

Investment Views November 2024

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Back to the Future

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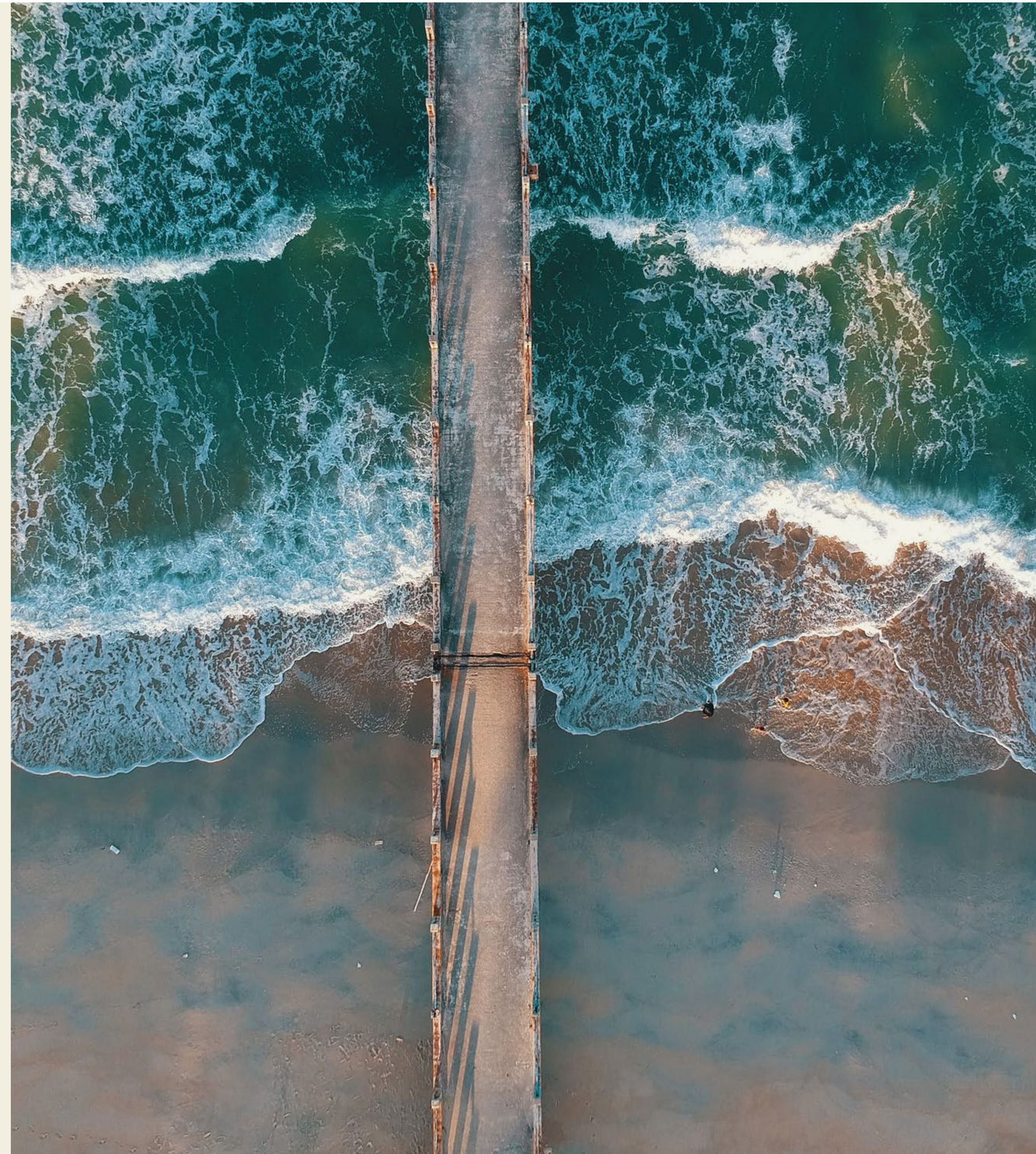
The Trump Trade – Risk-On

Back to the Future

- Echoes of 2016 as Trump is re-elected
- Inflation frustration hurting incumbents globally
- Much uncertainty around future US policy

In the weeks leading up to the US election, financial markets started to sense that Trump might emerge victorious, and this proved correct. Bond yields rose (prices fell), the US dollar appreciated, cyclical stocks (such as financials) outperformed, while clean energy stocks fell. Trump not only won the presidency, but also the popular vote tally. This is only the second time since 1988 that any Republican has done so.

A diverse array of regions across the country and across different demographic groups voted to re-elect Trump for a second term. Republicans also won a decisive majority in the Senate and likely a small majority in the House of Representatives. Overall, this gives Trump a strong mandate and the ability to enact substantive changes to policy.



STRATEGY

Assessing the potential implications of a Trump presidency is particularly difficult due to the wide variety of competing ideas, some of which are contradictory. Trump's agenda includes lowering taxes, imposing tariffs on imports, cutting regulations, and reducing immigration. Much of Trump's agenda is positive for US economic growth, but it is also inflationary. Some aspects of the agenda, however, are disinflationary (such as deregulation), while others could be detrimental to growth (tariffs and immigration restrictions).

The potential for large tariffs presents a significant downside risk for US and global growth. A tariff is essentially a tax on imports, which companies would then pass onto consumers, leading to higher prices. While a perceived lack of economic growth and opportunity propelled Trump to the White House in 2016, inflation was a much more salient issue for voters this time around. Incumbent governments have struggled in elections all across the world in recent years, and inflation is a key reason why.

Concerns around inflation therefore act as a constraint on the new administration, although this is at odds with a recent interview, where Trump noted "to me the most beautiful word in the dictionary is 'tariff'". A re-negotiation of the United States-Mexico-Canada Agreement (USMCA) is highly likely, as are some tariffs, but they will also be used as a negotiating tactic, as we saw during Trump's first term. Many promises were made on the campaign trail, and it remains uncertain which policies will be enacted and on what timeline. A recent J.P. Morgan research note stated that the results of the election have created "significant uncertainty about future policy".

The US Federal Reserve cut rates again in early November, as expected by the market. In the press conference, there was unsurprisingly a lot of focus on what potential policy changes may mean for the outlook for interest rates. Inflation has fallen, but is





50%

The percentage that European exports to the US are up..

STRATEGY

still above the Fed's 2% target. Potentially inflationary government policy (tariffs and tax cuts) are therefore important considerations for the Fed. When asked about implications for monetary policy, Chair Powell was non-committal, noting that the Fed doesn't "guess, speculate or assume" anything about fiscal policy changes. This implies that the Fed will wait for any new policies to be announced before assessing the potential impact on inflation and employment.

While the election may be a catalyst for a pickup in animal spirits in the US, it presents a challenge for other countries round the world, notably Europe, China and other Emerging Markets. Europe's exports to China are roughly flat since 2021, but European exports to the US are up 50%. Growth in the US has therefore been helpful for other countries, and this is now at risk. We manage well diversified investment portfolios across both sectors and geographies. Political events have historically not been key drivers for markets in Developed Economies. However, in recent years we have spent an increasing amount of time thinking about how the policy environment impacts financial markets, and will continue to do so.



Bond Market Faces Reality

- Global bond yields rise; inflation expectations increase
- Credit spreads compress; minimal cushion for a volatility event
- US dollar strengthens

With the onset of the US easing cycle, fixed income markets initially adopted a strongly dovish outlook, pricing in a substantial 275bps of US base rate cuts, a weaker dollar, and inflation expectations nearing recessionary levels. A softer employment market supports this view, yet overall, the US economy's inflation and macroeconomic momentum do not align well with such drastic market pricing.

In retrospect, the bond market's dovish peak coincided with the Federal Reserve's surprise 50bps rate cut, and now, heightened expectations for an aggressive easing cycle are reigniting growth and inflation projections. With the Atlanta Fed GDPNow Forecast projecting close to 3% real growth policy makers need to tread carefully over the coming months with a hawkish reality check a real possibility. The election of Trump also introduces further uncertainty and upside risk for US interest rates.



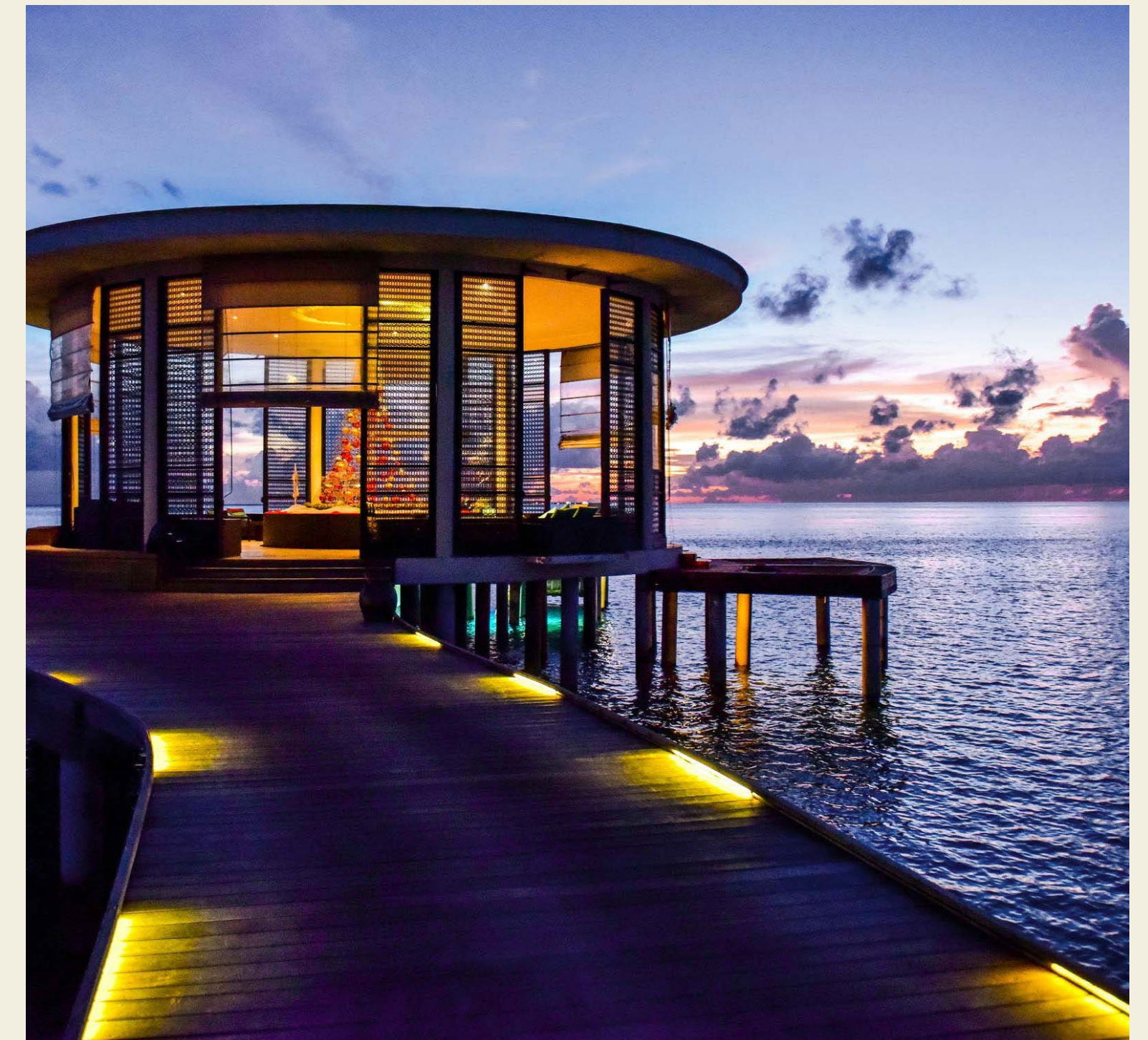
Global bond markets have taken note and, led by the US, sold off sharply. The benchmark US 10-year yield climbed from 3.78% to 4.29% in October, with parallel moves across the yield curve. Base rate cuts in Canada and Europe dampened some of the impact in government bond markets there but yields still rose as the move higher in the US drove sentiment. Relative to when the Federal Reserve cut base rates, the market is now pricing in a higher terminal rate of 3.75% vs 3.25% with global macro data continuing to positively surprise expectations. Notable releases include US consumer confidence, the ISM services index and average earnings which are stable at 4% YoY. Japan being the exception and showing signs of weakness.

Inflation expectations surged as the slowdown narrative was rapidly repriced, even though WTI oil prices remained stable around \$69 per barrel. This price held steady despite an early-October spike following the Iranian missile strike on Israel. Considering ongoing Middle Eastern tensions, the lack of a risk premium in energy markets stands out. This anomaly could be due to China's weak economic outlook and expectations of increased US supply driven by deregulation. In any case we continue to hold a core US inflation position and will likely remain invested with US monetary policy too easy and geo-political risks elevated.

The US dollar strengthened broadly in October as overly dovish monetary expectations were challenged, and the prospect of increased US tariffs led short-positioned speculators to close out positions. Globally, European macro data appears to be stabilizing, potentially slowing the ECB's rate-cutting pace, which would likely support the Euro while pressuring European bond yields—though much depends on US policy. Meanwhile, disappointing Chinese economic performance has prompted stimulus, with surprise indices in China, Europe, and the US turning positive, signalling a potential floor for global bond yields. The UK's latest budget—with tax hikes, growth downgrades, and

rising unfunded spending—has driven gilt yields sharply above levels seen under Liz Truss.

Given easy US monetary policy we lowered interest rate duration in September in our US dollar bond funds, which enabled portfolios to mitigate some of the impact of higher bond yields. We also increased our allocation to US inflation protection which has returned to levels last seen in July enabling portfolios to re-capture losses experienced in Q3. Credit spreads remain narrow, with US high yield spreads at 282bps over Treasuries—the lowest since 2021—offering minimal cushion against volatility and drawdowns, leading us to hold little exposure.



The Trump Trade – Risk-On

- Markets cheer US election outcome
- Financials and Energy benefit from deregulation
- Defensives sectors underperform

The S&P 500 index rallied 2.5% on the day after the US election, the strongest post-election day rally in history and the best day since November 2022. Equity sectors and companies thought of as beneficiaries of a Republican victory had already moved in advance of the vote, but the lifting of uncertainty around the outcome led to further gains.

The winners on the day were Financials, Industrials, Consumer Discretionary, and Energy which rallied 6.2%, 3.9%, 3.6%, and 3.5% respectively. Financials rallied on hope that the Trump administration rolls back banking regulation. Banks led the charge with large market capitalisation names like JPMorgan and Wells Fargo posting double-digit returns and regional banks also performing well. Industrials was the second-best performing sector



EQUITIES

on the day with Capital Goods stocks such as Rockwell Automation and Caterpillar, a bellwether for the US economy, posting near double-digit returns. Transportation stocks such as Union Pacific also benefitted from the election results.

Consumer Discretionary, despite being the third best performing sector, was a mixed bag. Tesla added 15% on the day, with investors acknowledging Elon Musk’s close ties with Trump and expecting this to benefit his companies. The stock has had a strong run and is up nearly 60% since its October low. Amazon, the other big driver of Consumer Discretionary, posted a positive return of 3.8% however other segments such as Consumer Durables & Apparel underperformed lagging 2.2%. Energy rallied 3.5% as investors latched on to Trump’s promise to “Drill, baby, drill”.

The laggards on the day were Real Estate, Consumer Staples, Utilities, Health Care, and Materials which were down 2.6%, 1.6%, 1.0%, up just 0.2%, and 1.2% respectively. Real Estate and Utilities underperformed due to their sensitivity to interest rates as US yields inflected higher. Utilities should benefit from deregulation but the move in yields was deemed more significant. Consumer Staples also lagged with the subsector Food, Beverage and Tobacco as well as Household and Personal Products, leading the sector lower. Healthcare diverged with Trump expected to let subsidies expire impacting some segments but offset by stock specific news which muddled the waters resulting in the overall sector remaining flat on the day. The Materials sector also had a lot happening with the Construction Materials subsector rallying but the Chemicals sector weak due to stock specific news.

Communications Services and IT both returned 2.5%. Alphabet rallied 4% with Trump acknowledging that Alphabet has too much power but that it was important for the US to have great companies. Meta, on the other hand, closed the day flattish, perhaps an indication of Mark Zuckerberg’s fraught relationship with Trump. In IT, Semis and Semis Equipment performed well with Nvidia returning 4.1%. Some of the renewable energy

5.8%

The percentage that Small market capitalisation stocks rallied as Trump’s growth policies outshone the negative impact of higher yields.

equipment providers, such as First Solar and Enphase Energy, got burnt as Trump’s policies on renewable energy shook the sector. Software and Services performed with Microsoft up 2.1%. Technology Hardware and Equipment lagged with Apple closing down 0.3% as investors worried about incoming tariffs.

Small market capitalisation stocks rallied 5.8% as Trump’s growth policies outshone the negative impact of higher yields. Europe underperformed as tariffs and Europe’s tricky relationship with Trump would likely be a drag on European equities. Emerging Markets underperformed as a stronger dollar and a more hawkish stance towards China would not be good for the region. We will see what the next four years bring, although the expectation is that uncertainty and volatility will reign.



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Global Asset Allocation

The chart below details our 6-12 month tactical investment strategy

	UNDERWEIGHT -	+ OVERWEIGHT
Asset Allocation	EQUITIES (MODEST UNDERWEIGHT) \$	CASH (MODEST OVERWEIGHT) ♘
Fixed Income		EMERGING MARKET DEBT INFLATION PROTECTION 🎯
Equities Regional		JAPAN EMERGING MARKETS EX CHINA 📊
Equities Sector	CONSUMER DISCRETIONARY UTILITIES 🏷️	ENERGY HEALTHCARE 📡

