OUTLOOK POST TRUMP VICTORY

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SUMMARY OF OUR VIEWS

MACROECONOMIC BACKGROUND

The extent of the victory by former President Trump was not expected but financial markets have been discounting a Trump victory since the end of September.

Some of the rise in US 10-year bond yields last month (from 3.79% to 4.28%) were a reflection of that trend. Trump's policies, including tariffs on imports and the likelihood of lax fiscal policy, are seen as potentially inflationary.

The dominant narrative in markets for most of this year has been the expectation of waning inflationary pressures that will allow central banks on both sides of the Atlantic to continue cutting interest rates, as each has begun to do. The Trump victory may call that into question.

We have already seen expectations for the extent of future rate cuts being pared back in both the US and UK, with the UK budget on October 30th limiting the Bank of England's ability to reduce rates as quickly or as much as previously anticipated.

The good news though is that, for now at least, there is not a change to the direction of travel for policy interest rates. The expected trough for the Fed Funds rate may have moved up to 3.75% from 3.25%, but that is still well below the current 5.0%.

The key for determining whether the market begins to doubt that rates can go materially lower will be whether expectations for inflation change significantly. Inflation breakevens and inflation swap rates have moved higher in recent weeks but are not yet at levels that would imply concern that central banks will be unable to continue to ease policy. Watching these inflation markets will be critical in the coming weeks.

The fact that the Republicans appear to have won both houses of Congress means that Trump has more freedom to act. That makes renewal of the 2017 tax cuts for individuals and small businesses more likely when the decision has to be made at the end of 2025.

It also implies that Trump will be able to make other changes. Winners from a Trump Presidency include big technology companies who no longer face the threat of greater regulation (e.g. on perceived dominant market positions in areas such as internet search).

Light touch regulation was a theme of the first Trump term and that will likely be a positive for investment banks. Expect to see more mergers and acquisitions in corporate USA. Trump is known to advocate energy self-sufficiency, so oil service companies should benefit from the likely increase in domestic drilling activity.

Conversely, markets have already been discounting that losers could include renewable energy providers and those companies still heavily reliant on China for parts/products e.g. apparel retailers.

Tariffs will be imposed on Chinese-made goods but the implications of that are more subtle than they may appear. Tariffs will also increase tension with Europe, Australia, Canada, Japan and South Korea. That may make the overall pressure on China from the international community less than it otherwise would have been. Trump's energy policies also leave China free to continue its efforts to dominate the electric vehicle sector.

In the end, if markets expect supportive monetary policy and light regulation, the backdrop for financial markets could remain constructive.

RATE CUTS EXPECTED IN THE US AND UK

The top chart shows current expectations for the US Federal Reserve policy rate over the next two and a half years and how those expectations have shifted since early October.

Market expectations for monetary policy do tend to be volatile and have been in recent months.

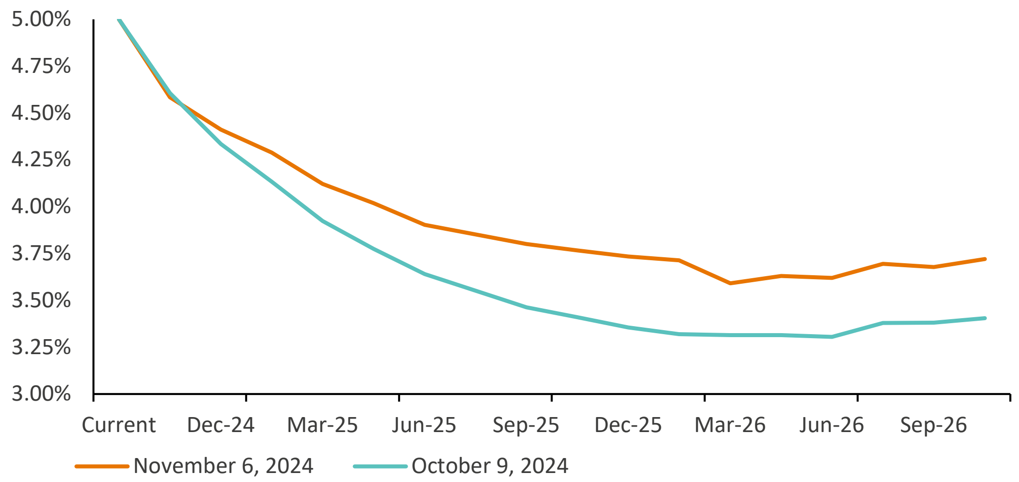
The market still expects the Fed to cut rates further in coming months but not by as much. There is a similar picture in the UK (bottom chart).

The US election has influenced the expectations for Fed policy as there is more concern about the likelihood of higher budget deficits given the apparent Republican sweep of all three branches of government. This makes the renewal of the tax cuts that expire at the end of 2025 more likely.

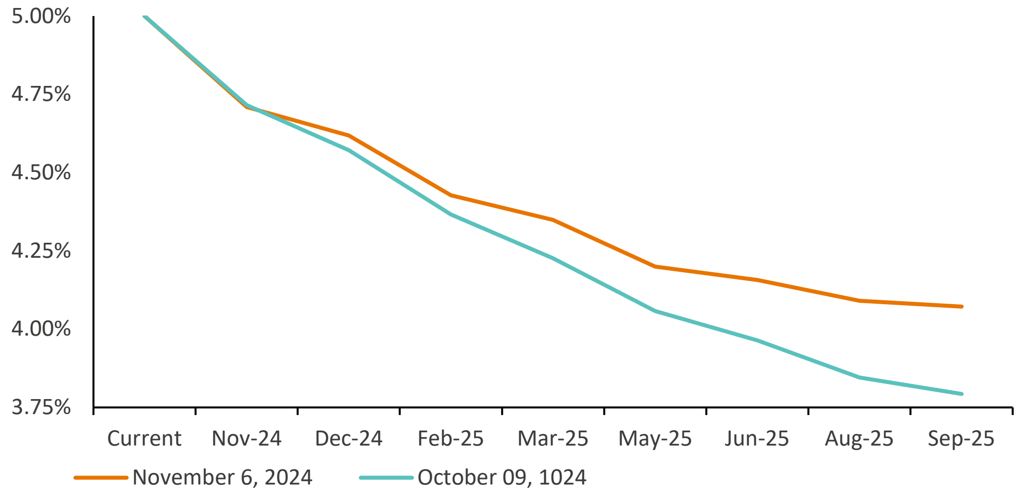
The possibility that the new Trump administration could be a risk to the dominant market narrative in recent months on inflation which until now the market has been confident would remain under control. That risk comes from a combination of loose fiscal policy and the imposition of potentially significant tariffs on a wide range of imports which, by definition, will raise prices.

Market expectations for inflation are likely to be the critical thing to watch in coming weeks and months. If they do move up materially that will have a detrimental impact on markets as it will imply that the benign picture of central banks easing monetary policy in coming months may need to be questioned. That could be bad for bonds and equities.

IMPLIED US FED FUNDS RATE %



IMPLIED UK BASE RATE %



Source: Bloomberg, Waverton. As at 06.11.24

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A TRUMP WIN HAD BEEN DISCOUNTED TO SOME EXTENT

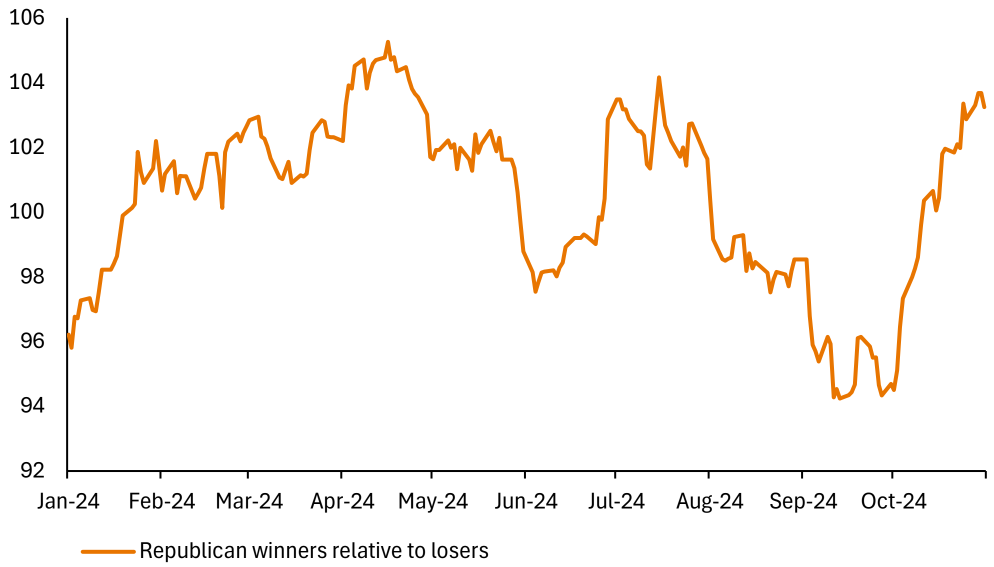
The market has to some extent discounted a Trump victory. Stocks that are deemed to be winners from a Republican victory outperformed those seen to be losers in the final month of the campaign. From the end of September to the end of October that was a clear theme in the equity market as the chart on the left shows. There was some profit taking in the final days of the campaign so we end the chart on October 31.

It was also notable that Bitcoin also performed well in the last weeks of the campaign which seems to bear some optical relationship to the probability of Trump winning in betting markets.

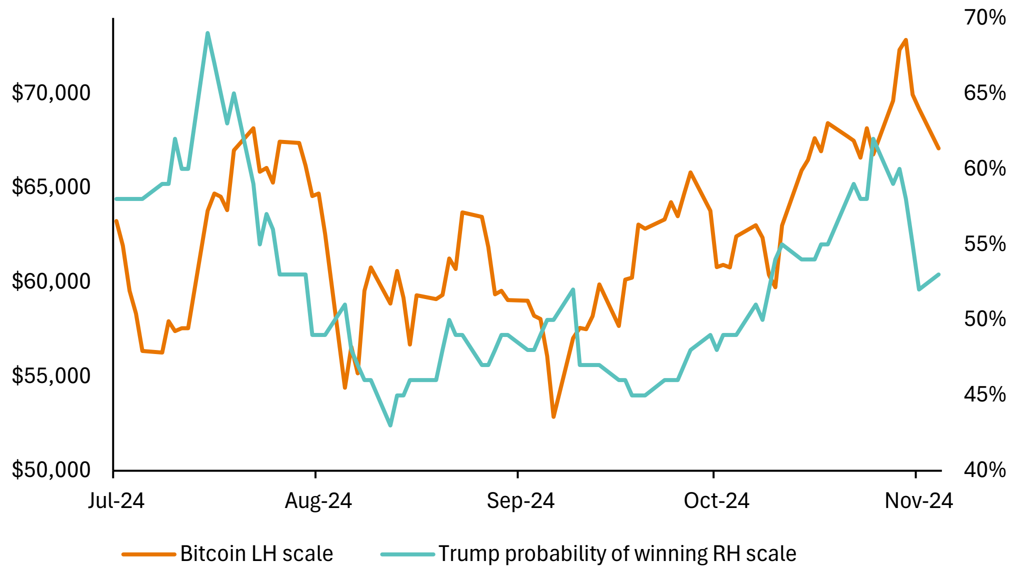
The chart on the right shows the price of Bitcoin in green and the probability of Trump winning on www.predictit.org, one such betting market.

Crypto is deemed to be a winner under Trump as he has made several positive comments about it including vowing to keep government holdings of crypto that has been acquired from seizing assets from financial criminals. He has also said he wants to create a crypto Presidential advisory council.

WINNERS FROM A REPUBLICAN WIN RELATIVE TO LOSERS



BITCOIN AND TRUMP PROBABILITY OF WINNING ELECTION



Source: Bloomberg, Goldman Sachs, PredictIt.org, Waverton. As at 04.11.24.

FISCAL POLICY WILL BE DOMINANT ISSUE IN 2025

This chart shows the US budget deficit as a % of US GDP. It is currently 6.3% of GDP. So far, the bond market has been relaxed about the likelihood of more supply of government bonds in the months and years ahead. But that could change in 2025 for two reasons.

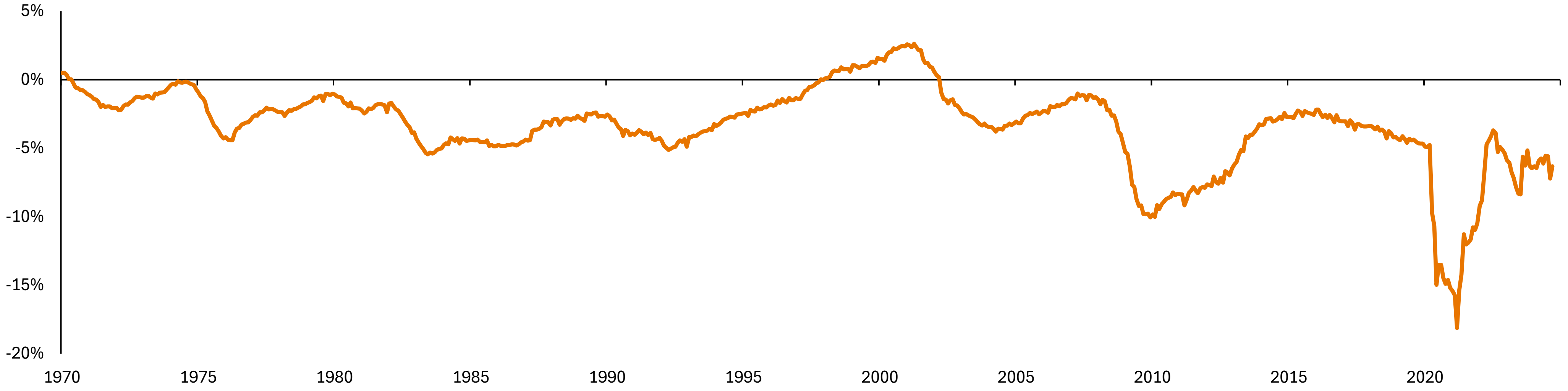
Firstly, the Federal government debt limit will be reinstated on 2 January 2025 at the level that includes all borrowing since the June 2023 suspension of the debt limit by Congress. So, it is a legal requirement that at some point next year Congress will have to raise the debt limit to permit more borrowing. The US Treasury can rely on its cash holdings for a little while before the limit needs to be raised but it is likely that the new Congress will have to deal with this issue in the first weeks of 2025. If no one party controls both houses of Congress and the Presidency that could be a challenge.

Secondly, the 2017 tax cuts for individuals and small businesses roll off at the end of 2025. If new legislation is not passed to renew them, then taxes will rise by over $4 trillion.

A Trump administration with Republicans in control of both houses will definitely renew them. It could be a battle to do so if that is not the situation.

Renewed tax cuts would be a positive for demand in the economy in the short term but will boost the deficit further in the medium term. Could the bond vigilantes come out of hibernation at that point?

US BUDGET DEFICIT AS % OF GDP 1970 - CURRENT



Source: Bloomberg, Waverton. As at 30.09.24

GOVERNMENT BONDS REMAIN INTERESTING AT THESE LEVELS

The top chart shows how the yield on 10-year gilts and 10-year US Treasuries has evolved over the last two years. Bond yields have risen since the Fed cut rates in mid-September, aided by some stronger than expected economic data.

There has also been some discounting of a Trump victory going on, as there has been in the equity market. A Trump victory is deemed potentially a risk to the benign inflationary picture that has been the dominant market narrative in recent months.

The bottom chart shows those same yields after deducting the current 10-year inflation swap rate in each market. The swap rate is one indication of market expectations for inflation over the life of the bond.

Inflation swaps are priced on RPI in the UK so we have deducted 1.2% from the swap rate to get an implied indication of expectations of CPI inflation (1.2% is about the long-term “wedge” between RPI and CPI inflation).

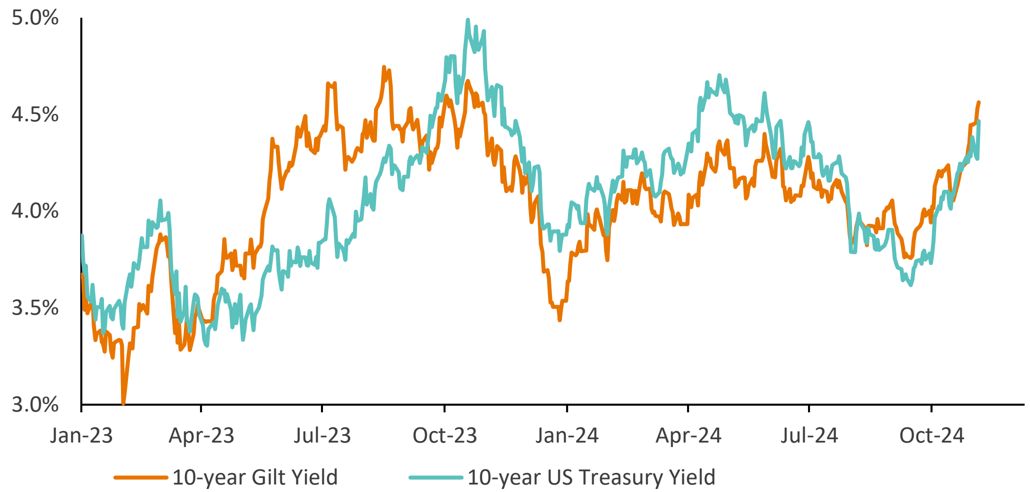
As the chart shows, both markets continue to offer, on this measure, a positive real yield, and a higher yield that we have seen since late 2023.

The inflation linked bond market is saying something similar in the US where the Treasury Inflation Protected Securities (TIPS) market is giving a positive real yield. The January 2034 TIPS yields 2.06%.

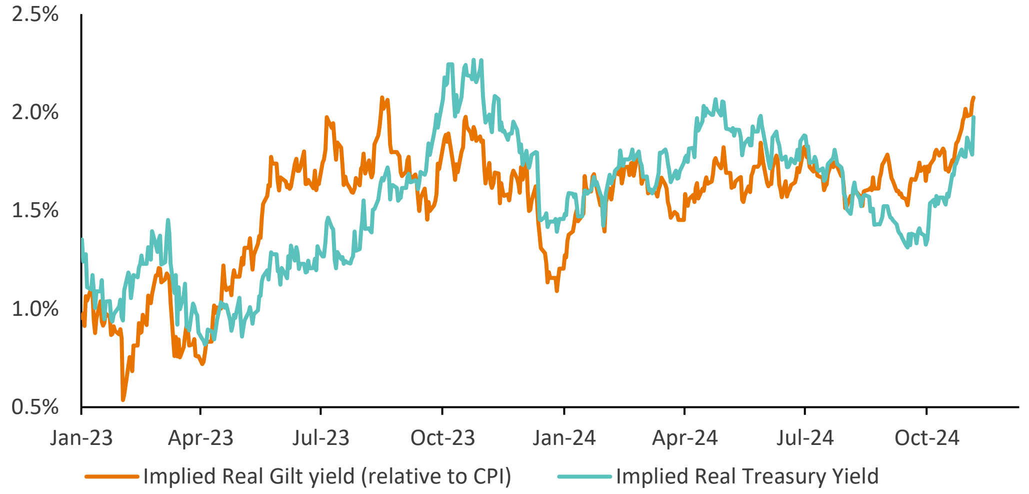
The UK linker market is optically less attractive (the March 2034 linker yields 0.94%) but as this is based on RPI, the total return (thanks to RPI being higher than CPI) is similar between UK and US linker markets.

We still think there is value in government bonds given the positive real yields on offer.

US AND UK10-YEAR BOND YIELDS (%)



US AND UK IMPLIED REAL 10-YEAR BOND YIELDS (%)



Source: Bloomberg, Waverton. As at 06.11.24

2024 EARNINGS GROWTH ESTIMATE +9% GLOBALLY AND 9% FOR THE US

The consensus for the Global Index is for Earnings Per Share (EPS) to rise 9% in 2024. For the US the expectation is also for an 9% increase. For 2025 the consensus numbers remain very robust at +13% and +15% respectively.

Both 2024 forecasts have been stable in recent months. The numbers are down a bit over the last month but some of that will be to do with the dollar being firmer in the last month (these numbers are shown from the perspective of a dollar based investor).

It remains the case that there are valuation excesses in some of the leading companies in the US but valuations in the rest of the US market, and in the rest of the world, are not stretched.

EARNINGS PER SHARE CALENDAR YEAR GROWTH RATE

			GROWTH RATE		
REGION	PE NTM	RELATIVE	2024	2025	2026
World	17.8		+8.5%	+12.6%	+11.7%
US	21.6	122%	+9.4%	+14.9%	+13.1%
Europe ex UK	13.9	78%	+1.8%	+9.1%	+10.7%
UK	11.4	64%	+2.7%	+6.5%	+9.5%
Japan	14.3	81%	+10.3%	+8.2%	+9.3%
Asia Pac ex Japan	12.9	73%	+24.9%	+13.3%	+12.3%
Latin America	8.7	49%	(16.6%)	+16.2%	+8.6%
Emerging markets	12.7	71%	(0.7%)	+8.9%	+10.7%
World ex USA	13.3	75%	+7.3%	+10.1%	+10.5%

Source: MSCI, FactSet, Waverton. Data as at 01.11.24

US PROFITS AS % OF GDP REMAIN RESILIENT

This chart shows pre-tax profits of corporate America relative to GDP through Q2 2024, the most recent data available. This profit series shows aggregate profits across the whole economy and shows them in US dollars, not as earnings per share.

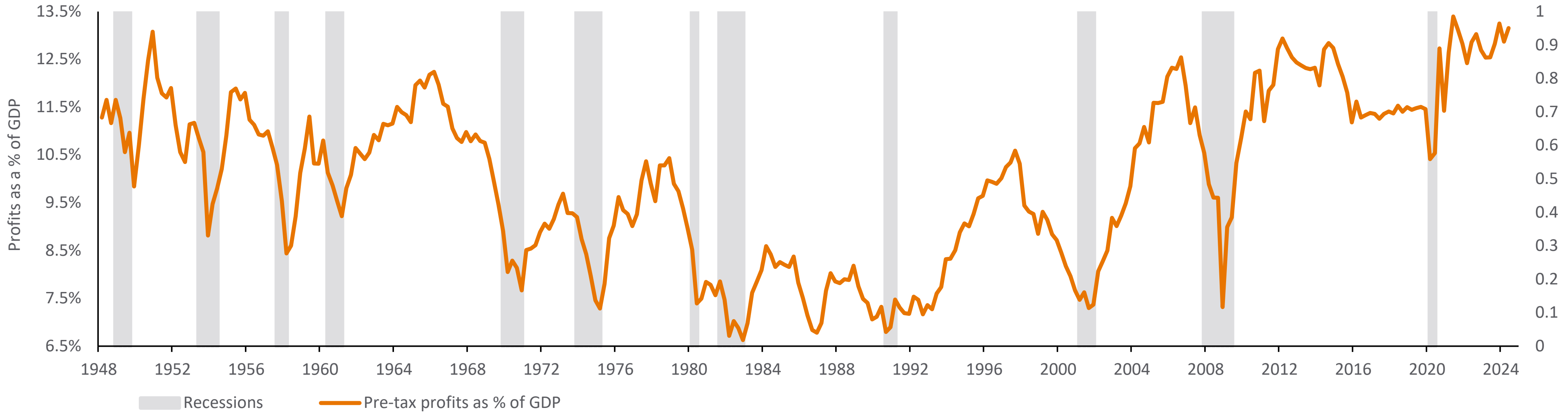
Consequently, this series is not susceptible to financial engineering via such things as share buybacks to boost earnings per share. It is a proxy for profit margins. In every recession except 1982, profits were falling as a % of GDP before it.

But on this measure profits have been resilient in recent quarters. Profits are below the cyclical peak as % of GDP which was 13.4% in Q2 2021.

The profit data has just been given a boost by the annual update of the National Income Accounts. Profits were increased by $550bn combined in the last three years which equates to an average of over 5% per annum.

The effect of this is to eliminate the drop in profits as a percentage of GDP in 2023 that had added to the indicators suggesting an economic slowdown was likely. Now, this is another indicator suggesting a recession in the near term is unlikely, and indeed confirms that the health of the corporate sector is genuinely robust.

US PROFIT CYCLES AND RECESSIONS (%)



Source: MSCI, FactSet, Waverton. As at 30.06.24

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