



Insigneo Weekly Dispatch

The US Election: The Revival of the Trump Administration



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The US Election: The Revival of the Trump Administration

- In a near landslide result, Donald Trump has been elected as the 47th president of the United States with 295 electoral votes and counting. Republicans also took control of the Senate, while the House remains up for grabs but very likely to remain in Republican control.
- As markets digested the news, the reaction was positive for equities and for the USD, while Treasuries have been penciling in a steeper curve and higher supply.

- We expect that the Republican, bicameral majority will provide the incoming administration with a relatively benign governance environment.
- Increased tariffs, which will likely be a high priority item in a Trump administration, are seen as an inflationary measure over time, potentially resulting in a slower pace of rate cuts by the Fed.
- Potentially, renewed inflationary risks from the incoming Trump administration may lead to a higher-for-longer rates environment, together with a steeper Treasury curve.

- From an equity standpoint, value-oriented sectors that would benefit most from a Trump presidency would be Financials, Industrials, Consumer Discretionary, Energy, and Materials. At the market-cap level, domestically focused mid and small cap companies should benefit more than large multinationals.
- EM currencies are expected to underperform after the elections due to expected USD strength and disadvantageous trade dynamics.

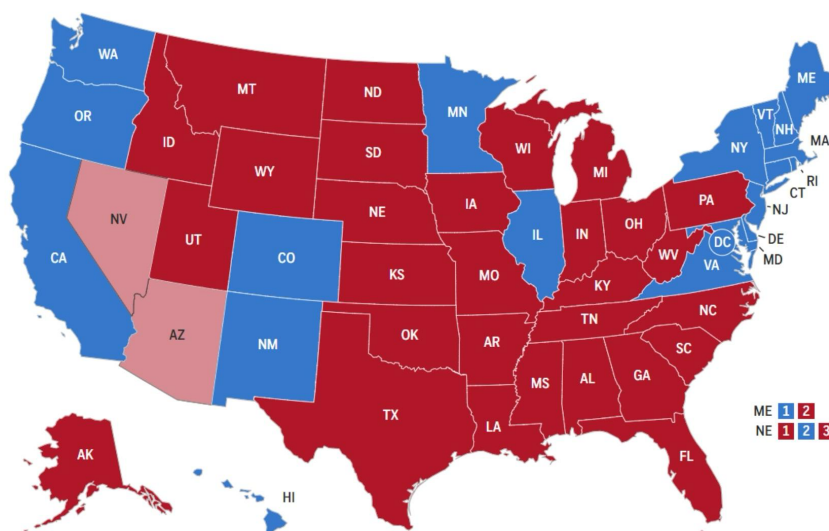
Election Results

One of the most awaited elections in recent history is finally over. This past Tuesday, November 5, Americans went to the ballots to elect, among others, the 47th president of the United States. This

was a highly contested election, and a few congressional results are still being tabulated but the trend is clear – Republicans should control all branches of the federal government. This was not unexpected for us. What did surprise us, however, was the magnitude of the popular vote that Trump garnered, which gives him an important mandate. Here, we will address what the election results mean for different asset classes, as well as delineate the main winners and losers from an investment perspective.

As was penciled in by the latest figures from the betting markets and poll aggregators, Donald Trump was elected as the 47th president of the United States with 295 electoral votes. Trump’s dominance was visible across the typical Republican states, together with all of the crucial swing states that cemented his triumph.

Trump's victory was generalized across the country



Source: Jennifer Campbell-Hicks for 9news, updated as of November 7, 2024

In terms of the legislative race, it is worth highlighting that the Republican party also got control of the Senate, gaining four seats and flipping the Democratic majority to a 53-45 ratio at the time of this writing. In terms of the House, according to the latest available information, Republicans were inching closer to clinching a full sweep in congress, with the voting numbers standing at 211 – 199. As a reminder, a total of 218 seats are needed to win majority control of the House.

As we said before, what surprised pollsters and markets alike was the fact that President Trump won the popular vote by a surprising margin. Contrary to what we saw in 2020 and 2016, President Trump was on track to win the popular vote by a difference that, as of Friday morning, neared 4.5mn. Even if the current popular vote figures are still to be confirmed, the message from the American people was loud and clear: they wanted change, and that change came in the form of the candidate that was contrary to the incumbent administration. This situation underscores a clear and strong mandate for the incoming administration, which could allow for the easier approval of Trump's main policies related to tax cuts, immigration, and deregulation.

Policies and Potential Effects

Increased tariffs appear to be the most pressing issue in everyone's minds. According to different analysts, tariffs could be implemented via an executive action by mid-2025 and could have a

negative impact on economic activity due to their inflationary nature. Additionally, as stated by Capital Economics, tariffs could also shift production to other 'cheap' places that are not China instead of driving production back to the US. Tariffs implemented during the first Trump administration showed mixed results, as technology-intensive industries were negatively affected by a lack of imported components. However, domestically focused industries like industrial manufacturing and oil and gas benefited from the re-shoring of production. An undeniable effect of tariffs, however, is the likelihood of increased inflation. Two other policies from the Trump administration that are top-of-mind for investors' minds revolve around the possibility of lower taxes and decreased regulation. For starters, Trump will likely be able to extend the tax cuts he implemented in 2017, which are set to expire next year. Additionally, reductions on corporate income taxes, as well as taxes on tips, and overtime pay should spur domestic spending and consumption. Coupled with the possibility of deregulation, these policies should create a consumer and business-friendly environment. However, some of the benefits engendered by these policies could be eroded by the increase in inflation that will likely follow.

Increased economic activity at home, coupled with higher costs on imports from abroad, is expected to have an inflationary effect on the economy, potentially undermining the downward rate trajectory the Fed has recently started. A key factor that will likely be monitored by market participants is the central bank's independence when determining its monetary policy amid its fight against inflation, which is moving in the right

direction, but is not yet out of the woods. Looking back at Trump's previous Administration, despite fiery rhetoric from both the Administration and the opposition, the Federal Reserve maintained its independence in formulating and implementing monetary policy, something that Chairman Powell is likely to also maintain this time around. This topic was briefly broached during the Fed's press conference on Thursday, where Powell stated, in no uncertain terms that by law, he cannot be forcefully removed as Chairman of the Fed. As we stated above, the biggest concern for the Fed will be the possibility of increased inflation and its fight against it.

The Fed

During Thursday's Federal Reserve meeting the committee announced that it was reducing interest rates by 25bps, leaving the Fed Funds rate in a range between 4.5%-4.75%. This move came as no surprise to markets, as it had been widely expected and priced in. What markets were really interested in hearing was how the incoming Administration would affect the future path of rate cuts. To this point, Chairman Powell stated that "In the near-term, the election will have no effect on policy decision". However, in the longer term, things could be different. Over the past year, the Fed stated that it was going to remain data dependent. However, the tone had changed over the past couple of months, as Powell appeared more open to providing a clearer path for monetary policy. The tone appears to have changed yet again, reverting to a focus on data dependency. "We know the destination, not the path...you don't want to tie

yourself with guidance." "We are not on any pre-set course and will continue to make decisions meeting by meeting." "We are on a path to a more neutral stance; we will see where the data takes us." Chairman Powell reiterated this idea many times on Thursday; setting a less dovish tone for the future ahead. This makes sense, as the Fed does not want to back itself up into a wall, retaining flexibility and leaving the door open for a pause in monetary easing next year, if necessary.

At this point, the Fed believes that the risks between its dual mandate of maximum employment and stable prices are roughly in equilibrium. However, it is keenly aware that inflation could rear its head again, upsetting this delicate balance. Sometimes we learn more from what is not said than from what is stated. To this point, it was interesting that the words "growing confidence in inflation" were removed from the Fed's statement, acknowledging the fact that inflation is the key, unknown variable that could change the pace and magnitude of its current monetary easing cycle.

We think it is likely that the Fed will cut rates again in December by 25bps. However, we would not be surprised if we see a pause sometime next year, to allow the economy time to digest some of the effects of the new policies of the incoming Trump administration. The debate on Wall Street has now shifted from soft versus hard landing to the possibility of no landing, meaning that economic growth could continue while inflation moves higher. It is important to keep in mind that tariffs could be less onerous than expected, having a more muted impact on inflation than feared. Regardless, there is an increasing possibility that the Fed could step off

the gas in its monetary easing cycle to get better clarity of the road ahead, potentially leaving rates higher for longer.

Fixed Income

As highlighted above, the main risk for fixed income markets stems from renewed inflationary risks due to new tariffs. If history works as a guide, when the first round of Trump tariffs was implemented in 2018, US CPI exhibited a pike in the following months after the implementation; however, the increase was underpinned by gains in gasoline prices, not necessarily by shipping and trucking costs that usually take longer to build up. However, that round of tariffs was not as aggressive as the one initially proposed by the incoming Administration; hence, its effects are less certain. Still, a plausible consequence of the expected inflation pressures is a higher-for-longer rate environment underpinned by a Federal Reserve that, as previously stated, could be forced to abate monetary easing. As of today, the market is expecting a Fed Funds rate of 3.75 by December of 2025. The pause in cuts could lead to higher yields in the short end of the Treasury curve, as markets gauge what the new terminal rate should be amid a more fluent inflationary environment.

Another topic that is getting additional traction among fixed income investors pertains to the US's fiscal outlook. Some market analysts are forecasting up to USD 7.5tn in additional deficit from the incoming Trump administration, and with the current debt/GDP ratio nearing the 100% figure,

the US does not seem to be in a sustainable fiscal path. Moreover, to finance most of Trump's policies, and to compensate for the potential fiscal revenue that will not come in the form of taxes, the government will probably have to ramp up its long-term debt issuance. An increase in debt supply will eventually increase yields at the long end of the Treasury curve as investors demand an additional premium for government bonds. What remains to be seen is whether the market's appetite for Treasuries will increase in tandem with the issuance level, and how the Trump administration is going to deal with an increase in its interest payments – a phenomenon that adds more fuel to the fiscal fire.

Furthermore, if Treasury yields rise, another segment that needs attention is corporate debt. Currently, spreads for both IG and HY bonds are at their tightest level since the late 1990s, which could set the stage for credit to underperform if Treasury yields rise. We continue to favor exposure to the short and mid ends of the curve, while favoring quality and liquidity over offered yield.

Equities

From an equity standpoint, US equity markets rejoiced with the election results. Over the first two trading days after the election, large cap stocks rose over 3.3%, mid cap stocks went up by 4% and small cap stocks gained 5.4%. Going forward, we believe that domestically focused, value-oriented sectors should benefit the most from a Trump presidency, although growth is likely to benefit as well. At the market-cap level, we believe that small

and mid-cap stocks should also outperform large cap.

Increased tariffs coupled with lower taxes and decreased regulation at home will likely lead to an increased level of de-globalization. This should benefit smaller domestically focused companies over large multinationals that have a higher degree of dependency on demand, as well as supply, from abroad. Sectors such as Industrials, Energy and Materials and Consumer Discretionary would likely benefit the most from this trend. At the same time, the Financials sector should also benefit from decreased regulatory pressures. Interestingly enough, four of these five sectors are traditionally associated with value investing. At the same time, these sectors tend to be composed by smaller, domestically oriented companies, which is why we believe that that we will continue to see the rotation that we have been seeing over the past few months, out of large cap tech and into value-oriented mid and small cap equities.

Stemming from this belief, we would expect the “great rotation” to continue and would not be surprised if the Mag-7 companies finally give way to the other 493 companies in the S&P 500, potentially propelling the equal-weighted version of the index to catch up and outperform its market cap weighted twin. We have already seen this trend, as we discussed in last week’s Weekly Market Musings piece [“Half Time Report”](#). In this piece, we also discussed the possibility that the Fed could potentially keep rates higher for longer if faced with increased inflation, postulating that mid cap stocks could prove to be a good vehicle through which to get exposure to US equity

markets in this environment. We ended the piece by stating: “We are not saying that investors should completely sell out of large cap stocks and avoid small caps. We are just urging investors not to overlook mid-cap stocks.” We continue to subscribe to this view, especially after Tuesday’s election results.

The US Dollar

As could be expected, the likelihood of increased tariffs, coupled with an increased focus on domestically oriented policies is beneficial to the US Dollar. Additionally, the possibility that the Fed may keep interest rates higher for longer has also propelled the Greenback higher, at the detriment of emerging market currencies like the Mexican Peso, Brazilian Real, and Chinese Yuan. We believe that the relative strength of the US Dollar is likely to remain in place, as tariffs would also reduce demand from countries that export large quantities of manufactured goods to the United States, such as China.

Focusing on Latin America, amid a generalized currency depreciation that was underway after the US elections, it is worth keeping in mind that both Mexico and Brazil, aside from being the two biggest economies in the region, are also China’s two main trading partners in the region. Amid the heightened importance of nearshoring for Mexico, worsening trade relationships with the US could add additional pressure to the MXN and the BRL, the two most depreciated currencies in the last month.

Parting Thoughts

Regardless of party affiliation, it is hard to argue that the American people voted for change. As a result of the large mandate resulting from the near electoral sweep as of the time of this writing, the incoming Trump Administration is likely to enjoy a relatively benign governance environment, at least for the next two years until the midterm elections take place. As a result, President Trump is likely to be able to implement his policies with limited pushback, something that could be deemed as good or bad, depending on who you ask. With our

personal views aside, when it comes to investing the important thing is not to overreact. We do not want to pile into the market or sell out blindly. We urge you to consider our opinions above and speak with your financial advisor when thinking about how to invest in this new environment.



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