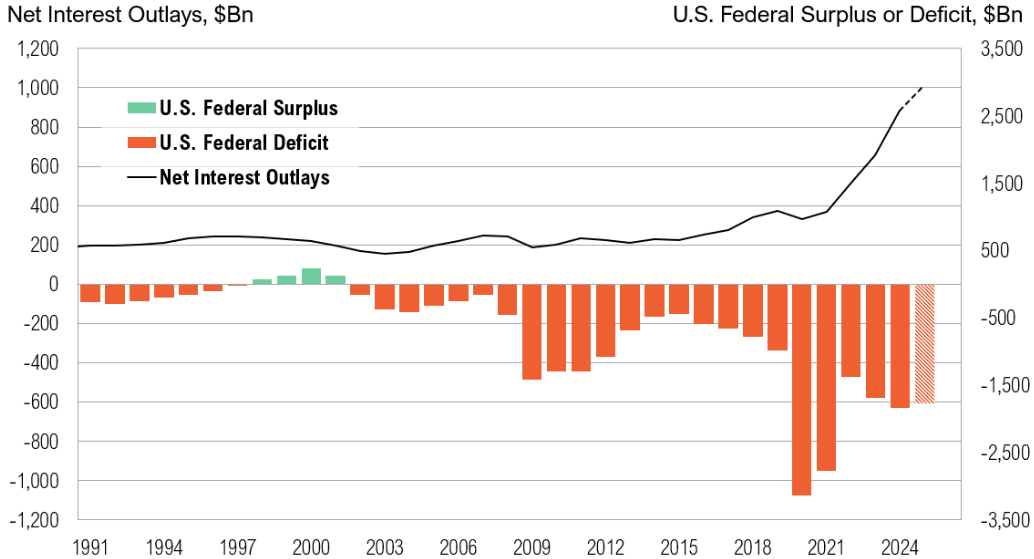


Source: Bloomberg

- **Fiscal policy implications:** The consensus is that a Trump victory will negatively impact the deficit, primarily due to the estimated $4 trillion cost of extending the Tax Cuts and Jobs Act (TCJA), with any offset from higher tariffs remaining uncertain.

The fiscal deficit will continue to worsen

The U.S. Fiscal Deficit Reached $1.8Tn in 2024



Source: Bloomberg

- **Can the bull market continue?** There is no reason it cannot continue, as long as the policy backdrop contributing to it remains in place and the bond market tolerates the excesses (i.e., yields do not rise too much). Historically, markets tend to rally following elections, as uncertainty subsides. While a split Congress has historically been the most favorable outcome for the stock market, a Republican sweep is the next best outcome. Years featuring a split Congress (since 1951) averaged gains of 14.5%, compared to 11% under a Republican Congress and 6.7% under a Democratic Congress.[3]

Consider extending duration if the 10-year Treasury yield surpasses 5%

- **What does the result mean for bond yields?** As long as the current policy mix focuses on near-term growth priorities at the expense of addressing the U.S. fiscal deficit, we remain cautious. Even in the event of an economic slowdown, we believe policymakers would view any meaningful decline in yields as further justification to continue with stimulative monetary and fiscal policies, which would ultimately be detrimental for bonds. We would, however, consider extending duration if the 10-year Treasury yield approaches 5%, but any adjustments will be modest and incremental.

Opportunities

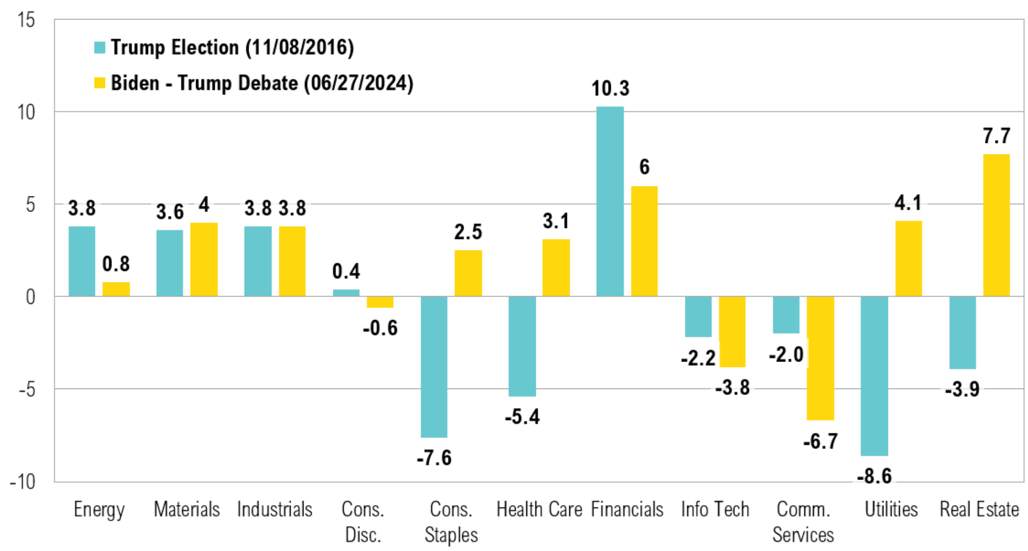
Opportunities stemming from a Trump presidency would include profitable small caps, energy, and digital assets.

Trump's focus on fossil fuels would lead to increased drilling activity and potentially lower energy prices

1. **"Drill, baby, drill":** We believe that energy and fossil fuel stocks could perform well under a Trump administration, as observed following the 2016 election. We also anticipate that Trump's focus on fossil fuels would lead to increased drilling activity and potentially lower energy prices, all else equal.[4] For example, crude oil prices fell by more than 9% during the October Trump surge (from 10/4 to 10/29). This could benefit oil services companies, which are currently out of favor, and have favorable fundamentals (oil services are currently trading at a 9.2% forward free cash flow yield). Additionally, energy has historically been the top-performing sector following elections, on average, since 1972. We remain constructive on nuclear energy. Lower energy prices also support consumer spending.

A Trump Win Could Favor Cyclical Value Sectors

21-Day Sector Performance Relative to S&P 500, %



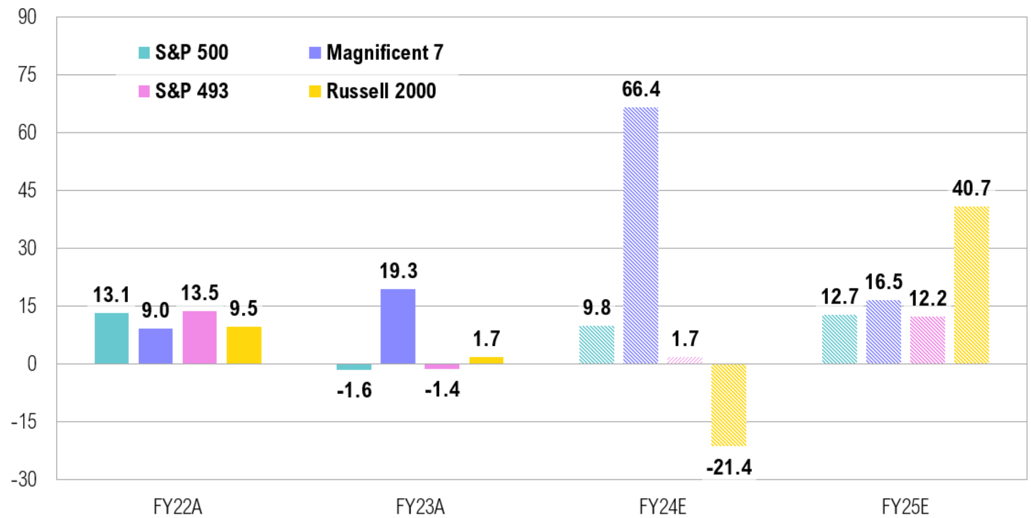
Source: NDR, SpringTide.

The potential for increased onshoring and reduced regulation could benefit small caps

2. Rotation to small caps: The potential for increased onshoring and reduced regulation could benefit small caps. Additionally, small-cap earnings growth is projected to accelerate, even as earnings growth for the broader market slows. If market estimates are directionally accurate, this shift in growth rates could favor small-cap stocks. Historically, small caps also tend to outperform large caps following elections, with average gains of 17% in the year after elections compared to U.S. large-cap stocks, which gain an average of 12%.

Despite Coming Off Low Base, Small Cap EPS is Expected to Accelerate in 2025

Earnings per Share Growth, Y/Y %



Source: Bloomberg

Funding for Israel and Taiwan will continue without interruption

3. Other sectors & industries: Additional areas that we believe could benefit include financials and defense stocks. With Republicans controlling the White House and Senate, support for higher defense spending is likely to grow, though control of the House could affect some priorities and specific budget levels. We expect funding for Israel and Taiwan to continue without interruption, but aid for Ukraine may face challenges. Overall, increasing defense funding remains the path of least resistance in Washington. Financials should continue to benefit from a steeper yield curve and more supportive M&A and consolidation backdrop.

4. Digital assets: Trump and Vance have been unambiguously supportive of digital assets including bitcoin and we view the result as good news for the space. The suggestion of a strategic bitcoin reserve could drive further gains should it materialize.

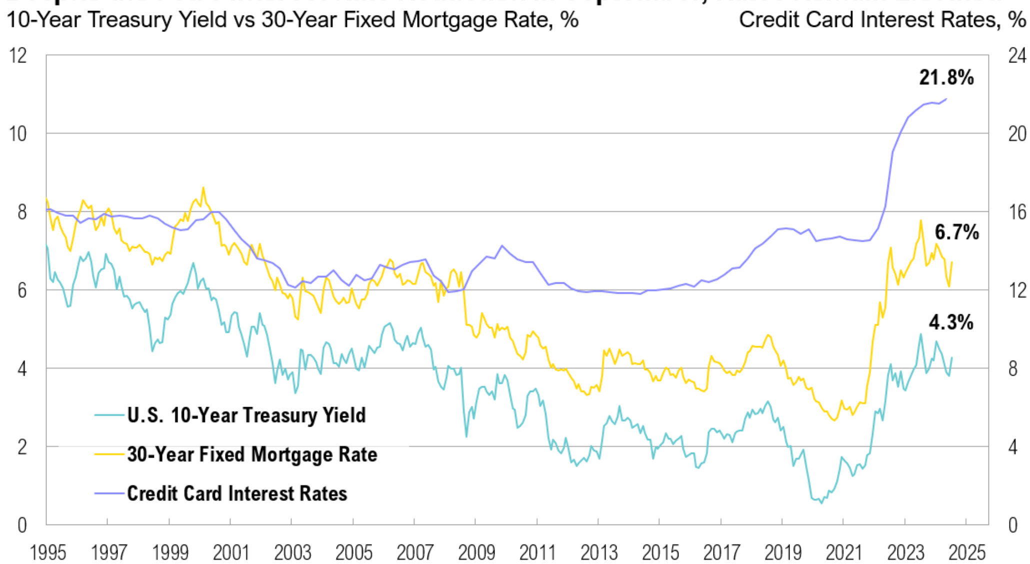
Risks

Increased tariffs, particularly on China, are likely

1. Trade and Tariffs reignite inflation: While some of this may be a negotiating tactic, it is likely that Trump would impose additional tariffs, particularly on China, which could have inflationary effects. Estimates suggest tariffs could range from 10-20% on most foreign goods and potentially reach as high as 60% on imports from China.[5,6]

2. K-shaped divergences continue: A significant risk that was present under both administrations was the increasing polarization of wealth distribution in the U.S. The "average" consumer appears to be disappearing, with wealthier households benefiting from asset inflation, while lower-income consumers are squeezed by rising living costs without the advantages of asset ownership. This trend is likely to continue.

Despite the Fed's Interest Rate Reduction in September, Rates Remain Elevated



Source: Bloomberg

Pressures on low-income consumers are likely to continue

3. **Green energy deemphasized:** The preference for fossil fuels will come at the expense of further subsidies and policy support for green energy investments. We would expect the Trump administration to remove restrictions on drilling on federal land and to withdraw from the Paris climate accord.

Bond yields could continue to see upward pressure

4. **Deficits and the bond vigilantes:** Between potentially higher nominal growth, lower taxes and continued loose fiscal policy, bond yields could continue to see upwards pressure. While the U.S. deficit is clearly unsustainable, and recent moves in bond yields suggest concern, it is less clear when the rise in yields will start to be viewed negatively by equities. This is key risk we will be monitoring.

Summary & Positioning

Opportunities stemming from a Trump presidency include profitable small caps, energy, and digital assets, among others. Risks are focused on the growing budget deficit and a potential resurgence of inflation. If the so called "bond vigilantes" are provoked too much, pressures could build on policymakers to rein in loose monetary and fiscal policy. At some point, higher yields could negatively affect stock prices. On balance, we want to echo the guidance we shared leading up to the election: diversification should include healthy exposures to risk while minimizing exposure to longer-term bonds.

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Performance Disclosures

All market pricing and performance data from Bloomberg, unless otherwise cited. Asset class and sector performance are gross of fees unless otherwise indicated.

Asset Class Definitions

Asset class performance was measured using the following benchmarks: U.S. Large Cap Stocks: S&P 500 TR Index; U.S. Small & Micro Cap: Russell 2000 TR Index; Intl Dev Large Cap Stocks: MSCI EAFE GR Index; Emerging & Frontier Market Stocks: MSCI Emerging Markets GR Index; U.S. Interm-Term Muni Bonds: Bloomberg Barclays 1-10 (1-12 Yr) Muni Bond TR Index; U.S. Interm-Term Bonds: Bloomberg Barclays U.S. Aggregate Bond TR Index; U.S. High Yield Bonds: Bloomberg Barclays U.S. Corporate High Yield TR Index; U.S. Bank Loans: S&P/LSTA U.S. Leveraged Loan Index; Intl Developed Bonds: Bloomberg Barclays Global Aggregate ex-U.S. Index; Emerging & Frontier Market Bonds: JPMorgan EMBI Global Diversified TR Index; U.S. REITs: MSCI U.S. REIT GR Index, Ex U.S. Real Estate Securities: S&P Global Ex-U.S. Property TR Index; Commodity Futures: Bloomberg Commodity TR Index; Midstream Energy: Alerian MLP TR Index; Gold: LBMA Gold Price, U.S. 60/40: 60% S&P 500 TR Index; 40% Bloomberg Barclays U.S. Aggregate Bond TR Index; Global 60/40: 60% MSCI ACWI GR Index; 40% Bloomberg Barclays Global Aggregate Bond TR Index.

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