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Holding the Wheel Steady Ahead of US Election

Key Takeaways

- Ahead of the US election – which might mean substantial changes in US policies ahead – we've updated global economic forecasts to provide a new baseline. Our world GDP estimates edge up. We continue to expect new record highs in US corporate profits next year and keep our global equity allocation 4.5% overweight this month (global fixed income and cash remain 4.5% underweight). For now, our overweight positions are generally concentrated in US assets in both equities and bonds.
- Tracking data for the US economy have been stronger than we expected. We've raised our US real GDP estimate for 2024 from 2.4% to 2.7%. We've raised 2025 from 2.3% to 2.4%. Following disappointing data this year and more aggressive policy announcements, we've raised our GDP estimate for China from 4.8% to 5.2% in 2025.
- Changes to US domestic tax policy and potentially large tariffs could alter the global interest rate and foreign exchange trajectory for the year ahead. Alternatively, "status quo" policies may be maintained, implying a different trend for the US dollar and many global assets. It's not difficult to image a 100 basis point difference in US yields under opposing political scenarios.

Potential Portfolio Implications

- US equities have outperformed the rest of the world for 15 years with both profits and valuations generally escalating. US equities rose at a 16% annualized rate while President Trump was in office and at a 14% annualized rate during the administration of Biden. This does not take into account the impact of inflation, which would make realized returns lower.
- If US trade and tax policies don't change, Fed rate cuts could ease a strong US dollar, benefitting the remainder of the world. Conversely, with Fed easing still strongly embedded in bond market valuations, the chance of a jump in the US dollar seems high if US trade and tax policies follow the course of Trump's platform.
- Post-election US policy has been the reason why we've been conservative on non-US allocations, but potential opportunity is building. US equities have outperformed non-US by about 15 percentage points over the last 12 months. Broadly, Asia looks appealing for growth and valuation.

Be Patient but Ready

With a consequential US election two weeks ahead, we are updating global economic forecasts with all the information that we have today (please see our October Quadrant for full analysis). As US policy becomes clearer in the months to come, important variables could change. Tracking data for the US economy have been stronger than we expected. We've raised our US real GDP estimate for 2024 from 2.4% to 2.7%. We've raised 2025 from 2.3% to 2.4%. Following disappointing data this year and more aggressive policy announcements, we've raised our GDP estimate for China from 4.8% to 5.2% in 2025 (see **FIGURE 1**).

FIGURE 1: CGWI real GDP and EPS forecasts

CGWI Real GDP Forecasts (%)							
	2020	2021	2022	2023	2024E	2025E	2026E
US	-2.2	5.8	1.9	2.5	2.7 ↑	2.4 ↑	2.1
China	2.2	8.5	3.0	5.2	4.9 ↓	5.2 ↑	4.8
EU	-6.3	6.2	3.4	0.5	0.7	1.2 ↓	1.6
UK	-10.3	8.6	4.8	0.3	1.0 ↑	1.1 ↓	1.5
Global	**-3.2**	**6.0**	**3.3**	**2.6**	**2.6**	**2.9** ↑	**2.9**
CGWI EPS Forecasts (%)							
	2020	**2021**	**2022**	**2023**	**2024E**	**2025E**	**2026E**
S&P 500	-13.5	46.9	6.0	0.6	9.2	7.6	6.9
EPS Level	122	209	222	223	244	262	280
P/E	27.6	24.4	17.8	22.8	24.0	22.4	20.9

Source: Factset and CGWI as of October 23, 2024. Methodology for forecasting includes, but is not limited to, analyzing real net exports/imports, real GDP, hours worked, and yield spreads. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. 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.

Post-election policies matter

No one can be certain whether candidate Harris or candidate Trump will win or how strongly their Congressional mandate will be expressed by US voters on November 5. The former is campaigning on tax and spending increases, the latter on tax cuts and tariff increases. If any party "sweeps" it is more likely to be "Republican Red" than "Democrat Blue" as nearly three times as many Senate Democrats face election this year than Republicans (please see the September 14th CIO Bulletin).

As we highlighted in our last CIO Bulletin, prediction markets have moved in favor of former President Trump in the past month. Yet polling data for both the nation and in "swing states" are less conclusive. We believe neither of these sources can be fully trusted as results are within the statistical margin of error.

For the same reason, financial markets have swung wildly on past election nights. The range in S&P 500 futures has been nearly 6% during the evenings of the past two US presidential elections. The 10-year US Treasury yield moved 27 basis points on average and the broad US dollar gained or lost about 2.5% on the election nights of 2016 and 2020.

We would suggest avoiding getting caught up in a mere "moment" of volatility as markets attempt to absorb critical policy implications. We should, however, be prepared to act when the dust settles. This is particularly the case if markets price in views that seem misaligned with reality.

On growth and yield, we overweight US stocks and bonds vs rest of world…

As our Global Investment Committee (GIC) met this week, we believed that any further "gaming" of election outcomes for portfolio allocations would be unwise at this point. For many reasons, our current weightings have been skewed to expect US outperformance. Powered of late by a strong tech sector recovery, EPS growth has been faster in the US equity market than in other large regions. While EM Asia – a region we slightly overweight – anticipates double-digit EPS gains this year, Europe is expecting a 3.6% regional EPS gain, Latin America just +1.8%. This compares to a 10% gain for the US with 29% for US large cap tech shares.

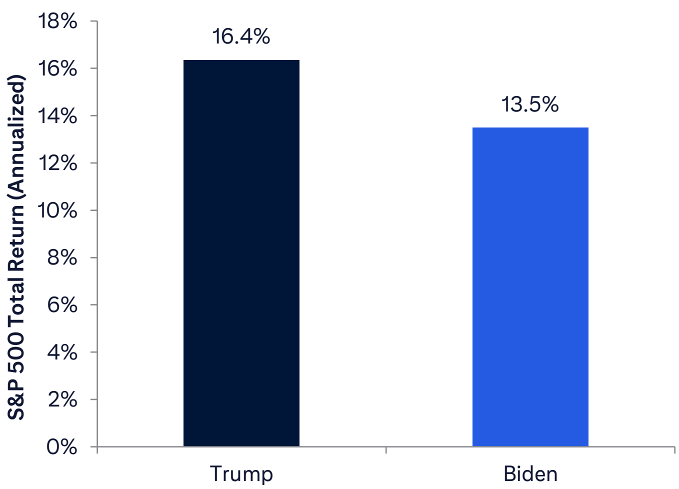
Meanwhile, in the bond market, US sovereign yields have also been higher than all but a group of emerging markets, mostly in Latin America.

Looking forward, we believe valuation favors the rest of the world over the US in equites. Yet US political risk could favor further gains for the US. These issues are the reverse for the bond market (i.e., the positives of a Trump administration for certain equities might be negative for US bonds).

…But have to question how far the outperformance can run

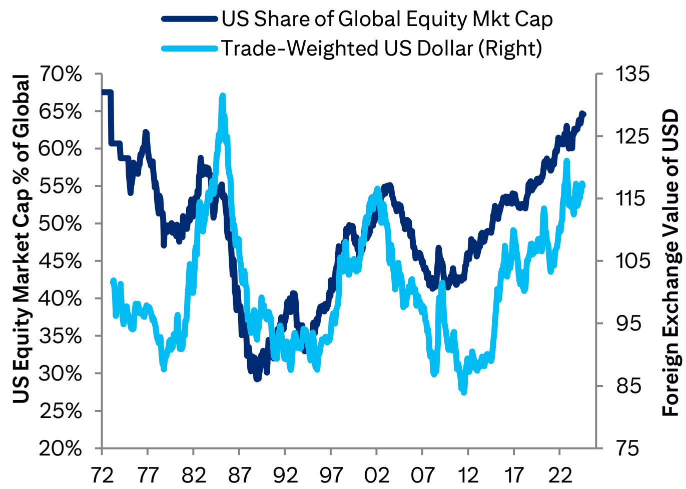
It is striking that US equity returns annualized 16% while President Trump was in office and at a near 14% rate during the Biden administration. The US has been on 15-year long winning streak of outperforming other world equity markets (see **FIGURE 2-3**). The US dollar fell immediately following Biden's election. Yet it surged for most of his administration, as it did for Trump.

FIGURE 2: S&P 500 annualized return during presidential tenure of Trump vs Biden-to-date



The annualized returns do not take into account inflation and therefore realized returns were lower.

FIGURE 3: US Market cap as % of global equities and real trade-weighted dollar index



Source: Haver Analytics and Bloomberg as of October 23, 2024. The dates for Trump are Jan 20, 2017 to Jan 20, 2021. The dates for Biden are Jan 20, 2021 to Oct 23, 2024. 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.

When will US outperformance be so fully embedded in valuations that it progresses no further? Technically, the outperformance doesn't have to end if one stretches the time horizon out far enough. Yet to repeat the outperformance pace of the past 15 years, US equities would have to either continue to rise much more rapidly than profits, or US profits would have to accelerate much faster than they have during any historic period (see **FIGURE 4**).

FIGURE 4: A rising gap: US equity share of global market cap and US share of global EPS

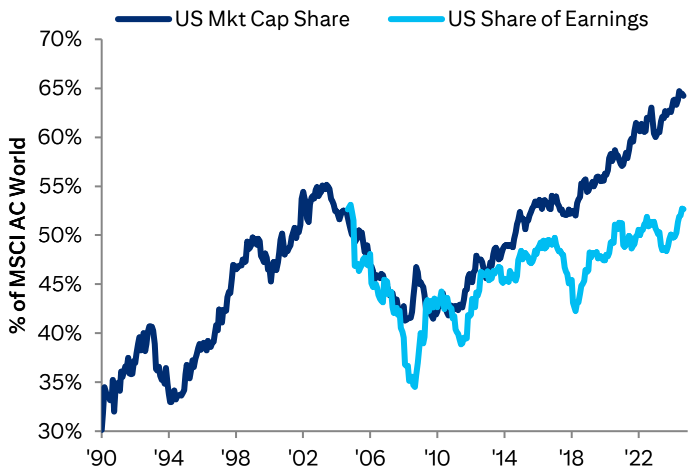
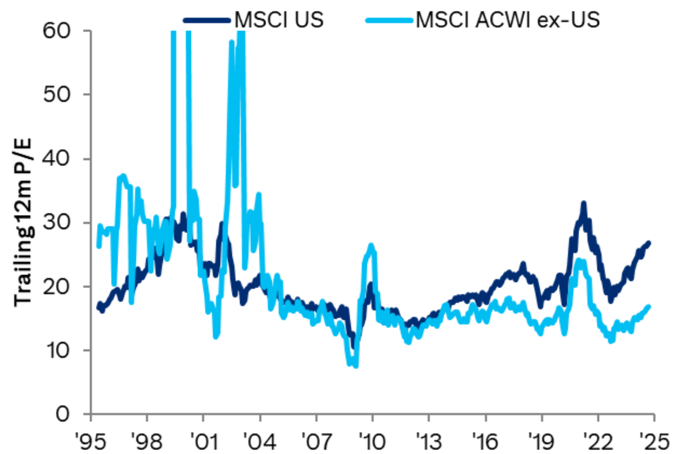


FIGURE 5: US vs non-US trailing P/E ratio



Source: Bloomberg as of October 23, 2024. 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.

The outperformance of US equities in not at the mere start. The 15 years of outperformance over non-US equities since 2009 roughly matches the longest stretch in history. This does not by itself suggest a negative outright performance. We see no other market close in size where innovation is generating such large and rapidly growing profits. But this is of course reflected in the price investors pay for US shares (see **FIGURE 5**). And as **FIGURE 6** shows, even the equal weight S&P 500 has returned 34% over the past year, a gain that is nearly nine percentage points stronger than non-US shares (we've held the equal weight S&P 500 overweight since August 2023).

Optimistically, our updated economic forecast – before major US policy changes are considered – suggests a broadening of profit gains across regions and industries globally (see **FIGURE 7-8**). China's strengthening action to battle deflation could be a helpful catalyst in 2025. If the US doesn't take strong fiscal actions to stimulate demand, US interest rates could stay on an easing track allowing global easing to proceed in line with the actions taken by key central banks this year (see **FIGURE 9**). But if the US does stimulate demand while restricting foreign supplies, it could turn challenge the dovish narrative.

Given swings in US Treasury yields of more than two percentage points in recent years, it is not difficult to imagine that US interest rates could be swayed by 100 basis points in different hypothetical policy scenarios across maturities (see **FIGURE 10-11**).

FIGURE 6: S&P 500 equal weight index Y/Y% and Citi Wealth EPS forecast

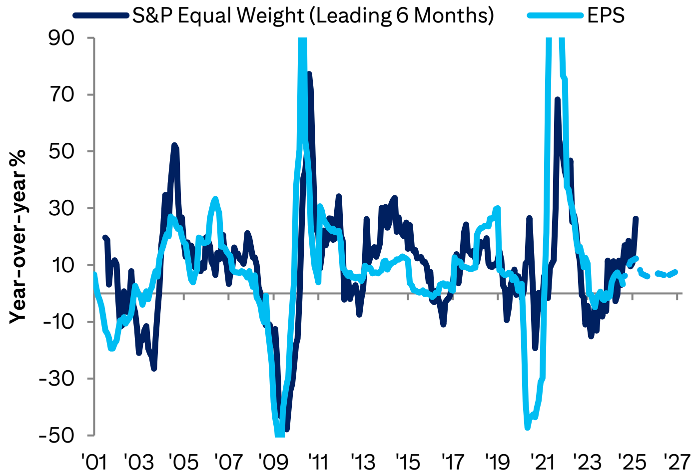
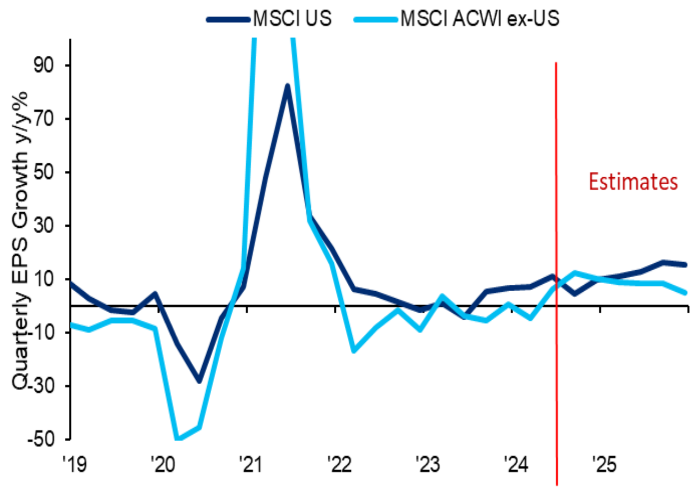


FIGURE 7: US vs non-US EPS Y/Y%



Source: CGWI and Bloomberg as of October 23, 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. 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 8: EPS by region: consensus 2023 vs 2024

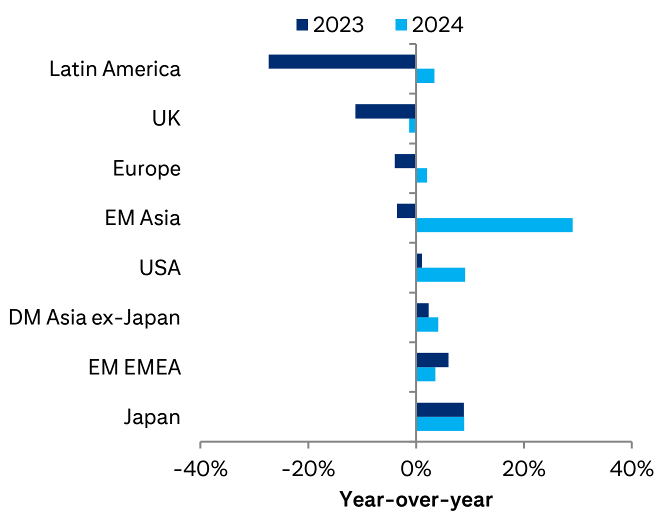
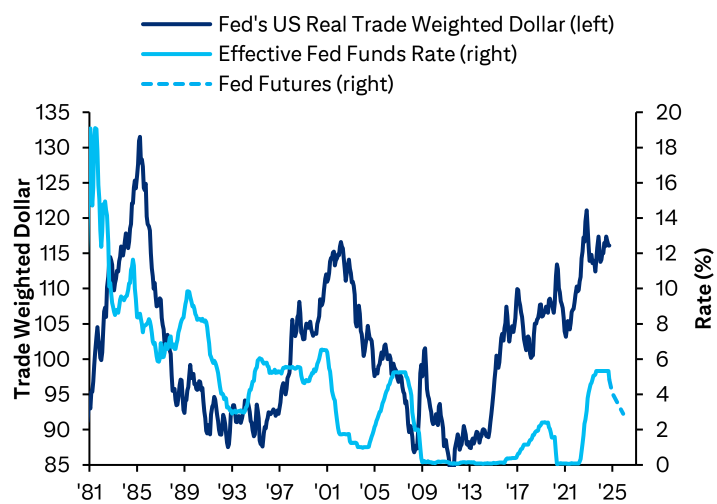


FIGURE 9: US real trade-weighted dollar index vs Fed Funds rate and futures expectations



Source: Haver Analytics and Bloomberg as of October 23, 2024. Regions are using their respective MSCI indices as proxy. All forecasts are expressions of opinion and are subject to change without notice and are not intended to be a guarantee of future events. 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 10: US 10yr Treasury yield (12-month change)

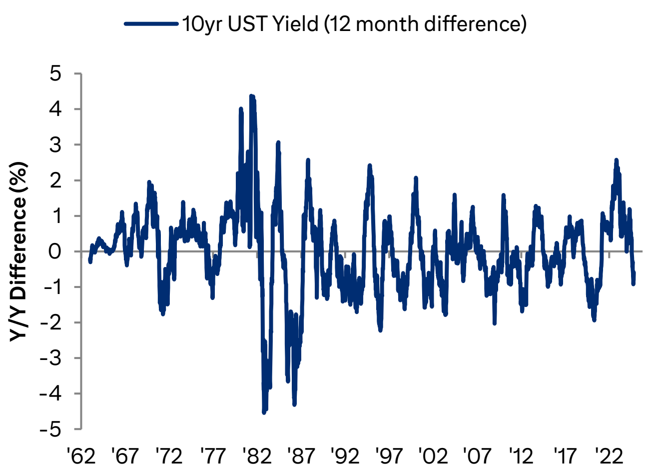
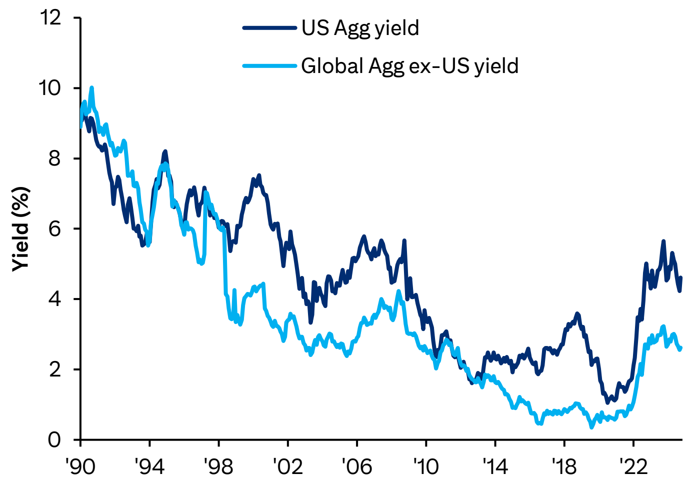


FIGURE 11: Investment grade bond yields: US vs non-US



Source: Haver Analytics and Bloomberg as of October 23, 2024. Bloomberg US Aggregate index and Bloomberg Global Aggregate ex-US index are used 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.

All things considered, where would we add?

As discussed, there is a great deal of immediate political and macro policy uncertainty to consider. The direction of US interest rates is again in question and is not a trivial matter for global markets. But these issues may pass with the political calendar too.

This brings us to the issue of where we might look for equity returns outside the US. In general, we would hope to add exposure highly selectively by industry, across the world's best firms regardless of domicile. Regionally, however, Asia stands out for having markets with growth, value and positive historical performance when US rate/FX pressures ease. (see **FIGURE 12- 13).**

A large, concentrated positioning China's recovery is not necessary to take a more positive view. Shares across Emerging Markets and Developed Markets Asia – including a more richly priced India – trade at about 15X this year's profits, with EPS expected to rise at a double-digit pace in both 2024 and 2025. Regional shares could also benefit from new changes to China's economic policy to address the aftermath of a burst property bubble and industrial deflation.

FIGURE 12: Which regions and themes are most sensitive to US rates

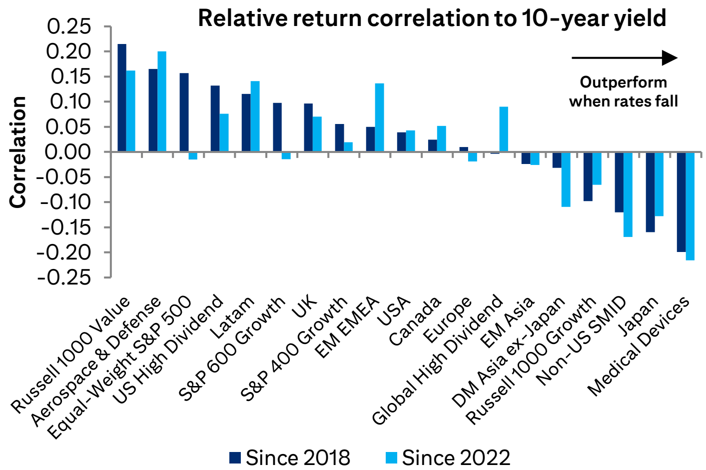


FIGURE 13: Which regions are most sensitive to the US dollar?

Correlations to Bloomberg Dollar Index		
Equity Country/Region	Return	Rel. to ACWI
CEEMEA	-0.45	0.24
US Large	-0.61	0.11
EM Asia	-0.60	0.09
Japan	-0.62	0.01
DM Asia ex-Japan	-0.68	-0.06
UK	-0.65	-0.11
Latin America	-0.58	-0.20
Europe ex-UK	-0.69	-0.22
US SMID	-0.61	-0.28
Non-US SMID	-0.76	-0.29

Source: Bloomberg as of October 23, 2024. Regions are using their respective MSCI indices as proxy. Industries are using their respective S&P indices as proxy. Indices are unmanaged. CEEMEA stands for Central and Eastern Europe, Middle East, and Africa. US Large is using MSCI US as proxy. US SMID (small/mid cap) is using Russell 2000 as proxy. Non-US SMID (small/mid cap) is using MSCI World ex USA SMID cap index. 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. Correlation is the extent to which the values of different types of investments move in tandem with one another in response to changing economic and market conditions. Correlation is measured on a scale of -1 to +1. Investments with a correlation of +.5 or more tend to rise and fall in value at the same time, while investments with a negative correlation of -.5 to -1 are more likely to gain or lose value in opposing cycles.

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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			
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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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2 The rating from AA to CC by Standard and Poor's and Fitch Ratings may be modified by the addition of a plus or a minus to show relative standings within the category.

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Changes in Regulatory or Tax Treatment of Energy Related MLPs. If the IRS changes the current tax treatment of the master limited partnerships included in the Basket of Energy Related MLPs thereby subjecting them to higher rates of taxation, or if other regulatory authorities enact regulations which negatively affect the ability of the master limited partnerships to generate income or distribute dividends to holders of common units, the return on the Notes, if any, could be dramatically reduced. Investment in a basket of Energy Related MLPs may expose the investor to concentration risk due to industry, geographical, political, and regulatory concentration.

Mortgage-backed securities ("MBS"), which include collateralized mortgage obligations ("CMOs"), also referred to as real estate mortgage investment conduits ("REMICs"), may not be suitable for all investors. There is the possibility of early return of principal due to mortgage prepayments, which can reduce expected yield and result in reinvestment risk. Conversely, return of principal may be slower than initial prepayment speed assumptions, extending the average life of the security up to its listed maturity date (also referred to as extension risk).

Additionally, the underlying collateral supporting non-Agency MBS may default on principal and interest payments. In certain cases, this could cause the income stream of the security to decline and result in loss of principal. Further, an insufficient level of credit support may result in a downgrade of a mortgage bond's credit rating and lead to a higher probability of principal loss and increased price volatility. Investments in subordinated MBS involve greater credit risk of default than the senior classes of the same issue. Default risk may be pronounced in cases where the MBS security is secured by, or evidencing an interest in, a relatively small or less diverse pool of underlying mortgage loans.

MBS are also sensitive to interest rate changes which can negatively impact the market value of the security. During times of heightened volatility, MBS can experience greater levels of illiquidity and larger price movements. Price volatility may also occur from other factors including, but not limited to, prepayments, future prepayment expectations, credit concerns, underlying collateral performance and technical changes in the market.

An investment in alternative investments can be highly illiquid, is speculative and not suitable for all investors. Investing in alternative investments is for experienced and sophisticated investors who are willing to bear the high economic risks associated with such an investment. Investors should carefully review and consider potential risks before investing. Certain of these risks may include:

- loss of all or a substantial portion of the investment due to leveraging, short-selling, or other speculative practices;

- lack of liquidity in that there may be no secondary market for the fund and none is expected to develop;
- volatility of returns;
- 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.

Individual funds will have specific risks related to their investment programs that will vary from fund to fund.

Asset allocation does not assure a profit or protect against a loss in declining financial markets.

Diversification does not guarantee a profit or protect against loss. Different asset classes present different risks.

The indexes 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.

International investing entails greater risk, as well as greater potential rewards compared to US investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economics.

Investing in smaller companies involves greater risks not associated with investing in more established companies, such as business risk, significant stock price fluctuations and illiquidity.

Factors affecting commodities generally, index components composed of futures contracts on nickel or copper, which are industrial metals, may be subject to a number of additional factors specific to industrial metals that might cause price volatility. These include changes in the level of industrial activity using industrial metals (including the availability of substitutes such as manmade or synthetic substitutes); disruptions in the supply chain, from mining to storage to smelting or refining; adjustments to inventory; variations in production costs, including storage, labor and energy costs; costs associated with regulatory compliance, including environmental regulations; and changes in industrial, government and consumer demand, both in individual consuming nations and internationally. Index components concentrated in futures contracts on agricultural products, including grains, may be subject to a number of additional factors specific to agricultural products that might cause price volatility. These include weather conditions, including floods, drought and freezing conditions; changes in government policies; planting decisions; and changes in demand for agricultural products, both with end users and as inputs into various industries.

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