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US ELECTION 2024
THE REAL ELEPHANT IN THE ROOM

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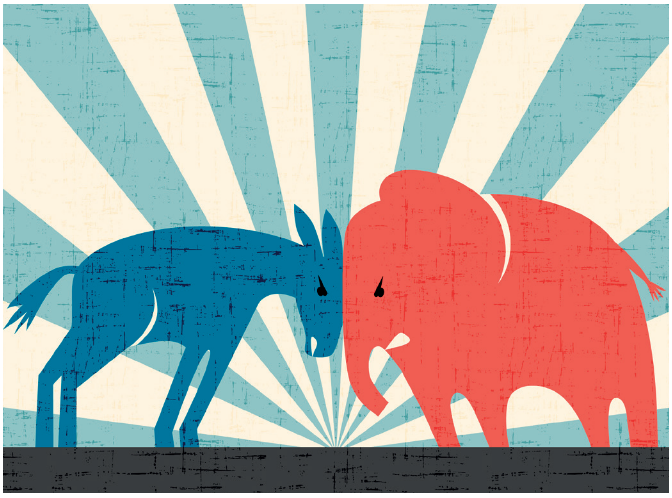
Carmignac's chief economist, Raphaël Gallardo and Kevin Thozet, a member of the investment committee, look ahead to the potential impact of the US election result on the economy, markets and asset allocation.



- **The election** is set against the backdrop of an economy more vulnerable than its recent performance suggests
- **A 'Red sweep'** would be inflationary and widen the deficit. Bond yields would increase sharply
- **A 'Blue sweep'** would mean a 'tax and spend' programme negatively impacting equity markets
- **A divided government** would keep the extremes at bay – markets generally prefer stalemate to policy uncertainty

A PARADOXICAL BACKDROP

Raphaël
GALLARDO

The US has enjoyed the most robust post-pandemic recovery of all the large, developed economies. Nevertheless, this long expansion has aged into a slowing phase, as the 'sugar-high' from giant Covid-related stimulus measures fades, a strong dollar weighs on the manufacturing sector, and the high real rates that were needed to fend off inflation have crushed demand in rate-sensitive sectors such as construction and real estate.

Consumers are still carrying the torch of growth, but, despite a low level of unemployment, most of the dynamism increasingly stems from the highest quintiles of the wealth distribution, who benefit from the ongoing wealth effects of an already expensive stock market. Ageing, increased welfare transfers and subsidies to the energy transition have also widened the fiscal deficit to levels unheard of outside of recessions, wars, or pandemics (7% of GDP).

This is the paradox of this election. After eight years of outperformance of the US economy and a stellar performance of its equity market, voter frustration with the state of the economy has shaped the electoral platforms of the two main candidates. The next administration will inherit an economy that is more vulnerable than its recent track record suggests, and why the populist measures that both candidates defend could have outsized impacts on financial markets.

The real elephant in the room, is that regardless of the outcome, this election could change the engine of an economy that has been the envy of the world for decades.

IMPACT OF THE DIFFERENT SCENARIOS

Annualised impact in 2025-2026 vs current trend. Based on Carmignac calculations as at 21/10/2024.

54%

46%

	SCENARIO 1	SCENARIO 3	SCENARIO 4	SCENARIO 2
Subjective probability	**Red sweep**	**No sweep**	**No sweep**	**Blue sweep**
	38%	**16%**	**29%**	**17%**
GDP	+0.1%	-1.0%	+0.3%	+1%
CPI	+1.1%	+1.0%	+0.1%	+0.3%
Fiscal balance	-3.2%	-2.1%	-0.4% to -0.7%	-0.7%
EPS impact	+5%	Differentiated according to sensitivity to tariffs/ deregulation	Slightly positive	-6% (tax hikes)
USD impact	Strongly up then downside tail risk on Fed intervention	Up	Down	Down
Fed policy in 2025	Plateau at 4% then return to 5% by end '25 until Trump interferes	Plateau at 4%	Cuts to 3%	Plateau at 4% then hikes until equity market breaks
Bond yields	Strongly Up	Up	Flat	Up initially

RESULT SCENARIOS

Given the high probability that the Senate flips Republican and the fact that the winner of the White House will probably also carry the House of Representatives, we have narrowed down the outcome of the election to four scenarios.

SCENARIO 1:
REPUBLICAN SWEEP

Raphaël
GALLARDO

ECONOMIC IMPLICATIONS

Donald Trump is campaigning on a platform of protectionism, massive tax cuts for firms and families, broad-based deregulation (with Elon Musk allegedly to be made into a ‘chief deregulation officer’), promotion of fossil-fuel extraction and massive deportations.

While deregulation, energy permitting and corporate tax cuts would typically boost the supply potential of the economy while pressuring prices down (a deflationary boom), our assessment is that these forces would be counterbalanced by the negative effects (i.e. lower GDP and higher prices) of prohibitive tariffs and massive deportations. Furthermore, tax cuts on labour income (tips, overtime, regular wages) and Social Security transfers (pensions) would boost consumer demand, resulting in higher inflation.

Even in a watered-down application of all Trump’s promises, GDP would barely move from its baseline 2% trend, given a starting point of no idle capacity (in labour or capital) and the negative impact of tariffs and deportations on future supply potential.

In this scenario, inflation would accelerate by 1.1ppt and the deficit would widen towards 10% of GDP.

This second wave of inflation would force the Federal Reserve (Fed) to pause rate cuts early in 2025 and resume hikes by the end of the year. The dollar would initially rip higher on higher rates, lower trade deficits and an inflow of foreign capital chasing an artificially higher return on capital on the equity market.

This surge in the greenback would infuriate a mercantilist president and risk an early demotion of Fed Chair, Powell to the benefit of a dovish political appointee.
This would spook foreign investors, in turn leading to a weaker dollar.

In the extreme, the exodus of foreign capital from the US Treasury and equity markets would reverse the wealth effects that have kept the US economy humming in the past two years.

Kevin
THOZET

MARKET & INVESTMENT IMPLICATIONS

The revival of the 1980’s style ‘reaganomics’ is likely to initially elongate the bull market in equities and the economic cycle into 2025. But Trump’s ‘pro-business’ agenda would be at the cost of higher real rates, which entails new risks for the global financial system.

Within equities, smaller companies and financials would benefit from deregulation and tax cuts, consumer stocks from a prolonged cycle, manufacturing stocks from protectionism and the fossil-fuel complex (services as well as infrastructure) from the prioritisation of domestic oil and gas production.

For the almighty technology sector, expectations are more mixed, given trade tensions with China could negatively impact the global supply chains of firms such as Nvidia or Apple.

As growth prospects and inflation rises, and the independence of the Fed becomes increasingly challenged, we’ll likely see higher rates globally. As a result, bond yields across the ‘curve’ will rise, but those with long-term maturities are likely to lead the charge (in a so-called ‘bear steepening movement’).

Upward pressure on bond yields is likely to put high-duration assets (growth stocks) and ‘bond proxy’ equities at risk, especially given the current elevated valuations.

On the fixed income side, the combination of improved growth expectations (at least on the cyclical side), higher inflation expectations and questions over the adequate compensation required for holding longer-term bonds, advocates for a flexible yet cautious approach towards core interest rates and a preference for real yields (i.e. those accounting for inflation) over nominal ones.

The US dollar would be caught in the crossfire of Trump’s interference with the Fed, protracted US exceptionalism and tariffs. The latter, being central to his economic plan, would likely take the driving seat in pushing the greenback higher. If the dollar eventually weakens due to foreign capital exodus, this could lead to a possible de-rating of the US equity market.

Lloyd
McALLISTER
Head of Sustainable Investment

A SPOTLIGHT ON SUSTAINABILITY

Since the last US election, there is no denying that the commitment to tackling climate change has been a polarising topic.

The Biden administration, primarily through the Inflation Reduction Act (IRA), has shifted the US onto a 'sustainable path' that has deep consequences. This has seen incumbent systems push back, especially following the surge in interest in ESG investing between 2015 and 2020.

Clearly, a Republican 'sweep' (seeing them take both the presidency and Congress) would be the most consequential outcome from a sustainable investment perspective. A Trump administration would seek to dismantle a 'pro-ESG architecture' to reinforce the 'old economy' at a time of significant global change.

These consequences should not be viewed in isolation, however, as we expect state-level power to continue to significantly influence economic activity, which should remain more stable.

Nevertheless, in the case of a Republican 'sweep' we expect:

- Trump will likely begin proceedings to withdrawal from the Paris Climate Accord.

  > This is part of 'Project 2025' and is symbolically important for his 'US-first' approach. It would require Senate approval which would likely get dragged out, but simply the act of beginning proceedings would be sufficient to evidence implementation of his agenda.

- Pressure to be exerted on the SEC to drop the climate disclosure rules.

  > These have been contentious even under a Democratic administration with significant push back on simply mandating companies to disclose pollution levels – an established practice around the rest of the world.

- The IRA, which Trump dubbed the Green New Scam will be under the microscope.

  > The IRA is forecasted to causally reduce GHG emissions by 8% (from a forecast base) through swifter adoption of clean technology. Trump believes it is a waste of money and he needs to find dollars to fund his tax-cut policy. His newly forged friendship with Elon Musk could be consequential in shaping how the axe swings, given his proposed leadership role in a "government efficiency commission".

60%[1] of IRA projects are in Republican states. We expect these projects to be supported given their nature (carbon capture and storage) and the boost to manufacturing jobs.

Musk's relationship with Trump reduces the risk around EVs, but not entirely, as Musk has publicly stated that removing the clean vehicle tax credit would benefit Tesla relative to its competitors.

As a China-hawk, Trump is likely to rescind the current flexibility from the Treasury in delaying the domestic supply chain rules until 2027. This will force a slowdown in green manufacturing as domestic supply chains take time to build up. Although, on the manufacturing side, Trump is likely to be transactional. He could let Chinese manufacturers into the US, so long as the production is taking place in the US.

Clean energy support is likely to be on the chopping block, particularly offshore wind, which Trump has described as "horrible".

⇒ Biden's light vehicle emissions standards - a key driver of automakers' shift to EV – will be scrutinised.

California, which leads the charge on emission standards, requires sign-off from the Environmental Protection Agency (EPA) to impose stricter requirements than the current federal requirement. This request could be rejected.

⇒ Fees on methane emissions to be removed.

These are a key driver of reducing greenhouse gases, as without the removal of methane leaks, natural gas electricity generation can be as polluting as coal.

⇒ More broadly, and possibly more consequentially in the long term, is the potential for the gutting of federal institutions.

The EPA being knee-capped and filled with political-loyalists rather than scientists would have a significant long-term impact.

For investors, these changes mean a slowdown in the adoption of green technologies via lower capital investment based on revised demand requirements and higher rates. As a consequence, the uncertainty in future cash flows from the reduced capital investment, alongside the negative sentiment, would result in a reduction of demand for securities in exposed sectors.

(1) https://s3.documentcloud.org/documents/25042572/e2-clean-economy-works-ira-two-year-review_august-2024.pdf

SCENARIO 2:
DEMOCRATIC SWEEP

“ Raphaël GALLARDO

ECONOMIC IMPLICATIONS

Kamala Harris basically has a ‘tax and spend’ program that entails $5-7 trillion (over ten years) in tax cuts and welfare spending for the middle class, financed by corporate income taxes.

Assuming Democrats enjoy even a thin majority in both chambers of Congress, President Harris could pass most of these measures through a reconciliation process despite lacking a super-majority in the Senate (albeit the measures would have a lifespan limited to 10 years).

Intense lobbying from K Street and resistance from moderate Democrats would water down the tax bill in the end, but we fear the most influential outcome of such a fiscal plan would be a sharp revision lower of the earnings prospects of US equities.

Equity wealth effects have effectively been the main driver of continuous growth in private consumption, so a de-rating of the US equity market would thus aggravate the slowing of the US economy. It would then behove the Fed to pursue audacious rate cuts to safeguard a soft landing for the economy in 2025.

“ Kevin THOZET

MARKET & INVESTMENT IMPLICATIONS

The Democrats ’tax and spend’ programme would basically mix new welfare spending with large tax increases, thus limiting the impact on long-term rates.

Cuts to discretionary spending, like defence, along with increased regulation and corporate taxation would negatively feed into earnings expectations and reduce returns on capital, hence threatening current equity valuations and the US dollar.

We expect a negative impact of -6% in earnings per share growth for 2025 as a result of an increase in corporation tax from 21% to 28%. Such measures could also weigh on valuation multiples. The average stock in the S&P 500 is being priced at 22 times next year’s earnings, likely reflecting the current exceptional profit margins of US companies. A 28% corporate tax would put the US on par with countries like the Netherlands, Canada, or France, where average valuations are 7x lower than their US peers.

Harris’s policies could stimulate consumer spending among the lower and middle income cohorts while the top quartile of earners (who account for close to 50% of total US consumption) would be negatively impacted. As a result, the ‘value end’ of the consumption spectrum could benefit, at the expense of the ‘premium end’. Consumer staples would be expected to outperform the consumer discretionary sector in a period of stock market uncertainty. The former would also see less of a hit from corporate statutory tax rates rising.

The real estate sector would benefit from plans to build millions of housing units and assist first-time buyers with deposits. Healthcare and renewables could also prosper given Harris has, in her vice presidency, contributed to the implementation of humongous subsidies supporting access to health care and climate change mitigation.

In fixed income markets, some form of fiscal 'responsibility' (albeit not huge, given the budget would still be running at an estimated additional +0.7% deficit), higher taxes and increased recessionary dynamics would likely ultimately keep bond yields in order, following an initial period in which they will rise, on the back of more upbeat economic growth. The longer-term downward adjustments of US equity valuations, and the consequent negative spillover to consumer confidence, means bond yields would eventually start to trend lower.

SCENARIO 3:
DIVIDED GOVERNMENT

Republican president, Republican Senate, Democratic House

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ECONOMIC IMPLICATIONS

Even without control of the House, Trump could still enact some key pillars of his program: impose tariffs, close the border, reallocate some federal funds to finance a deportation campaign, and deregulate the economy through executive orders and nominations of pro-business justices.

What he could not do is pass all his promised tax cuts. Admittedly, the Democrats would likely agree to a renewal of some of the 2017 tax cuts limited to the middle classes, but that would still leave some tightening taking place on the fiscal stance. Overall, this cocktail would be net stagflationary (GDP down 1.6pt vs potential, inflation up 0.6%).

The magnitude of the slowdown would probably convince Trump to water down some of his signature policies, but financial markets would still suffer from a reintegration of a stagflation risk premium into bonds and equities.
cuts to safeguard a soft landing for the economy in 2025.

SCENARIO 4:
DIVIDED GOVERNMENT

Democratic president, Republican Senate, Democratic House

Raphaël GALLARDO

ECONOMIC IMPLICATIONS

Given Harris's agenda mostly consists of redistributive policies, lack of control of the budget process (which requires approval by both chambers) means that her agenda would be dead on arrival.

If the Democrats control one chamber (plausibly the House), they could forge a compromise on the renewal of the 2017 tax cuts in exchange for some increase in social spending. In that case, the fiscal stance could shift more positive by the turn of the year and facilitate the pursuit of a soft landing, helped by a Fed on a methodical rate-cut path.

SCENARIO 3 & 4:
DIVIDED GOVERNMENT

Kevin THOZET

MARKET & INVESTMENT IMPLICATIONS

Divided governments have been synonymous with periods of tamed volatility and favourable market outcomes. This implies some fiscal compromise leading to positive fiscal impulse i.e. nothing thrilling but nothing dramatic either. And, it would likely prevent the candidates most 'disruptive' measures from coming to fruition. Ultimately, markets prefer stalemate stability over policy uncertainty.

In a Trump presidency, executive actions would likely see him pass some of his most inflationary measures, but without full control of the two houses, there is limited potential for pro-growth policies. A combination which would likely see him dialling back on some measures, but the risk for markets is a period where the negative combination of higher prices and lower growth ('stagflation') is reflected in asset prices first.

Nevertheless, regardless of who secures the presidency, the increased probability of renewed gridlock could, counterintuitively, result in a positive market environment, as it would lead to further liquidity being injected in the system with the US treasury raiding (again) its general account at the Fed. Likewise, given the difficulty of a lame-duck government to enact important fiscal support, the Fed would have to do most of the heavy lifting, while not having to worry about inflation pressure.

In terms of sectors, growth stocks which are less (or in some cases, not) dependent on the economic cycle to flourish, would likely be sought after. While those more dependent on government spending or regulation, such as environmental services, and those leaning on consumer confidence and spending, such as financial services, would lag – with the exception of infrastructure which could benefit from middle ground and bipartisan support.

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