Financial markets gear up for the US elections

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Key Takeaways

- The outcome of the Senate and the House of Representatives will be just as important for the US economic outlook.
- In the years characterised by positive EPS growth, we observed a higher probability of positive returns for equity markets independent of the political party in power.
- Gold, quality stocks and cryptocurrencies offer an opportunity if the post-election scenario defaults to gridlock.

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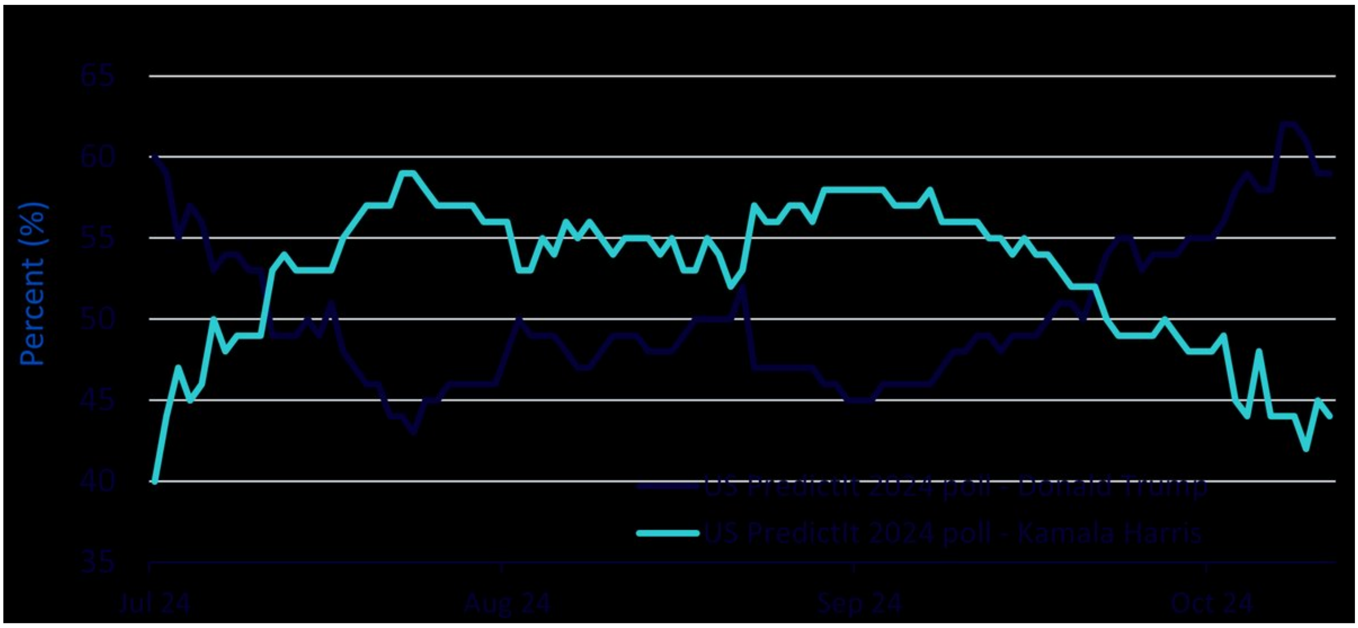
We are at a moment of peak uncertainty as we head into the final week of the US elections. It is a race that Trump is favoured to win, but it is almost a coin toss. The PredictIt betting market has Republicans ahead of the Democrats with a 59% probability of a Trump victory compared to 44% for Kamala Harris.

Don't forget that a US president needs both houses of Congress on their side to exercise real power. The outcome of the Senate and the House of Representatives will be just as important for the US economic outlook. Currently, a clean sweep for either of the two parties seems unlikely, more so for the Democrats than for the Republicans.

Figure 1: Probability of winning the presidency, implied by betting markets



Source: PredictIt, WisdomTree as of 29 October 2024

The US election has the potential to significantly impact risk assets globally. Donald Trump's policies vastly differ from Kamala Harris', which could have significant implications for the global economy.

Key Trump policy differences versus Harris

Taxation: Trump would seek to extend the tax cuts from his 2017 Tax Cuts and Jobs Act (TCJA) beyond their scheduled expiry at the end of 20251. The Democrats would probably insist on changing some details but largely agree with the request. However, under a split Congress, Trump would not be able to cut taxes further. In the case of a Republican sweep, Trump has proposed to cut the corporate tax rate from 21% to 15% and eliminate taxes on social security benefits1. Harris would extend the expiring 2017 tax cuts for those earning under $400,000, provide bigger tax credits for caring, raise the corporate tax rate to 28%, raise the capital gains tax rate to 28% for those earning more than $1mn, and tax unrealised capital gains2.

Trade: Trump is threatening a much bigger ramp-up in protectionism, though, with a 10-20% tariff on all imports and a 50-60% tariff on imports from China3. This would take the average US tariff rate from around 2.5% to around 17%, a level last seen in the 1930s. Countries with a sizeable trade surplus with the US (China, Europe and Japan) will likely be targeted by Trump. In retaliation, the impacted countries could respond with tariffs on US imports thereby accelerating the process of deglobalisation. The non-universal nature of the tariffs could allow companies to substitute goods from elsewhere in the world. A universal tariff would require the full support of Congress. The unlikelihood of a third Trump term may drive him to exert maximum pressure earlier on trade than his first term as he will be less constrained by political considerations. Harris is likely to continue the Biden administration's use of targeted tariffs to support strategic industries.

Immigration: While immigration surged under Biden, making it a key issue, it has been limited lately, with Harris likely to continue. Trump is expected to aggressively curtail immigration, threatening mass deportation4.

Cost of living: Harris has proposed a ban on “price gouging” by food suppliers and grocery stores, as well as support for home buyers and drug price caps5.

Climate policy: Trump could roll back environmental policies, though broadly overturning the Inflation Reduction Act (IRA) looks unlikely due to its positive impact on Republican states. Yet Trump could more easily limit vehicle eligibility for the IRA’s $7,500 consumer Electric Vehicle (EV) subsidy by increasing the stringency of definitions for critical mineral, battery component, and foreign entity of concern restrictions, thus making EVs more expensive and less appealing to consumers6. A second Trump administration would probably continue to politicise EVs as a boon to China's economy while trying to replace the IRA tax credits with other consumer carrots, like a "buy American" car-purchasing program. Similar to Biden, Harris could find courts opposing any extreme policies on imposing nationwide bans on federal drilling7. In the past, Harris has taken a harder stance on a ban on fracking, on zero-emission vehicle (ZEV) mandates and using the Department of Justice (DOJ) to sue oil companies for climate damages.

Regulation: Harris is likely to continue the aggressive antitrust enforcement activity under the Biden administration, which includes challenging monopolistic conduct, blocking M&A, and expanding the reach of antitrust laws8. Federal Trade Commission (FTC) and Department of Justice (DOJ) leadership changes could increase the likelihood of settlements8. This is contingent on the Senate confirming appointees. Narrow margins in the Senate could make this process acrimonious and less efficacious. At the very least, new anti-trust legislation seems less likely in a Republican sweep scenario.

Economic impact of the US elections

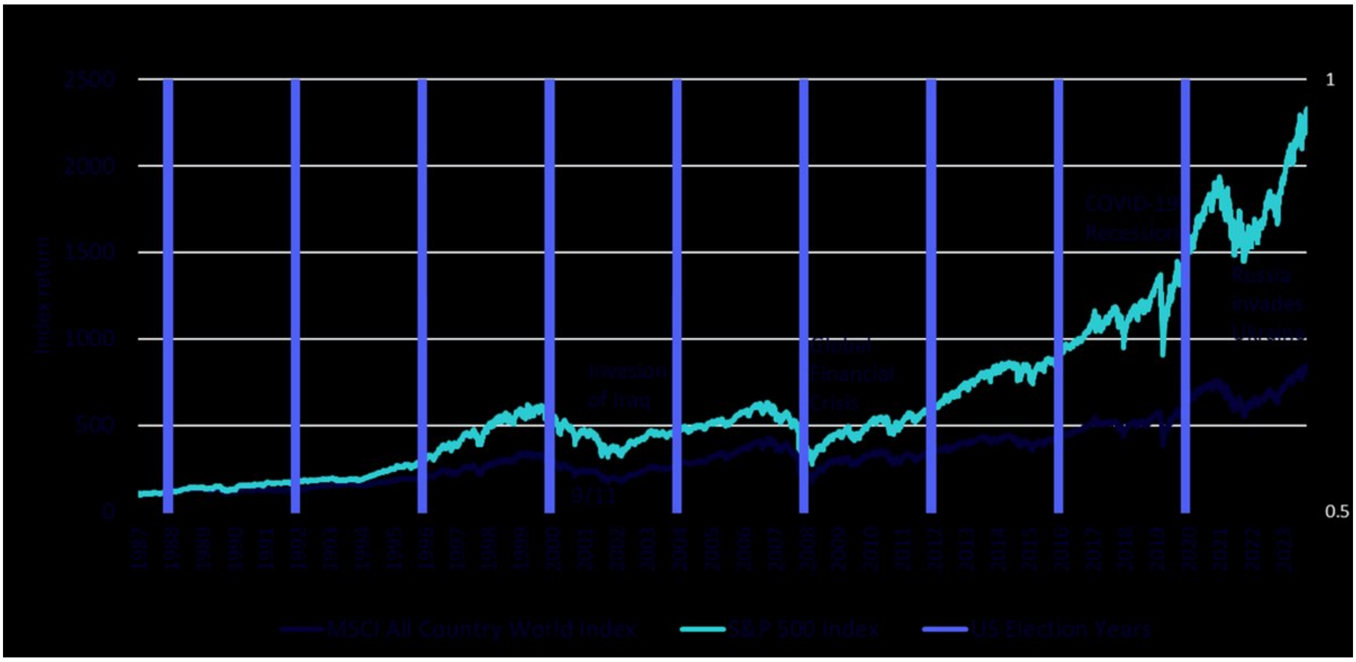
Trump’s policies in support of tax cuts and deregulation could support the supply side of the economy via a boost to productivity. Yet his policies, with higher tariffs resulting in higher import prices and curtailing immigration resulting in lower labour force growth, raise the risk of higher inflation, thereby weakening the Federal Reserve’s (Fed) credibility. Additionally, the risk of an even higher budget deficit under Trump could augur the return of the market’s bond vigilantes and higher bond yields. The dollar could strengthen with a Trump victory especially if he continues to promote an aggressive approach to trade alongside expansionary fiscal policy. A Trump victory could reignite geopolitical uncertainty by weakening US alliances but could also lead to a quicker end to the Ukraine war.

A Harris victory would see a continuation of the prior four years, which we judge as a benign scenario for both the US and the rest of the world. Harris plans to restructure the tax system with more cuts for the lower and middle classes, partly financed by a rise in the corporate tax rate from 21% to 28%4. Harris has given her unwavering support for women’s healthcare rights, her plans to restore federal abortion protections and her likely efforts to appoint liberal judges, potentially to the Supreme Court9.

Profits have always trumped politics in equity markets

While US presidential elections are significant, election outcomes have little influence on markets. Since 31 December 1987, there have been nine presidential election years, and it's clear that long-term market returns have little to do with election outcomes. The events that did trigger large corrections included the bursting of the dot-com bubble and the global financial crisis. Stock markets eventually recovered from these major events.

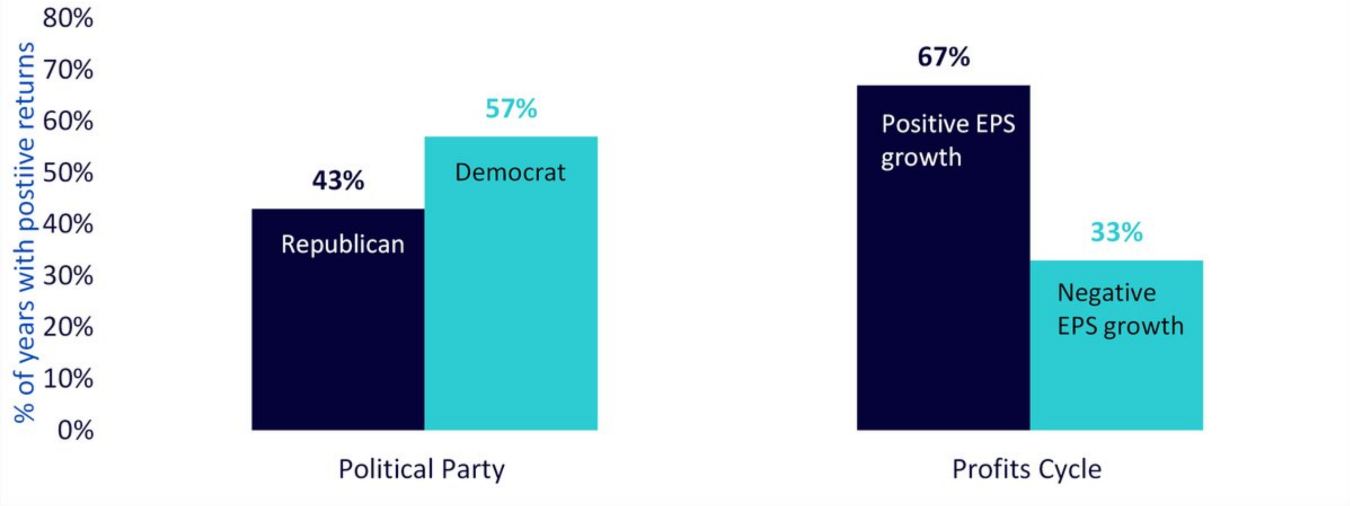
Figure 2: Stock market performance



Source: WisdomTree, Bloomberg from 31 December 1987 to 30 September 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

What does trump politics is the profit cycle, as evident from the chart below. In the years characterised by positive EPS growth, we observed a higher probability of positive returns independent of the political party in power.

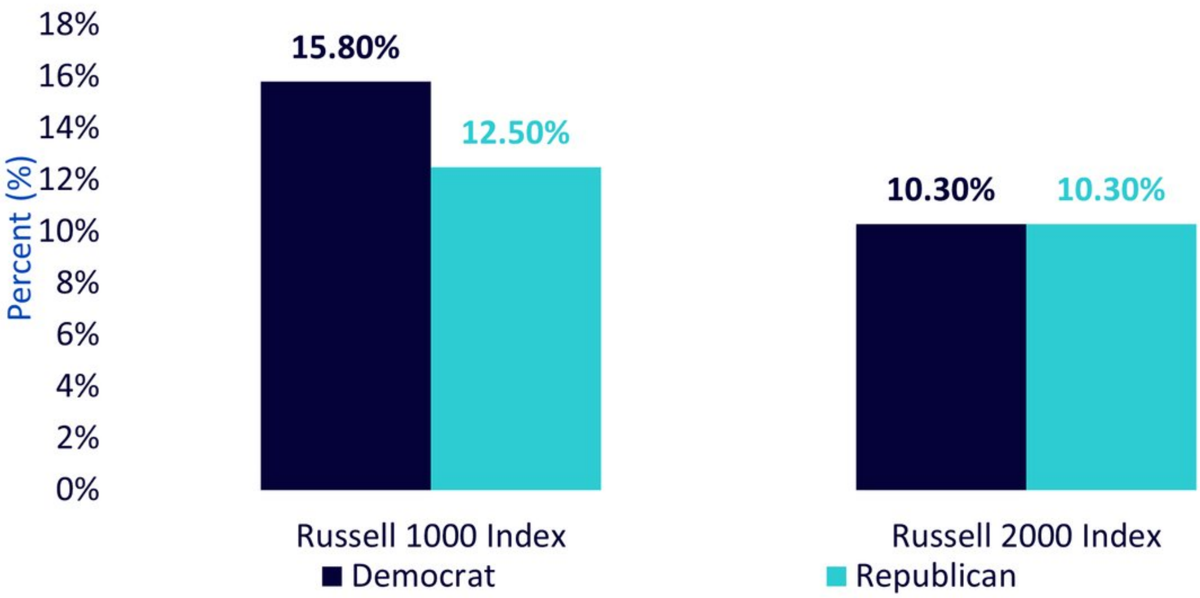
Figure 3: Profits matter more than politics



Source: Bloomberg, FactSet, BofA, WisdomTree from 1928 to 2023. **Historical performance is not an indication of future performance and any investments may go down in value.**

Since 1981, US large cap stocks have outperformed small cap stocks. This outperformance may be attributed to the characteristics of large cap companies, such as their diverse revenue streams, stronger balance sheets, and greater access to global markets. While both large and small cap equities have seen positive returns during different presidential terms, the outperformance of large-cap equities over small caps has been more pronounced during Democratic administrations.

Figure 4: US large versus small cap average returns (1981-2024)



Source: Bloomberg, WisdomTree as of 31 December 1980 to 31 August 2024. **Historical performance is not an indication of future performance and any investments may go down in value.**

A contested election or an election without a clear winner the next day could trigger further volatility, which would favour adopting a tilt to high-quality stocks.

Implications for commodity markets

- Potentially de-escalating the Ukraine war and Middle East tensions could shorten supply lines for energy, metals and agriculture, increasing supply into the market and reducing the geopolitical risk premium.
- Production and volumes to Europe could rise in the case of natural gas. Meanwhile, stricter enforcement of Iran trade restrictions could reduce some crude oil supply.
- Restrictive trade policy could drive up the US dollar, which is likely bearish for commodity prices in the near term.
- However, building new supply chains and nearshoring could be bullish for some metals in the medium term.
- A wide US budget deficit could also continue to drive strong demand for gold by central banks around the world.
- Potential status quo on Ukraine war keeps supply lines long, and Iranian exports elevated at around current levels, having little impact on energy prices.
- Natural gas volumes into Europe likely tighten as the Ukraine transit agreement for Russian gas lapses.

- Fewer new trade barriers than under a Republican White House could eventually lead to a weaker USD, supporting global commodity demand growth.
- Industrial metals would perform relatively better in the short term on softer tariffs on China.
- Budget deficits would likely expand faster than in a split government but slower than in a Republican White House and Congress, setting up a positive backdrop for industrial and precious metals.
- This scenario would accelerate decarbonisation initiatives and regulation, speeding up fossil fuel phase-out while boosting industrial metals demand.

Implications for digital assets

Bitcoin's performance in recent months has tracked closely with US political developments, especially as the presidential election nears. Trump has positioned himself as the pro-crypto candidate, offering a friendlier policy stance over the current administration's regulatory chokehold, stifling crypto adoption and innovation. With Trump gaining momentum in the polls, the 10Y treasury yield, bitcoin, and gold have risen as markets start to price in potential inflation under his leadership. Volatility lies ahead as the election outcome approaches and the public response remains uncertain. While a Harris win could dampen crypto sentiment, post-election clarity may ease volatility as markets settle. Conversely, a Trump victory may boost bitcoin prices and fuel markets, driven by a pro-crypto stance and inflationary pressures.

Conclusion

Markets are starting to pay more attention to the US election, with Trump pushing further ahead. Financial markets reflect the higher odds of a Trump victory, with bond yields up partly on concerns that Trump's policies will add to the huge US budget deficit. Equities are beginning to feel the pressure amidst rising bond yields. The US dollar strength over the past month resonates concerns of Trump kicking off another trade war. Trump's policies to cut taxes and regulation are certainly supportive for equities but his tariff policies would introduce a considerable dose of volatility as we saw in 2018. Its worth noting that the Presidency, the House and the Senate must be controlled by the same party, or the post-election scenario immediately defaults to gridlock, lowering the ability to push forward any major agenda. Gold, quality stocks and cryptocurrencies offer an opportunity if we end up in limbo.

1 Forbes as of 16 October 2024
2 Tax policy centre as of 10 October 2024
3 NBC News as of 25 September 2024
4 Peterson Instiute for International Economics as of 9 September 2024
5 Politico
6 Washington Post as of 10 September 2024
7 The Hill as of 24 October 2024
8 Forbes as of 28 October 2024
9 Economist as of 18 October 2024

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