Perspectives on the Recent Election

November 12, 2024

On November 5th, Americans reelected Donald Trump to the presidency by a wide margin. Republicans also gained control of the Senate and are expected to maintain control of the House.[1] In this note, we share our perspective on the potential economic and market implications of the election and what it might mean for portfolios.

Potential Policy Changes and Their Implications

We expect the likely Republican sweep to have broad implications for the economy.

First, Trump has proposed significant tax reform, including extending the individual tax cuts under the Tax Cut and Jobs Act of 2017, exempting Social Security, tips and overtime from taxation, repealing the cap on state and local tax deductions, and reducing corporate tax rates to as low as 15% for domestic production.[2] This could potentially boost corporate profitability directly and indirectly, as consumers and businesses with more income are liable to spend more.

Second, Trump has proposed broad tariffs on imports of 10-20% and tariffs on imports from China of up to 60%.[3] Such tariffs could potentially turbocharge imports in the very near term (before the tariffs take effect) and will likely drive corporate spending to reorient supply chains, increase goods prices, and boost domestic manufacturing. Overall, we expect the tariffs to be inflationary and hurt profitability for importers, including retailers, manufacturing firms (e.g., foreign automakers), and tech companies reliant on China.

Third, Trump has promised to roll back financial and environmental regulation.[4] This could ease access to credit for businesses and consumers and increase oil-and-gas production at the expense of renewable-energy initiatives.

Fourth, Trump has taken a firm stance on border security and vowed to deport illegal immigrants[5] – policies that could reduce the labor supply or at least slow its growth, with potential knock-on effects in the form of higher wages, labor costs and, ultimately, inflation. The impact will depend on the magnitude of the initiatives and the time horizon over which they are implemented, with inflationary pressures partially offset by reduced demand (e.g., for housing).

Finally, Trump has been hawkish with respect to the Iranian regime, which he sees as the leading sponsor of terrorism and a major source of instability in the Middle East and globally, and which recently tried to assassinate him.[6] We believe that the potential for military escalation in the Middle East is heightened and could affect markets generally and energy markets in particular.

Market Response to the Election

Trump's definitive victory sparked a rally in stocks and bitcoin, with the S&P 500 ending the week of the election up 5% since the day before the election and bitcoin surging (now up 25%). Treasuries were flat on the week after yields initially rose 15 bps on Election Day, oil and gold ended the week down slightly, 1-2% each, and the dollar rose 1%. Notable winners within equities have included defense, which may benefit from increased military spending, financials, which may benefit from a more relaxed regulatory environment, and consumer discretionary stocks, which rallied on prospects of stronger growth. In contrast, renewable energy has sold off, with solar stocks now down nearly 15% since Election Day.[7]

Economic and Market Implications

Consistent with market moves and commentary, we expect Trump's victory and Republicans' likely control of both houses of Congress to be broadly supportive of economic growth and corporate profitability through a combination of lower tax rates, increased income for households and corporations, increased spending across the economy, and deregulation. We also see potential for a second wave of inflation if a) economic growth accelerates, b) aggressive tariffs are implemented on imports, c) a crackdown on illegal immigration reduces the labor supply and fuels wage growth, and/or d) escalation in the Middle East disrupts shipping routes and/or energy supplies, sending prices higher. Finally, we think market volatility could remain elevated depending on how geopolitical conflicts evolve and how new policies are practically implemented.

Investment Implications

One of our fundamental investment principles is that markets are relatively efficient, meaning that it is difficult to identify and profit from mispricings based on information that is generally known to the markets. We see the stock market's reaction to Trump's victory as a good example of this – stocks have broadly rallied on expectations of stronger economic growth, increased government spending and deregulation, with the companies and sectors expected to benefit most rallying disproportionately.

Nevertheless, when we look at prospects for the economy in view of current pricing, a few points stand out. First, policies take time to implement, and new spending takes time to flow through to the economy. This may limit the near-term impact of tax cuts and deregulation on growth. Second, deficits are already at record highs and growing quite fast. Economic reality may not allow for the large tax cuts and spending increases currently contemplated without exacerbating risks to Treasury and related markets and the dollar. Third, a potential rebound in inflation could lead to another wave of tightening – a headwind for borrowers and assets generally. And finally, stocks are not cheap, with the S&P 500 now at a forward P/E multiple of 22 – levels last seen in 2020-21 and before that in the dot-com bubble of 2000-01; corporate spreads are near record lows; and longer-term Treasury yields offer little incremental compensation for duration risk relative to history at a time when inflation risks look elevated.[8]

Taken together, these observations make us hesitate to lean further into traditional markets like stocks and bonds, which most portfolios are already overweight. We continue to favor diversification with less correlated assets, including those that may offer inflation protection, and with active management, which can potentially take advantage of discrete mispricings based on proprietary insight and enhance returns in the private markets through liquidity premia, proprietary sourcing, and operational value-add capabilities.

Notes

[1] Decision Desk HQ projects Republicans will retain US House majority | Reuters.

[2] Wall Street girds for Trump 2.0: Tariffs, tax cuts and volatility | Reuters; Harris Tax Plan vs. Trump Tax Plan | Election 2024.

[3] Ibid.

[4] Donald Trump eyes Doug Burgum as new 'energy tsar' to slash regulations; Banks Eye Trump Regulatory Reprieve, Starting With Capital Rules - Bloomberg.

[5] Trump to appoint former ICE director Tom Homan as US 'border czar' | Reuters.

[6] Office of Public Affairs | Justice Department Announces Murder-For-Hire and Related Charges Against IRGC Asset and Two Local Operatives | United States Department of Justice; Iran ordered an operative to assassinate Trump before the election, federal prosecutors say - POLITICO; Iran's Revolutionary Guard: Its Role in the Conflict with Israel - Bloomberg.

[7] Source: Bloomberg (SPX Index, USGG10YR Index, XBTUSD Curncy, CL1 Comdty, XAU Curncy, DXY Curncy, ITA US Equity, IYF US Equity, IYC US Equity, TAN US Equity, TSLA US Equity); data as of 11/11/2024.

[8] Stock Market P/E Ratios - Yardeni Research, Forward P/Es - Yardeni Research, Bloomberg (CSI BBB Index, ACMTP10 Index, KIMWTP10 Index).

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