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Zooming In: Episode 5 – US Election Results: Potential Policy and Investment Implications

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Willem:

Welcome everyone to our Zooming In special about the US elections. Now, 2024 has been the year of elections. But the US election probably affects the market most. So we want to look at its impact on the current economies and markets, how are tariffs, policy changes, the tax cuts and the deficit, for example, going to impact the different markets. And to do this, I'm here with Jose Rasco, who is our CIO for the Americas.

Now Jose, to examine the impact of the elections, of course we need to know first where we are currently and we are actually at a very favourable starting point. I think the US economy is quite resilient, recession risks are low, falling inflation is helping the consumer and is also allowing the Fed to continue to cut rates. And companies are making a lot of money because I think investors have been underestimating the power of innovation and been overestimating the impact of the past rate hikes on companies' interest expenses and profits.

So given that we have that healthy starting point, where do we go from here? What's the impact of the elections, Jose?

Jose:

Willem, historically, after US elections, especially after presidential election years, the US markets tend to outperform global markets for the first 6 to 12 months. Secondly, we're at the beginning of a Fed easing cycle. And again, in the first 12 months, US financial markets tend to outperform. So those are very important factors from history. Secondly, I think if you look at the Trump administration focussed heavily on cutting taxes, in both the corporate and the household sector, that should be positive for the economy as well as financial markets. And if they look to increase the amount of deregulation, in other words, reduce the regulations already in place, that should help reduce costs, which should help make companies more profitable. And then last but not least, if you combine all of these factors and you still have above trend growth and inflation that is under control, we think those are very positive fundamentals for US financial markets in the next 6 to 12 months.

Willem:

That's all positive and a good reason for us to further add to our existing overweight that we had on the US equity markets and to maintain that positive view. But that risk-on stance, of course, reduces the appeal of safe haven bonds; and there's also some mild nervousness about the Fed rate path and the deficit. And the argument goes that if tariffs increase and if those costs are charged through to the customer, that could lead to higher inflation. Therefore, change the Fed rate path. We think that this is offset at least to some extent by productivity gains, thanks to technology and also the easing of the labour market pressures that already remain in place. So the Fed should continue on its rate cutting path in the next couple of months. And Jose, with regard to the deficit, I know that you think that those concerns, as to their impact on the bond markets are a little bit exaggerated, aren't they?

Jose:

Absolutely, Willem. I think if you look at the Treasury markets, we've seen rates back up a little here, but really nothing relative to what some have expected. And I think we will see more volatility in fixed income markets and that's going to be, in part due to the fact that we're going to have a shift in government. We have other issues like the debt ceiling, but the bottom line is we don't think we're going to see a back up in rates here, as many people think. But given that volatility, that is why we have reduced US Investment Grade to neutral as well as EM hard currency debt where we feel that volatility just creates uncertainty for the markets.

Willem:

That's right. But of course you know those bond yields are at attractive levels. So it's still important to lock that in and also to be able to diversify. I think the US can also afford a bigger deficit than many other countries, simply because of that dominance of the US dollar in financial markets. For the rest of the world, the election has a little bit more of a mixed message. If growth is stimulated in the US and increases global growth, then of course that can be a positive. But tariffs will cause a mixed picture. Those countries which export more than they import from the US, are obviously going to be the target. That includes Germany and Mexico which we move to an underweight equity market position, and Korea, which we moved from overweight to neutral. The UK is in a different position. We actually import more than we export to the US, so we maintain our overweight there. And India has a lot of locally focussed investors and locally focussed companies that are doing very well.

Jose:

And Willem, if you look at Japan, we also think Japan should continue to do well. It has been very resilient as a market this year. And I think one of the key points here is the strength of the US dollar, given the American resurgence and the view or the outlook on the dollar here being relatively positive vis-a-vis the yen in particular. That speaks well for the Nikkei as when the dollar strengthens, the Nikkei tends to do well. The other question in Asia is China. What is going to happen in China? Willem.

Willem:

China clearly is one of the countries that is going to face a substantial US tariff headwind. But that has been known for a while. Chinese stocks are trading at a very big discount, in part because of that. So the Chinese government is trying to boost domestic growth through monetary and fiscal stimulus and our take currently is that these measures will help offset the headwind from the tariffs to protect against downside. But we don't see them yet as sufficient to cause a quick re-acceleration of economic growth and earnings. Therefore, we maintain our neutral stance on mainland Chinese equities, Hong Kong equities and instead prefer Japan, as you said, Jose, together with India and Singapore in Asia. In our multi-polar world, I do think there will still be demand for tail-risk hedges and diversifiers. We talked about bonds,Äô role in portfolios. We are overweight on gold and hedge funds where appropriate. But to go back to the equity market opportunities, very practically speaking Jose, what are the areas that you like most in the US stock market following the elections?

Jose:

Willem, with the continuation of the tech revolution we are clearly constructive on both technology and communication services. We are just in the infancy of this technology revolution. And you mentioned innovation and profitability and productivity. That is largely going to be driven by these technologies as they continue to emerge. So we like those two sectors. We talked about the Fed easing cycle. And as short rates go down, historically that's been very constructive for the financial sector. So we remain constructive on financials. And as the Trump administration maintains its pro growth status, and releases the animal spirits, we will see some elements of integration and consolidation. And we will also see new competitors, which means financial activity, M&A. Those things should do very well. Again, positive for financial companies. And last but certainly not least is the concepts of near shoring and the re-industrialisation of the US remain firmly in place. Some investors are concerned, the Trump administration will get rid of them. We don't think that's the case as they are constructive for the economy. They're creating jobs and wealth. He will refashion them in his own liking. But we think they remain in place. And that's why we remain constructive on the industrials sector as well.

Willem:

Fantastic. I think that's a great overview of our positioning and how we see the impact of the US elections on markets. Thank you very much Jose for sharing your insights and thank you all for watching.