# Current Positioning
# November 2024

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## The past month summed up

The election of Donald Trump probably means a stronger US economy in the short-term but could present deficit and inflationary issues in the longer term. The UK budget failed to persuade markets that it would deliver either growth or fiscal discipline.

## The rationale

Our central view remains that inflation has largely been stabilised and the global engine that is the US economy is ticking along nicely. The election of Donald Trump to the presidency for the second time magnifies some of the aspects of the US economy at present, on the positive front probably boosting growth and therefore the prospects for companies, and more negatively pushing deficits higher and increasing the chance of a return of some inflation.

After a nervous month in October for stock markets – the S&P 500 dropped 1% over the period – markets rebounded in the wake of the early election call for Trump. Does this mean that markets are all in thrall to the America-First protectionist ideology he espouses? Opinion on this is split, much like the US electorate itself. However, there is one thing that markets value above all else and that is certainty. With an emphatic win, taking the popular vote and winning all seven swing states, it pushed aside any idea of a drawn-out battle in Congress, courts and potentially even the streets over who had actually won the election. Added to this certainty is the fact that the Republicans now control both houses of Congress, meaning that the political stalemate that we often witness in the US may be replaced by a party and government that can get things done.

## Inflation returns?

The fly in the ointment is that what Trump espouses economically is certainly not classic Republican free-trade, small-government stuff, and his notions about the benefits of tariffs are emphatically not shared amongst the vast majority of economists. While Trump has told his supporters that foreigners will pay for the tariffs that he lumps on imports, the downside is more evenly spread – those companies exporting into the US will likely see lower demand, but that lower demand comes from increased prices for US consumers, and rising prices could revive memories of inflation. At the very worst, a round of tit-for-tat tariffs could lead to a trade war that sends the global economy into a recessionary tailspin. This outcome would represent a self-inflicted wound given the success of US policymakers in lowering inflation while keeping the economy afloat, and also deeply ironic, given that the original burst of inflation under president Biden seems to have pushed many supporters to the opposing party.

Trump's immigration plans could also prove inflationary. There is no doubt this proposal is popular and that many US citizens are dismayed at the numbers coming into the country through its southern border. However, the US has always depended on a fluid labour market to support its thriving economy. As well as costing billions to operate, the proposal could shrink the workforce undermining future growth and at a time when monthly labour reports continue to show a robust jobs market. One of the major contributors to inflation last time around was a labour shortage that gave workers leverage to up their incomes. More jobs chasing fewer workers would risk creating the conditions for rising wages to restoke inflation.

## The upside

On the positive side Trump has made noises about cutting regulation, something that can often give uplift to an economy because it lowers the burden on companies allowing them to be more dynamic and competitive. More immediately important is the prospect of tax cuts for both corporations and individuals. A lower tax burden gives people more income to spend while companies benefit from higher profits which can either be reinvested back into their businesses to support growth or returned to shareholders boosting their income.

The consequences therefore are likely to be mixed. US markets relieved by the political certainty can expect a possible fillip from the proposed tax cuts and deregulatory environment. Bonds face challenges, a possible pickup in inflation, and consequently elevated interest rates pushing down prices. Bonds are also valued on the ability of the borrower to repay its loans. While US debt is considered among the safest in the world, constantly increasing debt levels erode trust in the US as a lender – US national debt is already close to $36 trillion and nonpartisan analysis has suggested Trump could add another $7.5 trillion onto that. As a result, inflationary expectations have been climbing since September while the yield on US debt itself has risen from close to 3.6% at the end of September to more than 4.4%.

## In other news…

It's not just stateside where inflationary expectations have been creeping higher alongside fears of ballooning budget deficits. Whatever your views on the rights or wrongs of Rachel Reeves' first budget as Labour Chancellor, independent analysis by the Office for Budget Responsibility indicated it expected significantly increased levels of borrowing on the back of the proposals. While not anywhere near the levels of concern engendered by Liz Truss, the announcement helped push UK 10-year yields up to their highest in more than a year, climbing from near to 3.7% in late September to more than 4.5%.

Another key ingredient in our investment considerations has been the health, or lack of it, in economies and equity markets elsewhere in the world. The prospects for Europe are looking less than ideal with Germany, the region's powerhouse, expected to post a second year of recession in 2024, not aided by a political crisis that has seen the collapse of its so-called traffic light coalition. The region itself is vulnerable to even more economic stagnation through Trump's proposed tariffs, which could be as much as 20%.

Most threatened however by trade restrictions are the Chinese, where Trump has suggested rates as high as 60%. As we noted in previous reports this is a nation already suffering from a slow-motion collapse of asset and property prices, damping consumer spending, and creating a self-perpetuating economic malaise. The Chinese government again recently attempted to plug the decline, introducing a $1.4 trillion package to stabilise the economy, but as with previous interventions this doesn't go far enough in dealing with the very real problems the country faces.

## Investment changes

The prospect of even higher debt levels and a more inflationary environment supports again our move out of US Treasuries and into UK gilts earlier in the year. However, the pro-inflationary and deficit increasing characteristics of the UK budget has prompted a change to our bond positioning, moving investments to those with a shorter maturity. The further out the maturity of bonds, the more sensitive they are to changes in inflation and interest rates and so it seems prudent to reduce that sensitivity given increased risks to longer-term debt.

With the US election now settled, our existing nervousness about the economic prospects outside of the US, particularly for China, has been amplified given the promise of tariffs and trade frictions. The US economy looks very healthy at present compared to a relatively moribund rest of the world; one only has to look at a list of the most successful businesses globally to see where the most vibrant corporate opportunities currently lie. We have therefore further pivoted equity exposure away from Asia and towards the US

## Conclusion

The election of Donald Trump hasn't derailed our central thesis nor the fundamental strength of the US at present. It does, however, raise risks particularly should some of the more striking electoral promises become policy. That will only become evident with time and in the months after his inauguration in January. For the moment the positive noises, at least in equities, are winning out, but as ever we will be watchful for any signs that more negative consequences are beginning to manifest.

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