Trump 2.0?

Trump trade of recent weeks looks set to continue

IN A NUTSHELL

- In the race for the White House, Donald Trump appears to be getting closer and closer to victory.
- A quick, orderly and probably quite decisive U.S. election should come as a relief for equity markets.
- For government bonds, the fear of a decline in fiscal discipline is likely to be particularly decisive.

Elections outcome – what we know so far

In the race for the White House, Donald Trump appears to have the advantage in securing the crucial 270 Electoral College votes. According to the Associated Press, he has already claimed victories in the swing states of Georgia and North Carolina. While votes are still being tallied in several key states, as of this writing, a decisive Trump victory seems the most likely outcome and might arrive sooner than many anticipated.

Already, Associated Press calls in key Senate races in Nebraska, Ohio and Texas mean Republicans will have a majority in the U.S. Senate, having also flipped West Virginia as expected. In contrast, control of the House of Representatives is uncertain, with some early indications that the Republicans could narrowly retain the majority. This is likely to come down to California, where the counting is traditionally very slow. It will also be crucial for investors in terms of what policies the next president will be able to pursue, particularly on fiscal issues.

Assuming control of Congress is divided, or with narrow Republican majorities, it is unlikely that the next president will be able to deliver all the plans outlined during the campaign. However, the looming expiration of the tax cuts passed in 2017 during Trump's first term is likely to focus minds on Capitol Hill. Members of both sides have strong electoral incentives to extend the cuts, at least in part. Given concerns about the longer-term U.S. debt outlook, such as split outcome favoring bipartisan compromises may come to be viewed rather favorable.

Market and policy implications

Market reactions to the likely election victory of Donald Trump are, for the time being, a continuation of the Trump trade we have seen in recent weeks. U.S. Treasury yields are rising sharply, especially in the longer maturities, as the trend towards higher inflation and, above all, looser fiscal discipline will be on the agenda in the weeks ahead. U.S. equity futures are reacting positively, while skepticism seems to prevail in Europe. The U.S. dollar seems to be strong and Bitcoin is also rising, but not nearly as much as one might have expected. Gold's reaction is as of now rather unspectacular.

Markets don't like nervousness. And with the race for the White House seemingly over after what looks like an orderly and decisive election, at least investors know a little more. However, certain issues remain uncertain, such as Trump's tariff plans and what will happen to corporate taxes, not least while results for the House are in balance. Another important factor remains the movement of Treasury yields, which at a certain level could well cause disruption on Wall Street.

Taking a step back, we would point out that the medium-term impact of the election may be less significant for equity markets than it feels today - in the immediate aftermath of the election. During the last Trump presidency, the S&P 500 generated a total return of 70%; since the start of the Biden presidency, markets are up a roughly similar figure – about 80%. Other factors working in the background appear to be more important drivers for equities than politics in isolation.

A Donald Trump administration will probably be a burden for the European economy and the German in particular. In view of the wars in Ukraine and the Middle East, the unpredictability of his policies would likely weigh on the sentiment among consumers and investors. The threat of punitive tariffs on European imports could also create uncertainty among companies. Even if the tariffs will not be fully implemented companies might postpone their investment decisions until they have clarity. With Trump, that could take a very long time. We therefore expect slightly slower growth in Europe.

Asset-class implications

Fixed Income & Currencies:

For U.S. Treasuries, the likely outcome of the election primarily means the prospect of further rising yields, especially for longer-dated bonds. Fears of an excessively loose fiscal policy and a slight upward trend in inflation are likely to play a key role. However, shorter-dated yields could also come under some pressure if the prospect of fewer rate cuts by the Federal Reserve is priced in. On the other hand, in case of a divided Congress it would limit Trump's options and could lead to a limited move in yields that does not lead to a sharp sell-off. Europe is also likely to see some volatility and higher core rates as the market could see higher deficits. Eurozone core government bond- curves likely to steepen (2yr-10yr) as tariffs could be seen as negative for growth and lead to more rate cuts than expected so far. The spread between 10yr US-Treasuries and 10yr German Bunds has already widened overnight, a complete decoupling from the US market at the long end of the curve is unlikely.

On the currency side, the U.S. dollar has been strong recently, but we do not think that is a "Trump trade". Rather it is due mainly to the better U.S. economic data and the sharp increase of U.S. bond yields. Now, we have three aspects to consider: 1) high fiscal spending: A higher fiscal deficit leads finally to higher bond yields and potentially also higher Fed rate which is clearly positive for the Dollar. 2) Federal Reserve (Fed) independence will be a big topic for the financial market, and we think the result would be higher inflation in the medium term. A strong Dollar could be the result. 3) New imposition of tariffs will change the equation in favor of the Dollar. The Dollar is expected to stay strong and in the short term could even gain some momentum.

Equities:

On Wall Street, the chances of a continuation of the Trump trade are good, even though we do not expect the momentum from before the election to be maintained. Investors now must decide whether they prioritize the fear of higher inflation and thus fewer interest rate cuts by the Fed or the expected more business-friendly policies of Donald Trump. A further reduction of corporate taxes could add 3-4% in earnings to the S&P500, but not before 2026. Companies with a high share of domestic, i.e. U.S. earnings, have most to gain. These are mostly found in the financial sector and small- and midcap market segment. While big tech stocks have a large share of non-U.S. income, and are therefore less benefitting from lower taxes, we would expect the Federal Trade Commission to become less concerned about the market power of the large technology platforms. U.S. energy stocks could see some benefits from a more pro-oil and gas attitude of the new government. On the other hand, renewables, might continue to struggle and underperform in expectation of a partial reversal of the Inflation Reduction Act and the related tax benefits allocated to windfarms and solar energy.

Ex-U.S. markets on the other hand will probably have a hard time to perform initially given the unpredictability of or the new president. Higher tariffs might be more used as a negotiating threat, to lift the local US-content in manufacturing from European and Asian car companies and semiconductor companies. However, we feel that most ex-US corporations have prepared for such an election outcome and will be able to handle 2.0. In the unlikely case that Trump would be able to strike a deal with Putin resulting in an armistice in the Ukraine, we would expect European stocks - excluding defense names - to rally. However, should a Trump-led U.S. decide to cut down on military aids to the Ukraine, this would further deteriorate geopolitical stability in Europe and international investors may continue to avoid European equities.

Looking to China, the event risk for new tariffs and/or sanctions under a Trump administration is likely to be high though, which might result in higher volatility of emerging markets stock markets. Countries like Mexico, which benefitted from near-shoring activities in recent years, will find their position weakened as well. Aside from that, we see a hard time for emerging markets to outperform as long as China is struggling with its real estate overcapacity and weak domestic consumption demand. However, investors are still expecting a massive fiscal stimulus in China, which in turn could affect sentiment in the other direction.

Glossary

Bitcoin is the first and largest crypto asset, enabling decentralized peer-to-peer transactions.

Capitol Hill in Washington, D.C. is the place where the U.S. Congress meets; it also colloquially used to refer to both chambers of Congress.

The Electoral College is the body which elects the President and the Vice President of the United States. It is composed of electors from each state equal to that state's representation in Congress.

Federal Reserve Bank is a regional bank of the Federal Reserve System, the central banking system of the United States. There are twelve in total.

A futures contract is a standardized, contractual agreement to trade a financial instrument or commodity at a pre-determined price in the future.

The United States House of Representatives is a legislative chamber consisting of 435 Representatives, as well as non-voting delegates from Washington, D.C. and U.S. territories. Representatives are elected for two-year terms and each state's representation is based on population as measured in the previous Census.

The S&P 500 is an index that includes 500 leading U.S. companies capturing approximately 80% coverage of available U.S. market capitalization.

Small cap firms generally have a market capitalization of less than $2 billion.

Treasuries are fixed-interest U.S. government debt securities with different maturities: Treasury bills (1 year maximum), Treasury notes (2 to 10 years), Treasury bonds (20 to 30 years) and Treasury Inflation Protected Securities (TIPS) (5, 10 and 30 years).

The United States Senate is a legislative chamber consisting of 100 Senators, with each state being represented by two Senators. Senators are elected for six year, overlapping terms in their respective state.

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