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FIRST ANALYSIS

News or events that may affect your investments **November 7, 2024**

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Caution for investors — Market reaction may shift

Key takeaways

- Some vote counting remains, but the elections have produced a president-elect and a Senate majority, both by Republicans, while the House races have not yet indicated a majority party.
- Financial market reactions since Election Day have been fast and sharp, largely recognizing the potential for tariffs, limits on immigration, deregulation, and corporate tax incentives.

What it may mean for investors

- Initial post-election market reactions have been picking and choosing which policy possibilities to respond to. Our experience is that such narrow reactions have not historically made for durable investment opportunities, and we favor pausing to look more closely at the likely main policy initiatives.

Congressional election results are still incomplete (as of 9 p.m. ET on November 6)

Presidential race: The Associated Press (AP) estimates that Donald Trump has won 295 electoral votes so far. Counting continues in the final two swing states, Arizona and Nevada, but the president-elect has a lead in both. If he adds the 17 electoral votes from those two states, he could finish the election with 309 electoral votes, the most since President Barack Obama's 2012 re-election victory.

U.S. Senate races: The AP also projected Republican seat pickups in West Virginia, Ohio, and Montana, giving the party a 52-seat majority, so far. Additional wins in Pennsylvania, Nevada, and Arizona remain possibilities and would give the Republicans a majority with as many as 55 seats. This is not enough of a majority to defeat an opposition filibuster, but the margin should allow the Senate Majority Leader to allow some dissent in the caucus, without blocking or endangering the legislative agenda.

U.S. House of Representatives races: Counting continues in House races. In this chamber, 218 seats are necessary for a majority, and the AP so far has projected 206 seats for Republicans and 191 for Democrats. At the end of the day on November 6, there were still 38 House seats left to be decided.

When the counting concludes, we expect to see a narrow margin for the Republicans, perhaps several seats, similar to their four-seat majority in 2022 – 2024. Such a small margin could allow dissenters to exercise leverage in blocking or detouring the House Speaker's initiatives.

Financial market response has been rapid and reactive

Ten-year U.S. Treasury yields were up substantially between November 5 and 6. The yield bottomed at 3.65% on September 16 and rose through October but jumped from 4.27% to 4.43% between November 5 and 6, marking its highest level since July 2 and the second-largest daily change in 2024. The day after the elections also saw the third-largest daily jump in inflation implied by a one-year inflation swap. The expectation for additional tariffs gained immediate traction as Trump won the election.

U.S. equity indexes and sectors rose (except for the S&P 500 Index Utilities sector) from November 5 to 6. Expectations for deregulation and potential corporate tax cuts are consistent with equity gains broadly. But tariff expectations also played a part. The Russell 2000 Index of U.S. small-cap stocks outperformed the S&P 500 Index on Wednesday by the largest margin since July 31, also consistent with a tariff regime that attempts to redirect spending toward smaller, domestic companies.

At the sector level, deregulation and expected oil production boosted sectors that typically track closely with economic improvement. Cyclical sectors, such as Industrials and Financials, outperformed sectors that have tended to be particularly sensitive to interest rates (defensive sectors, such as Real Estate, Utilities, Consumer Staples, and Health Care). And equities related to hydrocarbon energy outperformed those that produce green energy.

International currency and equity market performance diverged around the potential for U.S. tariffs.[1] In Asia, following the election, all the major national currencies depreciated against the U.S. dollar. The Japanese equity market is especially sensitive to its currency's depreciation, and on Wednesday, the Japanese Nikkei 225 Index outperformed every other Asian index. By contrast, Chinese equity markets declined, unsurprisingly, considering that China is the largest Asian exporter to the U.S. and likely a primary target of new tariffs.

A new Trump administration also complicates Beijing's effort to stimulate the struggling Chinese economy. If tariffs limit China's ability to export its way back to health, officials likely will need to drive more consumption and private enterprise, but that shift still appears more than Beijing is willing to consider. Considering China's large, heavily government-enterprise oriented equity market and its equally daunting economic growth obstacles, we maintain our unfavorable view of Emerging Market Equities.

Some fragmentation in U.S. foreign diplomacy seems consonant with new tariffs that break the global trade system into competing, regional trading arrangements, and that direction also was evident on the day after the U.S. elections. For example, the Turkish Borsa Istanbul 100 Index (consisting of the largest Turkish companies by market cap) rose by 3%, largely we believe on hopes that a President Trump will negotiate a truce that reduces or ends U.S. military support for Ukraine, and thereby eases pressure on neighboring Turkey. Western European governments may feel impelled to take up that supporting role, but stretching their budgets further is likely to add financial strain and limit equity market gains. Western European equities broadly fell on November 6 and underscores our neutral rating on Developed Market ex-U.S. Equities.

All these trends are consistent with a broader-based economic recovery in 2025, but the trends have sped up since Election Night. These knee-jerk responses to potential policy changes reinforced longer-term trends, but the staying power of the latest surge may be less than it seems at the moment. We favor pausing to look more closely at the likely main policy initiatives.

1. The logic of tariff impacts on currencies is that a tariff tries to redirect spending to domestic and away from international suppliers. As U.S. tariffs come into place, and U.S. buyers look for substitutes, demand for foreign currencies declines, and those currencies depreciate against the dollar.

Looking ahead: Policies to watch for

Near-term policies that would need Congressional help in 2025:

Taxes: The Tax Cuts and Jobs Act (TCJA) expires at year-end 2025. If the Republicans lead in the House, we look for them to move quickly to extend the TCJA in the first half of 2025, in order to lock in current tax cuts. We foresee no real chance of corporate tax rates going meaningfully higher now, which we view as a tailwind to earnings (roughly 4% to 6%, in our estimation).

Debt ceiling on January 1: The suspension of the debt ceiling expires on January 1, 2025, but, as in past episodes, the U.S. Treasury likely can continue to pay obligations until July or August depending upon how robust April 2025 tax receipts are (and we expect them to be robust). Again, if the House is under Republican leadership, the Speaker may open debt-ceiling discussions during lame duck session to minimize the interference with the new administration's agenda in 2025. However, if the narrow majority develops, as we expect, working through the debt ceiling debate could become even more challenging and begin to interfere with the Republicans' legislative agenda.

Healthcare: Drug price controls and cuts to Medicare Advantage are a lot less likely, in our opinion. It remains unclear whether the enhanced Affordable Care Act subsidies will be extended, and we expect that some modest Medicaid cuts will be discussed, but they are unlikely to pass. The latter would hurt hospitals if enacted.

Executive Orders:

Immigration: Look for Trump to act quickly and attempt to make a statement soon after inauguration on immigration by enacting an order to either close the border completely or significantly reduce illegal immigration. The Executive Branch has the tools and power to do this, and we expect it will be the new president's top priority after entering office.

Trade policy: This may be the most vexing element for many during this election. We think of tariffs in two prongs — China, and then everyone else. We expect President-elect Trump to move quickly on China, increasing the 2019 tariffs he imposed. It may be too early to tell exactly the size of the new tariffs, but we expect them to be painful for the Chinese economy. For everyone else, we anticipate a slower path of tariff increases, and for this group, the tariff proposals may be more transactional. In other words, the initial threat of tariffs could be the first bid in what is likely to be a negotiation with other countries over trade policies. This group is likely to focus on parts of Europe, Mexico, and Canada, including a 2026 rework of the U.S.-Mexico-Canada trade deal, this time likely under new leaders in Mexico and Canada. A very important point here is that the new administration likely will try to increase indirect channels of global confidence and capital expenditure as an offset to the direct impacts of any new tariffs.

Foreign Policy: Still a little unknown is how the president-elect will handle the conflicts in Ukraine and the Middle East, although we believe he will try for a negotiated settlement. We also believe he will look for a path to blunt China's global influence. We expect acceleration in repositioning supply chains out of China.

Regulation: We expect the new administration to repeal or lift some of the liquid natural gas (LNG) emissions rules, reduce regulation over financials, and make new appointments to key bodies like the Federal Trade Commission (FTC). We expect to see less appetite for breaking up large telecommunication companies, but more merger and acquisition activity.

Of course, we expect the new administration's agenda and the priorities to become clearer between now and January, but we see a strong potential for the latest trend accelerations to go too far, particularly because there may be competing or contradictory elements across some of these. In particular, tariffs are likely to be a high administration priority, but tariffs raise domestic prices, and inflation has been a main problem that the Trump team has promised to address.[2] If tariffs trigger new inflation, driving yields higher, then mortgage rates should follow higher, and corporate investment plans for plant and equipment should become more expensive. The overall impact on the equity market would have to be weighed against potential positives, such as deregulation and lower taxes.

Many proposals put forward during election campaigns often evolve differently, if at all, into eventual policy following elections. The complexity and timing make it challenging to predict in an exacting way. That said, there are definite policy priorities and trends that investors should be watching closely for portfolio impacts. We outlined some key ones in this report and will continue to provide timely guidance as the policy path evolves.

2. Katie Lobosco and Tami Luhby, "Here is what Trump is proposing for the economy," CNN, November 6, 2024.

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Japanese Nikkei 225 Index is comprised of 225 stocks selected from domestic common stocks in the Prime Market of the Tokyo Stock Exchange.

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Russell 3000® Index measures the performance of the 3,000 largest U.S. companies based on total market capitalization, which represents approximately 98% of the investable U.S. equity market.

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S&P 500 Utilities Index comprises those companies included in the S&P 500 that are classified as members of the GICS utilities sector.

An index is unmanaged and not available for direct investment.

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