2024 Election Outcome

After another historic campaign season and election, the American people have handed Republicans a decisive victory. Trump carried both the electoral and popular vote (by more than 4 million votes), won all seven swing states, and made huge inroads with key demographics; particularly Hispanic, Gen Z/Millennial, and blue-collar voters.

Though 16 races in the House of Representatives have yet to be called, the GOP will almost certainly retain a slim majority in the lower House. In the Senate, Republicans will have a 53-seat majority. President Trump has been given a decisive mandate to return to the Oval Office with an agenda comprised of significant changes to tax, regulatory, foreign, and trade policy. Republican control of Congress will no doubt make it easier to enact those policies, though it is important to remember that the filibuster continues to give Senate Democrats the ability to retain some influence on policy.

Below we provide a list of the key initiatives that have been set forth by the Trump campaign. <u>We would emphasize that, though Trump has expressed enthusiasm for following through on all of his proposals, we are not entirely convinced that he will do so, or that Congress will embrace the entirety of his agenda</u>. There is also the possibility that many of Trump's policy proposals are simply bargaining chips with which to strengthen his negotiating position (both across the aisle and overseas).

- **Corporate Taxes:** lower the tax rate from 21% to 15% for companies that produce in the US, restore 100% bonus depreciation, R&D expensing, and EBITDA-based interest limitation

- **Personal Income Taxes:** make the TJCA top marginal tax rate of 37% permanent, make estate tax exemption of $13.6 million permanent, restore full deduction for SALT (State and Local Taxes), exclude overtime wages, tips, and social security income from income taxes

- **Tariffs:** a 20% baseline tariff on all imports (less likely) plus a 60% tariff on Chinese imports (more likely). As was the case during his first administration, Trump will be able to impose tariffs without Congressional approval for categories related to national security, though for how long and how widely he could impose tariffs without Congress remains up for debate

The Thinking Man's Approach

November 2024 | Series #106
Rene Negron | *Senior Analyst*

- Republicans achieved a decisive victory and a clear mandate, with likely control of both Houses of Congress, though GOP majority in the Senate will fall short of the 60-vote threshold for breaking the filibuster
- Significant uncertainty around details and implementation of policy remain, but overall administration is likely to provide a pro-growth, pro-business environment with lower taxes and less regulations; specific sector views are warranted
- Additional uncertainties remain around the fiscal outlook given extension of the TJCA and the ultimate effect of tariffs
- Under any policy outlook, a reflationary environment is most likely, with above trend economic growth and above trend inflation
- Episodes of bond vigilantism should be relatively short-lived given readiness to deploy Fed balance sheet
- Foreign policy outlook is both an opportunity and a threat

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- **Other:** additional spending to strengthen and modernize the military, securing the border and instituting a largescale deportation program for illegal immigrants, expand licensing and permitting for domestic fossil fuel production, eliminate the green energy subsidies in the Inflation Reduction Act, and loosen capital standards on banks as part of the Basel III Endgame implementation

Trumps Proposals are Still Proposals

The Committee for a Responsible Federal Budget estimates that Trump's policies will add $7.5 trillion to the fiscal deficit over the course of 2026 to 2035. These estimates, however, have a wide spread of possible outcomes due to the uncertainty around:

1. The fiscal impact of supply-side measures on tax revenues, i.e. increasing tax revenues by stimulating domestic economic growth via lower taxes

2. The fiscal and economic impact of tariffs, i.e. how much would be absorbed by corporate margins vs. passed on in the form of higher consumer prices, and what effect would retaliatory tariffs have on domestic prices

As of now, we agree with the consensus view that Trump's policies will be positive for economic growth, corporate earnings, and consumer health, but potentially negative for the longer-term goal of getting inflation back down to the Fed's 2% target. On one hand we have policies that are disinflationary, like stimulating domestic oil production and fueling technological innovation; and on the other hand, we have policies that are reflationary (if also good for growth) like tariffs, tax cuts, immigration reform, and looser bank capital standards. We tend to believe the latter will dominate, but again, implementation at this point, remains highly uncertain.

We would also not be surprised to see a return of the "bond vigilantes" depending on how much the fiscal situation deteriorates. As we have commented in the past, we expect these episodes to be relatively short-lived given the Federal Reserve's willingness to operate as a lender of last resort. As we noted in our prior Thinking Man, in as much as the United States remains the global capital of technological innovation, driving demand for US products, services, and financial assets, then we do not believe that the continued moderate expansion of the money supply is particularly problematic. This is due to the simple fact that in a world of indebted countries all operating on fiat currencies, relative economic contribution is all that really matters. We would, however, be concerned if Trump were to pursue policies that would threaten the at least "nominal" independence of the Federal Reserve. Ultimately, we maintain confidence in the system of institutional checks & balances / separation of powers which protect against extreme policymaking.

With respect to foreign policy, we believe that Trump's identity as somewhat of a maverick represents both an opportunity, as well as a threat. We are hopeful that the deal making philosophy on which Trump has operated for most of his life can bring peaceful ends to the wars in Ukraine and the Middle East. We are wary however of the possibility that today's conflicts could be replaced for broader conflicts with China, in the event of a broad-based trade war and all-out decoupling. Again, we will have to take a wait and see approach, but we are very sensitive to the fact that the global AI revolution is currently highly dependent on semiconductors fabrication in Taiwan. We continue to see near-term escalation of China / Taiwan relations as being an outside risk, but nonetheless a crucial piece in China's response to US hostility.

Conclusion

Though the broader policy outlook remains uncertain, we feel confident that lower taxes and lighter regulations will lead to a friendlier, pro-growth environment. The combination of supply-side economics from the likes of Arthur Laffer and Larry Kudlow, with more interventionist/ populist perspectives from the likes of Robert Lighthizer and Scott Bessent represents both opportunities and risks. As more nominations and policymaking agendas are released, we would expect to see heightened short-term market volatility, particularly given the speed and magnitude of the post-election rally.

Below we include potential sector impacts from Trump's policies:

- **Big Banks:** Trump a positive given that he would likely scale-back the proposed bank capital requirement increases that were scheduled to take effect in 2025
- **Energy:** Trump would benefit oil & gas companies by eliminating emissions curbs and increasing licenses/permits for exports; though more production could in theory lead to lower oil prices.
- **Health Care:** Trump likely a negative for insurers/hospitals as Obamacare subsidies would expire, but likely positive for big pharma given less pressure to negotiate prices with Medicare
- **EV:** Trump likely a negative for electric vehicles if EV tax credits are repealed (unclear if this would happen though given relationship with Musk)
- **Retail/Consumer Discretionary:** Trump tariffs likely a negative given that 97% of footwear & apparel and 90% of consumer electronics sold in the US are imported (primarily from China)

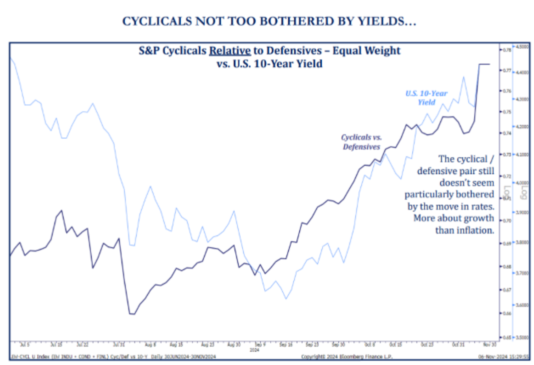
Lastly, we reiterate our favored asset classes for the reflationary environment of the next couple of years which we shared in our previous Thinking Man:

<u>Fixed Income:</u>

- Low duration investment grade (IG) over high yield (HY) corporate bonds
- Subordinated bonds from IG issuers, i.e. junior secured bonds and perpetual preferreds

<u>Equities:</u>

- Maintain focus on quality, i.e. profitability, cash flow, and competitive moats
- Cyclical sectors that trade at reasonable multiples: aerospace & defense, industrial services & equipment, oil & gas, basic materials, data infrastructure enablers, underweight in retail
- Overall focus on profitability and return of capital to shareholders (i.e. buybacks and dividends)



Source: Strategas

> *"Anybody who tells me what they think the world's going to look like two years from now, I'll bet all my money that they're wrong. The future is just too damn indeterminate to hang your hat on."*
> **Howard Marks, Oaktree Capital Management**

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