THE US PRESIDENTIAL ELECTION – WHAT NEXT?

The US Presidential & Congressional elections delivered a resounding victory for Donald Trump as he won the Presidency, popular vote and the Republicans won control of the Senate.

"This is going to be the golden age of America, which will allow us to make America great again" – Donald J Trump, the 47th President of the United States.

Betting and financial markets had both been tilting towards Trump in the run up to the election reflecting the potential for a Republican clean sweep. Equities and the dollar rallied sharply in response to the result and the decisive nature of the outcome removed the risks of any contesting of the result bringing further relief to markets.

At the time of writing, we don't know whether the Republicans have succeeded in taking the House of Representatives. Expectations are that they will but there is still a chance it could swing to the Democrats.
This matters, as both Houses of Congress are required to approve legislation and so split control could undermine Trump's flexibility to impose his tax, spending and deregulation agenda.

With the excitement of election night behind us, attention now turns to what the next four years could mean for policy and investment. While we now have more certainty of the direction of travel for policy, there will be plenty of devil in the detail. A clear assessment of the economic and market consequences will emerge as policies are given form in the coming months and as Trump reveals the key members of his Cabinet.

We see four key areas of policy today:

- Tax
- Regulation
- Trade
- Immigration

Tax

"When we were a smart country, in 1890…it didn't have an income tax"

Trump likes low taxes. The Republicans have promised to extend the 2017 tax cuts on individual income that were due to expire in 2025, there will be no increases to taxes on capital or inheritance. They have also mooted a cut in corporate tax rates from the current level of 21% to as low as 15%.

Tax cuts are usually good for growth and spending/investment. Analysts have estimated that a cut in the corporate tax rate to 15% could add 5% per annum to the earnings of companies in the S&P 500, providing an immediate boost to equities.

Alongside tax cuts, there has been little talk of spending cuts, other than loose promises that Elon Musk would lead a Department of Government Efficiency (DOGE, named after the crypto coin). Budget deficits look likely to rise from already high levels.

The US has been running large budget deficits of 6% of GDP, unusual during a period of low unemployment and when the economy has been purring along. The Republicans plans give barely a nod to fiscal rectitude.

The Committee for a Responsible Federal Budget concluded that the proposed plans could increase the deficit by $7.8 trillion over the next decade. No wonder yields on US Treasury bonds have risen.

Regulation

"It's going to be the largest regulatory reduction in the history of our country."

Deregulation is a key principle of the administration with red tape likely to be cut in a range of areas. We expect restrictions on financial services, merger policy and environmental regulation to become looser. Expected beneficiaries of these policies saw their share prices pop in response this week, including banks, energy companies, and big private equity houses.

Deregulation should, in theory, boost competitiveness, dynamism and profitability for US companies, and would contrast with the embedded biases of major competitors notably the EU. The regulatory playing field is getting less level. This should prove positive for US equities and the US dollar in general. Inevitably there are industries that have benefitted from regulatory incentives that will lose out, particularly those in the renewable energy space which have seen share prices under pressure since Wednesday.

Trade

"Tariffs are the greatest thing ever invented."

Tariffs look likely to move higher. They were a feature of his 2016 term and Trump's 2024 campaign promised a blanket 20% tariff on all imports and a 60% tariff on goods from China. US imports in 2023 were $3.8 trillion of which $450 billion (12%) were from China. The proposed tariffs would raise revenue but not enough to offset tax cuts elsewhere.

Trump has stated that he wants to revitalise US manufacturing; protectionism looks a core pillar to success and should spur domestic investment. The trend to reshoring and the building of domestic resilience alongside infrastructure renewal was already in train, tariffs simply provide further impetus.

Of course, there will be winners and losers, but ultimately protectionism will slow global growth. Trump expects others will take the pain. In reality it will be more complicated and take time for supply chains to adjust. Some companies will pass either part or all of any tariffs on to their end consumers, others choose to absorb it into their own profit margins. In the same way that tax cuts should be good for growth, so tariff increases are likely to prove a drag.

Blanket tariffs also risk a secondary impact on inflation. Taxes are normally not inflationary but, in an environment where consumers are already scarred by rises in the cost of living any sudden increase in goods prices could be perceived as another wave of price pressures and subsequently find their way into inflationary expectations and wage demands.

It remains to be seen where the rubber meets the road on trade. It may be that the headlines and promises are merely an opening salvo in a wider negotiation; the big stick of tariffs being used as a threat to extract better terms of trade with individual partners. For example, there is strategic bipartisan support for curtailing China, but Mexico and Canada could continue to enjoy free trade relations with the US. The populist nature of the administration may mean they row back.

Immigration

"They're eating the dogs…"

Immigration was a flashpoint issue of the campaign. Trump has promised to deport millions of undocumented workers. There are currently 11 million such immigrants estimated to be in the US.

There are of course legal and practical challenges to achieving this, it cannot happen quickly. We were interested to note that more people were deported under Obama's final four years as President than under Trump's first four.

That aside, the economic implications of reducing the size of the labour force are relatively straightforward. Fewer workers point to lower consumption, lower taxes and, combined with a trade policy promoting onshoring of domestic manufacturing and jobs, will increase pressure on employment and with it wages.

Documented (legal) immigrants have had a consistently positive impact on growth throughout America's history. More recently, analysts have credited immigration with allowing the US to grow its economy above trend this year and last whilst keeping wage demands sufficiently under control to allow inflation to fall.
A reversal in all types of immigration is likely to ultimately prove negative for the US economy's growth potential and could add to existing pressures on both the deficit and inflation.

Where does that leave us?

The key conclusion from an asset allocation point of view is that the risk of a hard economic landing for the US continues to decline. We do not yet know the extent of Trump's plans for financial deregulation, the fiscal deficit or tax cuts, but the direction of travel is clear. Tax cuts and deregulation are high on his agenda, relatively easy to implement should Republicans win a clean sweep and should happen quickly. Good for growth in the short term.

The longer-term impact of Trump's policies on growth are harder to determine. Any boost from fiscal spending might be offset by tariffs. If curbs on immigration prove to be severe, this could also weigh on the potential growth rate of the economy as a whole.

However, the attractions of the US when compared to the rest of the world are clear. The EU's political fragmentation and the vulnerability of governments in France and Germany have left it unable to grapple with the economic and demographic challenges writ large across the continent. That's before having to wrestle with both Trump's tariffs and his foreign policy agenda.

China is struggling. There are hopes that it is poised to unleash a fiscal bazooka now that it can calibrate for who leads the US. However, the party has consistently disappointed markets hopes, and the leadership looks to have long-term priorities over and above growth today. This may prove another triumph of hope over experience.

Put simply, the growth prospects look better and more certain for the US than most and that growth should be good for the earnings of US companies or companies operating in the US. This should in turn be good for the equity markets.

Within equities we continue to like businesses that will benefit from the reshoring of production and the US policy of industrial and infrastructural renewal. This is a bipartisan policy where the existing momentum under Biden looks set to continue under Trump.

Bonds by contrast face the strongest potential headwinds. We have seen this in the moves in Treasury yields since the start of October as ten-year US government bond prices have fallen sending yields up by 0.75% even as the Federal Reserve cut rates by 0.5%.

Their stated fiscal approach is likely to keep deficits rising while trade and immigration policy could put renewed pressure on bond prices and yields. Add Trump's proposed plan to meddle with the independence of the Fed and the risks to bonds have clearly risen – we reduced our US bond exposure in September in anticipation but further ructions could be felt, at least temporarily, in other areas of the market. Another reason why gold continues to attract attention despite having risen strongly this year.

Final thoughts

The clearing of the US election without any social disruption has proven a relief for markets and beyond. An initial assessment of policy does little to alter our prior view of the world over the next 12 months. It largely amplifies trends already well in train and for which we are already positioned.

The longer-term implications will take time to emerge and depend very much on the detail and extent that campaign promises become presidential policies.

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