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# Which Market Will Move? US Policies Matter

## Key Takeaways

- Polls and prediction markets suggest a very close US election on November 5. History suggests no one should "bank" on knowing the results. As we highlighted two weeks ago, one party uniting the House, Senate and Presidency seems somewhat unlikely. Only a strong "sweep" of red or blue could radically alter the course of domestic tax policy (please see our September 14th CIO Bulletin).
- Both parties have seen a history of economic expansion and solid US equity returns on average since WWII. The last US President to preside over a US equity market drop during the course of his administration was George W. Bush, who had the misfortune of ending his second term on Jan. 20, 2009.
- With this said, the "mere" choice of President may be a pivotal factor in market sentiment and preference for US vs non-US assets. One can look at tariffs – the favored policy of Trump – as a potential disruptor. Tariffs coupled with sizeable tax cuts could sway the course of the Fed and boost the US dollar. On the other hand, a Harris win would represent a status quo which would likely provide short-term relief for non-US asset markets and send the US dollar drifting lower.

## Potential Portfolio Implications

- The next US President and Congress are sure to surprise in some ways. The market setting, however, leads us to highlight some predictable tendencies when the winners of the Nov. 5 elections emerge. Non-US equities jumped in the past month when Harris's electoral prospects have brightened. They've fallen when Trump gained.
- US equities have outperformed the rest of the world for 15 years with valuation differences mostly escalating. If US trade and tax policy don't change, Fed rate cuts could ease a strong US dollar, benefitting the remainder of the world (as an example, please see our latest Asia Strategy: China Finally Begins to Fight Deflation). Conversely, with Fed easing so strongly embedded in bond market valuations, the chance of a snap back in the US dollar seems high if US trade and tax policies follow the course of Trump's platform.
- A variety of other trades such as green energy, domestic small caps and regulatory beneficiaries (banks) will vacillate on Harris/Trump prospects. Even if one doesn't take a position in these assets, a sizeable part of core, global portfolios will likely pivot on which leader is chosen Nov. 5.

# Which Market Will Move? US Policies Matter

Why do equities historically both rise and fall during periods of sustained growth? It's because share prices embed expectations of future growth that can fluctuate widely from day to day. Always looking to the future, share prices are more than today's reality. They are investors' uncertain and ever-changing view of "what's next."

We've noted many times that today's US presidential candidates of both parties have presided over historically large share price increases. The annualized return for the S&P 500 over the course of the Trump/Pence administration was 16.4% while Biden/Harris has averaged 13.1% to date. This can be credited significantly to the 10.9% annualized rise in S&P 500 earnings per share over the last eight years, not the person sitting in the White House (see **FIGURE 8** for returns and other data during each US administration.)

Yet US Presidents do wield much power, and can change market expectations, particularly over the short term. The foreign policy and mix of domestic polices of Harris or Trump (presented in alphabetical order) are more than enough to sway the expectations of global markets. In today's bulletin, we'll discuss how and why.

**Greater Uncertainty = Larger Market Reaction**

Polling data for the US election shows a tight race. The unusual qualities of the US electoral college make it fraught for investors to take a strong view of the outcome. The close election makes it likely that the results on November 5 will cause certain asset prices to move significantly.

**Certain Asset Prices? Which Ones?**

One of the clearest observations of the campaign period thus far is that non-US share prices can swing sharply with the prospects for Harris or Trump. As **FIGURES 1-2** show, the discrete events that changed polling data and prediction market odds in favor of Harris or Trump drove significant equity market gains or losses in large regions of the world.

**FIGURE 1:** Equity price movements following first Trump assassination attempt

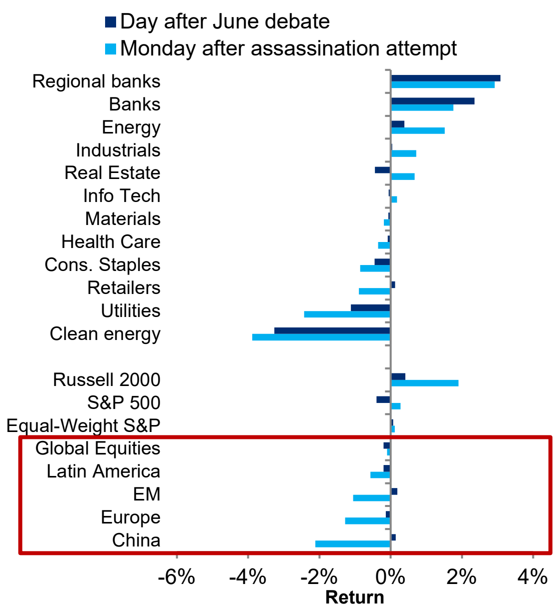
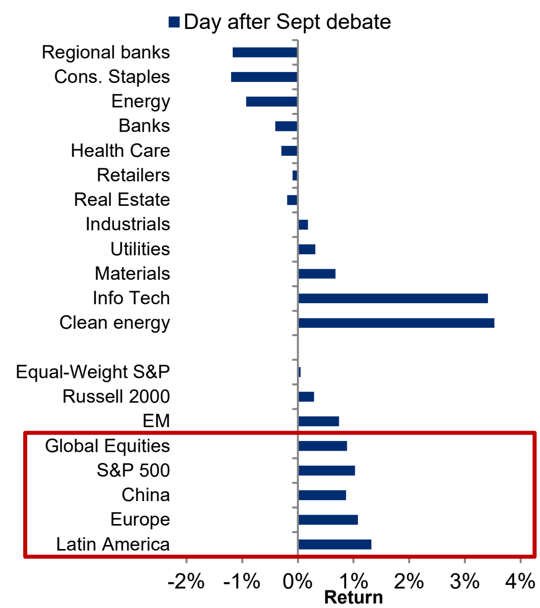
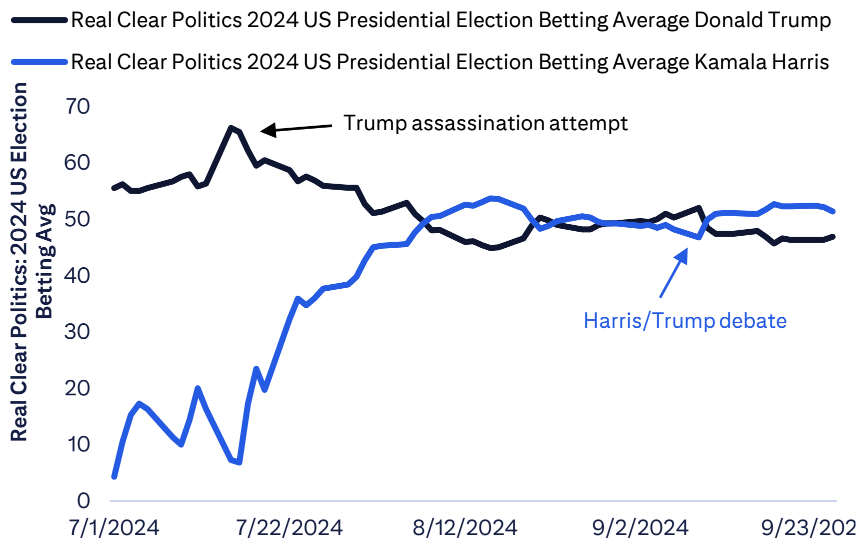



**FIGURE 2**: Equity price movements following Harris/Trump debate




Source: Bloomberg as of September 18, 2024. The red boxes identify the reaction diversion between a Harris/Trump presidency for non-US markets. Regions are using their respective MSCI indices as proxy. Sectors and industry groups are using their respective S&P indices as proxy. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. **Past performance is no guarantee of future results. Real results may vary.**

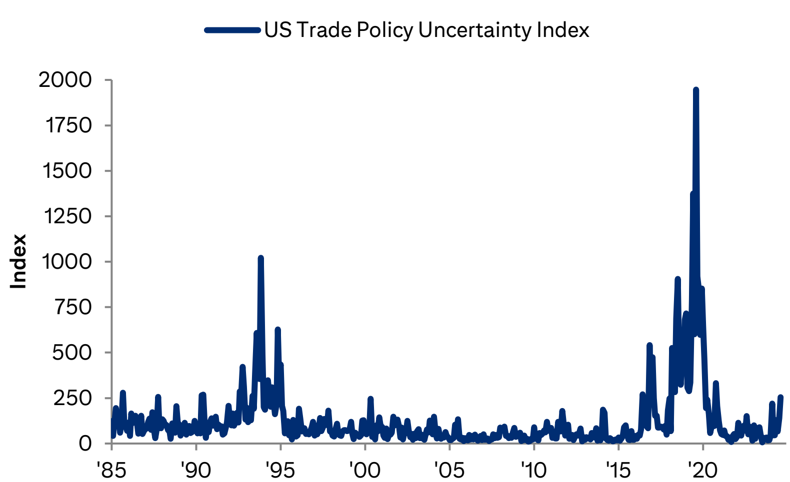
**FIGURE 3:** RealClearPolling odds of Democrat or Republican win




Source: Bloomberg and RealClearPolling as of September 25, 2024. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. **Past performance is no guarantee of future results. Real results may vary.**

Why would this be the case? As we noted, share prices rose through the economic expansions of both administrations, though interrupted briefly by the pandemic shock late in the Trump administration. Yet Trump's tariff increases – mostly focused on China at the time – caused great volatility spikes, more so outside the US (see **FIGURE 4**). While it is true that US importers pay the customs duties (taxes) on imported goods, equity and foreign exchange markets can reduce the value of a foreign producer's business. Tariffs change the economics of international trade.

**FIGURE 4:** US trade policy uncertainty index

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Other policy issues matter too. Like his first administration, Trump has again campaigned on significant net tax cuts. The non-partisan Committee for a Responsible Budget assesses a $4 trillion US deficit increase compared to current law under Trump's proposals and a smaller $2 trillion under Harris's proposals (As we noted two weeks ago, neither party is likely to allow earlier tax cuts to fully lapse at end 2025).

Along with immigration restrictions, the Trump proposals – including tariffs – are marginally more inflationary than Harris. This should not prevent the Fed from easing monetary policy further, but it bears a strong chance of swaying the Fed to e*ase less* than is currently priced in markets. A tighter US monetary policy under Trump vs Harris and "trade war affects" would strengthen the US dollar, just as it did in the first Trump administration. This would be a drag on non-US asset returns.

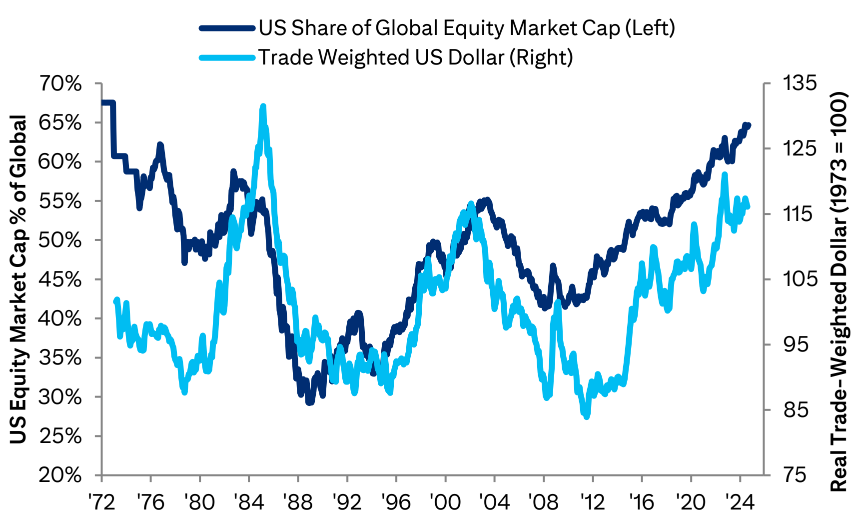
The Fed's first rate cut last week has already eased the way for China to ease monetary and credit polices (please see Asia Strategy: China Finally Begins to Fight Deflation). Pegged currency zones from the Middle East to Hong Kong will see interest rate relief (see our August 24th CIO Bulletin). But how much further this can go will depend in part on the US fiscal stance. Further Fed easing seems well discounted in the bond market but is less evident in US exchange rates thus far, particularly for key emerging market currencies.

With this in mind, the mere possibility of a new Trump administration is likely restraining returns in foreign markets at the margin. While we have been overweight US equities independently of election issues, our own risk tolerance for non-US risk has been held back by potential US policies. As we noted in the September Quadrant, a key question for global markets is how disruptive US policy will be. On this issue, Harris vs Trump differ.

## A potentially pivotal moment

The past 15 years have been one of unusually strong US outperformance on a sustained basis. US equity market capitalization has risen to a record 65% of the world measured in a historically strong US currency (see **FIGURE 5**). During the past century, it was rare for outperformance to persist more than a decade. With this outcome, investor portfolios throughout the world have become "US biased." US investors who favored their home market outperformed those who diversified across the world. But is this a risk for their portfolios going forward? At ever-higher levels, one would think so.

**FIGURE 5:** US share of global equity market capitalization vs real trade-weighted dollar

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To be clear, the US equity outperformance hasn't been driven on some irrational bias. As **FIGURE 6** shows, the profits of US firms have outgrown non-US. And as we showed last year, one can easily find examples of markets strongly rewarding any firm globally that outgrows peers. A Danish drug maker was one of last year's strongest equity market performers among global large caps, for example. Yet that was not true for Europe as a whole, as the region's EPS gains lagged.

Critically, faster EPS growth rates for US firms are strongly embedded in expectations for the future. Therefore, outperformance from here requires raising that expectation further. As **FIGURE 7** shows, the valuation of US shares is at a historically high premium to non-US shares.

So, will the US only outperform other regions? It's possible that the US could gain further. Like 2018, a trade war shock might sink all markets, but the US less for a time. As we have discussed, the strong growth performance for US technology shares in the decade to date is mostly behind US/Non-US valuation differences. China's polices are largely behind its weakening corporate performance (see our September 14th CIO Bulletin). These combined boosts to US relative performance might fade.

While we believe it is unlikely, Harris has proposed a somewhat higher US corporate tax rate and other forms of higher capital taxation. A stronger regulatory hand could also restrain US equities at the margin. We say this while overweight US equities, albeit expressed through segments with lower valuations than large cap US tech. There are no guarantees that the US election outcome and presidential policies will be the decisive factor that changes the relative return picture for US and non-US assets. But at a record high for the US share of global markets, it is critical to keep an eye on what might change a powerful driver of portfolio performance.

**FIGURE 6:** US vs non-US EPS Y/Y%

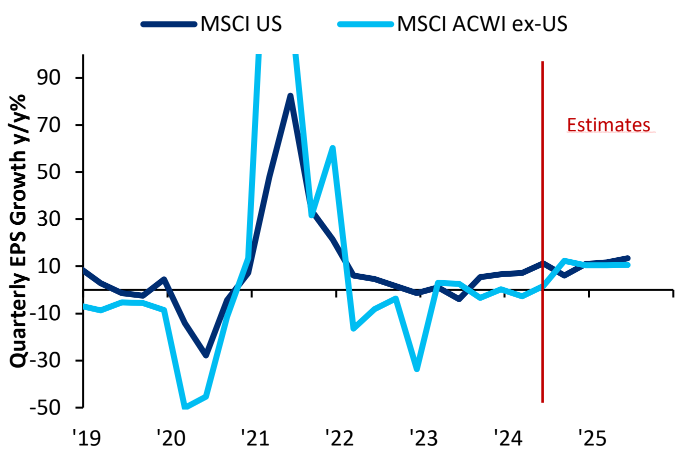


**FIGURE 7**: Non-US valuation discount to US

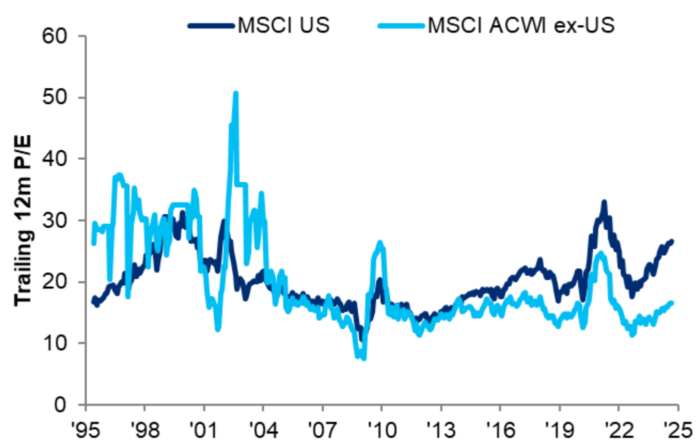


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**FIGURE 8:** Market and economic performance during each US president since WWII

| | Annualized Real S&P 500 Total Return (%) | Annualized Real GDP Growth (%) | Unemployment Rate At Start Of Term (%) | Annualized Real Trade Weighted Dollar Change (%) |
|---|---|---|---|---|
| Truman | 9.7 | 4.7 | | |
| Eisenhower | 13.3 | 2.5 | 2.8 | |
| Kennedy | 9.9 | 5.3 | 6.3 | |
| Johnson | 7.9 | 5.1 | 5.5 | |
| Nixon/Ford | -2.1 | 2.7 | 3.4 | |
| Carter | 1.3 | 3.2 | 7.8 | -1.1 |
| Reagan | 9.4 | 3.6 | 7.4 | -0.1 |
| Bush | 11.0 | 2.2 | 5.3 | 0.0 |
| Clinton | 14.2 | 3.8 | 7.4 | 2.3 |
| Bush II | -5.3 | 1.9 | 3.9 | -1.6 |
| Obama | 12.7 | 2.0 | 6.9 | 1.5 |
| Trump | 13.9 | 1.8 | 4.8 | -1.4 |
| Biden* | 6.8 | 2.9 | 6.7 | 3.1 |
| *Biden figures are through Q2 2024 | | | | |
| **Republican Weighted Average** | **5.5** | **2.5** | **5.8** | **-0.8** |
| **Democrat Weighted Average** | **9.9** | **3.6** | **5.5** | **1.6** |

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|---|---|---|---|
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| High quality (very strong) | Aa | AA | AA |
| Upper medium grade (Strong) | A | A | A |
| Medium grade | Baa | BBB | BBB |
| **Not Investment Grade** | | | |
| Lower medium grade (somewhat speculative) | Ba | BB | BB |
| Low grade (speculative) | B | B | B |
| Poor quality (may default) | Caa | CCC | CCC |
| Most speculative | Ca | CC | CC |
| No interest being paid or bankruptcy petition filed | C | D | C |
| In default | C | D | D |

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- restrictions on transferring interests in the Fund;
- potential lack of diversification and resulting higher risk due to concentration of trading authority when a single advisor is utilized;
- absence of information regarding valuations and pricing;
- complex tax structures and delays in tax reporting;
- less regulation and higher fees than mutual funds; and
- manager risk.

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