Election 2024: Mandate For Change

The Republicans' long predicted red wave finally happened. A vast majority of counties – and most voter demographics – moved to the right, becoming more red. The result was a landslide electoral college victory for Donald Trump, who will become the 47th president of the United States. Republicans will control the Senate with 54 members. Republicans will narrowly control the House as well. Put it all together, and this election was a clear mandate for the returning president.

The election results suggest a powerful desire for change among voters across various demographics. Many Americans have expressed dissatisfaction with the current state of the economy, with 70% of those polled indicating that the economy is not working for them. The Trump campaign's promises of tax cuts and economic reforms appear to have resonated with a sizable portion of the electorate. The stock market has shown positive movement since the election results were finalized, which may indicate investor optimism about the potential economic impact of the new administration's policies.

Based on the election outcome and campaign promises, several potential policy directions may be pursued by the incoming administration. These could include extending and potentially expanding previous tax cuts, strengthening border security while reforming legal immigration processes, reducing government regulations across various sectors, expanding domestic energy production, and efforts to reduce federal spending and balance the budget.

As Strategas Research Partners' Dan Clifton noted, the U.S. Presidential election was not close. Trump is the first candidate since Grover Cleveland to win the Presidency two times in non-consecutive terms. With a Republican Senate, Trump has greater flexibility to get his Cabinet appointments through. A Republican House and Senate can allow for budget reconciliation on the Trump tax cut extension. So, investors have more certainty than pre-election.

This year's American election took place amid good economic conditions. Growth has been robust, unemployment is low, inflation and interest rates have fallen, wages are rising, and equity markets have been strong. Those elements would tend to favor the incumbent party, but this was not the case. That is not to say that economic issues didn't have an essential influence on voters—they did. However, people's personal view of their condition has not aligned with macro data. The rate of inflation has improved, but the level of prices still feels too high, and average wages have not risen in line with the overall price level.

Policy Implications

Higher immigration offered many voters reasons to worry rather than hope. The flood of border crossings during the past two years has alleviated some labor shortages. Still, the influx has also increased demand for goods and services. After all, workers and families need food, clothing, and shelter, and any increase in marginal demand without an offsetting increase in supply can keep prices higher than average. Shelter prices, in particular, have remained stubbornly high.

The Republican sweep will give Trump a broad mandate. All presidents have used executive orders (EOs) to direct the bureaucracy, and we expect this to be no different. Many of the top items in the Republican platform can be implemented through EOs:

- Trade: Tariffs were the signature policy of the first Trump term, and they are still in force. They were passed through EOs under existing laws related to national security (metals) and to combat unfair trade practices (China). Most proposed tariffs could be advanced under these or other existing trade policies, often with an interval of months for warning and review. An across the-board tariff on all imports may not be legal, but the mere threat could compel new trade negotiations.
- Federal land use: When asked about inflation, Trump pledged to make more federal land available for oil extraction. Asked about the short housing supply, Trump promised to open federal land to development. Whatever the effect of these policies, restrictions on federal land use are set to ease.

Other vital items will require cooperation from Congress. Before getting to big policy questions, some tactical matters need attention. The government currently runs under a spending mandate that ends on December 20; the current legislature will likely extend authorization into January, but something more durable will be needed after that. Also, it's crucial to have a plan in place as the debt ceiling returns to force at the start of 2025 and must be raised sometime in the new year. These are not just routine matters but critical issues that will shape the future of the U.S. economy. ("Reflections On The 2024 Election - Northern Trust")

The Tax Cut and Jobs Act's income provisions expire at the end of next year. Trump favors making these provisions permanent and has expressed interest in lowering corporate tax rates. The Constitution vests Congress with the power of the purse, and these fiscal measures will require legislation. But even under unified Republican control, the party's more principled fiscal conservatives may balk at unfunded tax cuts and unchecked debt issuance. Further, any fiscal changes must be enacted through a reconciliation procedure, which carries some boundaries. ("Reflections On The 2024 Election - Northern Trust")

Trump's policies are likely to boost growth. Lower taxes and lighter regulation boosted the economy in Trump's first term and expanded defense spending will also be accretive. However, the boost may not be permanent. ("Reflections On The 2024 Election - Northern Trust")

The Trump agenda may carry inflationary risks, mainly depending on how tariffs are implemented. Tariffs are taxes on imports the importer pays to the U.S. government, which Donald Trump and Robert Lighthizer, U.S. trade representative in the first term and likely for the 2nd term, alternatively view as a tool to force trading partners to enter fair trade agreements. Higher tariffs can be a cost that will cut into margins or be passed along to final prices. (See Appendix for detail on Lighthizer's trade proposals).

Potential Policy Directions

Based on the election results and campaign promises, some potential policy changes may include:

1. **Tax Reform**: Extending previous tax cuts and potentially introducing new ones.
2. **Immigration**: Strengthening border security while also reforming legal immigration processes.
3. **Deregulation**: Reducing government regulations across various sectors.
4. **Energy Policy**: Expanding domestic energy production.
5. **Government Spending**: Efforts to reduce federal spending and balance the budget.
6. **Education**: Reevaluating federal involvement in primary education and student loan policies.

Economic Outlook

The stock market has shown positive movement since the election results were finalized, which may indicate investor optimism about the potential economic impact of the new administration's policies.

Challenges Ahead

Implementing significant policy changes will face challenges:

- Potential resistance from opposition party members.
- The need to balance diverse voter interests.
- Addressing long-term economic and social issues.

As the new administration takes office, it will be important to monitor how these potential policy changes are implemented and their effects on the economy and daily life of Americans.

The Economy and Markets

The recent election has not significantly altered the near-term expectations for the American economy, as the soft-landing scenario continues to take shape. The economic outlook is still favorable, underpinned by stable labor markets and ongoing disinflation. These factors are paving the way for continued interest rate cuts by the Federal Reserve. The U.S. economy has shown resilience, with GDP growth outpacing many other developed nations and unemployment remaining low. While inflation has been trending downward, reaching its lowest point since early 2021, consumers are still grappling with higher prices than pre-inflationary levels.

The Fed is expected to keep its course of gradual rate reductions, with the next cut anticipated in December or January, and perhaps every other meeting in 2025. This approach aims to support economic growth while ensuring inflation continues toward the 2% target. Despite potential policy shifts under the new administration, particularly in areas such as trade and immigration, the immediate economic landscape appears poised for continued stability and growth. However, the long-term implications of these policies will require careful monitoring in the months ahead. ("Reflections On The 2024 Election - Northern Trust")

How Policy May Influence Equities and the Economy

With a Republican House majority, the initial impacts will likely be directionally consistent with 2016, albeit to a lesser degree, given today's more mature economic backdrop and lofty embedded expectations. Trump's pro-business approach could once again rekindle animal spirits and buoy capital spending, M&A, and other forms of investment. For example, the National Federation of Independent Business Small Business Optimism Index jumped by 11.7 points during the fourth quarter of 2016, the most significant 3-month bounce since 1980. The outlook for corporate profits appears healthy with a more favorable corporate and individual tax regime and a lighter regulatory touch. ("AOR Update: Election implications for US equities - Franklin Templeton") These catalysts helped power equities higher both ahead of the election as the chances of a GOP sweep increased, as well as on November 6.

Not all of Trump's agenda is market-friendly, however. Potential headwinds exist, notably from the prospect of increased tariffs, reduced immigration, and the potential for higher long-term interest rates. The 10-year U.S. Treasury rose 16 basis points on the first trading day post-election, continuing a bond selloff that has seen yields rise more than 80 bps since mid-September. The previously mentioned tailwinds have been viewed as outweighing the potential headwinds from an economic and corporate profits perspective. ("AOR Update: Election implications for US equities") Still, the specific policy details will influence earnings and economic growth trajectory the most.

Which policies get advanced, the order in which they do, and the degree to which they are implemented will all be essential for equity investors' decision-making. For the overall market, the degree to which more robust corporate profits can offset the risk to valuations from higher long-term interest rates will be crucial. Within the market, however, the leadership rotation that began in early July is likely to continue in the coming months. Stocks' first response supports this notion, with further gains for many recent leaders supporting dynamics such as value over growth, small cap over large, the equal weight S&P 500 over the cap-weighted version, and cyclicals over defensives. ("AOR Update: Election implications for US equities")

Over the longer term, the economy tends to trump politics (pun intended) about what drives equity returns. The Federal Reserve's recent steps to normalize short-term interest rates have helped bolster the chances of a soft landing. Pronounced rate cuts typically come as the economy decelerates, but that is not the case today, with third-quarter GDP coming in at 2.8%, in line with the average over the prior three years.

Fed Policy

Fed Chair Powell is unlikely, in our opinion, to still be as chair when his term expires in May 2026 – so we will keep that on our longer-term radar. Bottom line: we expect any "growth air pocket" (e.g., weak U.S. nonfarm payrolls in Oct) to be short lived. We continue to watch for sectors that have already been weak for two years (housing, manufacturing) to turn around. In the meantime, the U.S. consumer has remained a workhorse for growth, with spending from upper-income cohorts robust. As we have noted previously, viewing the current U.S. episode as more of a mid-cycle adjustment, vs a recession, should yield better results. U.S. initial jobless claims remained low at 221,000 last week, so the hope for a soft landing remains intact as we head toward 2025. A question remains how low is the fed funds rate going to go (where is the neutral policy rate?). We believe a ~1% real (inflation-adjusted) policy rate should still be a good longer-term target. There are reasons inflation could be higher, given upcoming policy choices – so monetary policy may take a more cautious approach. A nominal number for fed funds in the 3.5-3.75% range could then be in the neighborhood of neutral. We now expect policy rates to be there by the end of 2025.

BASE CASE EXPECTATIONS

Sticking the Landing	Central Bank Transitions
Global growth will move below trend but remain positive, supported by ongoing U.S. economic strength and labor market/consumer resilience. Inflation will remain above target but continue to proceed toward 2%.	Major central banks have started to cut policy rates and we expect this to continue as the year progresses. Economic growth may afford policymakers more time to confirm that inflation progress is sustainable.

RISK CASE SCENARIOS

Stubborn Inflation	Lagged Impacts
Inflation does not move lower due to economic resurgence, tight labor markets, U.S. election-induced pressures related to tariff or immigration policies, and/or disruptions from conflict in the Middle East.	A soft landing is taken off the table as easing economic growth evolves into a traditional demand-led recession. In this scenario, a shallow recession is more likely than a deep contraction.

Attribution and Sourcing

Why now could be the time to transition from cash to bonds, https://privatebank.jpmorgan.com/nam/en/insights/markets-and-investing/ideas-and-insights/why-there-is-still-time-to-move-from-cash-into-bonds.

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Mandate For Change, https://www.ftportfolios.com/Commentary/EconomicResearch/2024/11/11/mandate-for-change.

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Appendix

Summary of Lighthizer's U.S. Trade Proposals

1) China: Decouple strategically across high tech and strategic sectors, e.g., chips, AI, robotics, advanced materials; through tariffs on Chinese imports and imports from allies containing Chinese components or software. Lower range of high tech (e.g., laptops) should be heavily tariffed to bring manufacturing back to the US or allies. Maintain "biggest and best" military to challenge Chinese aggression, and counter China diplomatically.
2) Allies: Negotiate for "fair and balanced trade," establish rules on E-Commerce and product standards, limit market distorting practices. Enforce anti-dumping laws and be prepared to take unilateral action under Section 301 since WTO talks take time.
3) Change US import laws, e.g., minimum standards in labor, environment, safety, and health. Add duties to import prices that offset the exporter's advantage (e.g., carbon border adjustable fee on imports).
4) Subsidize crucial industries (e.g., chips, AI, robotics, advanced materials; not across all US industries).
5) Balance the current account (trade), e.g., show proof of equal value upon importing a product into the US, use adjustable fees on foreign investment funds coming into the US, gradually raise tariffs on all imports until balance is achieved.
6) Plaza Accord cited as precedent for cooperation among US allies to balance the US current account. Source: No trade is free, Chapter 18: A Prescription for the Future (Lighthizer, 2023).

Summary of Stock Sector Implications of Expected Policy Changes.

Energy Sector
- Headwinds: Aggressive tariffs on China and others could impede global trade, reducing demand for oil and natural gas exports.
- Tailwinds: Legislation and/or tariffs encouraging the development of domestic energy sources (oil/natural gas/coal).

Financial Sector
- Headwinds: Unlikely to roll back regulations for regional banks.
- Tailwinds: Favorable regulatory environment for large banks.

Materials Sector
- Headwinds: None specified.
- Tailwinds: Favorable regulatory environment encouraging domestic production of critical minerals.

Industrials Sector
- Headwinds: Higher tariffs pressuring input costs; potential Chinese retaliation; changes to Inflation Reduction Act creating uncertainty and delaying investment; potential changes to emission rules creating uncertainty in power and auto sectors; restrictive immigration policies increasing wage inflation in construction and agriculture markets.
- Tailwinds: Likely increased activity in domestic oil/gas and liquified natural gas; likely increased foreign defense spending.

Consumer Discretionary Sector

- Headwinds: Increased tariffs or deterioration in trade relations between the U.S. and China.
- Tailwinds: Tax cuts to spur increased domestic consumer spending.

Healthcare Sector

- Headwinds: Lower drug prices; reduced funding for Medicaid and public health exchanges.
- Tailwinds: Improved funding for Medicare.

Communication Services/Information Technology Sector

- Headwinds: Restrictive trade policy and ongoing tensions in Taiwan Strait.
- Tailwinds: Favorable regulatory environment around media ownership.

Consumer Staples Sector

- Headwinds: Restrictive immigration policies increasing cost of labor; legislation increasing minimum wage.
- Tailwinds: None specified.

This information is sourced from Northern Trust Asset Management and reflects the informed views of their Capital Structure Team, which comprises sector-focused analysts.

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This information reflects insights derived from Northern Trust, Goldman Sachs and Strategas research.