

What are markets telling us about Trump's decisive victory?

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Key takeaways



Tax cuts

Trump is likely to focus on extending the Tax Cuts and Jobs Act and cutting corporate taxes. I would expect this to be very positively received by markets.

Federal Reserve (Fed)

The Republican Senate majority will likely serve as a rubber stamp for Trump's appointments. This could add some uncertainty for the makeup of the Fed.

Fiscal deficits

Some expect Trump's policies to result in larger fiscal deficits, and bond investors are already showing signs of impatience with US government spending.

The US presidential election has been decided, with voters giving Donald Trump a return ticket to the White House. Importantly, the US managed to avoid what markets feared the most: a contested election and prolonged uncertainty, which could likely have resulted in a significant sell-off. Instead, we have a decisive victory. Markets like clarity, and I expect them to reward this in the short term.

The Senate goes Republican while the House is a toss-up

President-elect Trump will have a Republican Senate majority to support him in achieving his agenda. The Senate is considered the "HR department" that votes to confirm presidential appointments, and this Senate will likely serve as a rubber stamp for Trump. This could add some uncertainty for the Federal Reserve (Fed), given the potential for Trump to nominate non-traditional candidates for seats at the central bank, especially the Fed Chair.

As I write this the morning after the election, the House of Representatives remains a toss-up at this point. I think whether or not there is a divided or unified government, stocks are likely to make gains in the near term. (The Dow Jones Industrial Average gained 3% on the election news.¹)

Immigration, tariffs, and deregulation are issues to watch

The key items on Trump's agenda — immigration and tariffs, as well as deregulation — generally do not need legislative action, so the composition of the House of Representatives is largely unimportant to the implementation of those policies. Trump can move ahead with those as soon as he takes office.

On the campaign trail, Trump suggested that he will not apply his proposed tariffs immediately. Rather, he may merely threaten them and then negotiate. It's also possible that tariffs could be applied only very temporarily. This would be somewhat similar to what we saw in the first Trump administration with significant volatility and short-term sell-offs followed by recoveries as the tariff wars played out. (And if tariffs are only threatened or are short-term in nature, I don't believe they would have a material impact on inflation even though they are anticipated to be as large as 60% for Chinese goods.²)

In terms of immigration, Trump has pledged to begin deportation of 15-20 million illegal immigrants immediately. If this were to come to fruition, it could be very inflationary since the labor market is already tight and some industries have labor shortages. However, the Fed would be unlikely to react with monetary policy changes until inflation shows up in the data, which could take time. Higher wage growth could trigger a Fed slowdown in rate cuts. (Inflation break-evens have risen, suggesting that higher inflation could already be a concern for markets).

Trump is likely to focus his legislative efforts around an extension of the Tax Cuts and Jobs Act as well as a cut in corporate taxes. I would expect this to be very positively received by markets, and that's likely why markets

rallied immediately after the election; they are anticipating lower taxes and less regulation.

Markets clearly believe economic growth will be amplified by Trump administration policies. We can see it in the results of the Russell 2000 Index, which was up more than 4% just a few minutes into the Nov. 6 trading session.¹ However, I still believe support for stocks is more about Fed easing supporting growth. (And the Nov. 7 Fed decision will re-focus investors on monetary policy.) As a reminder, US assets tend to do well in the year after an election (especially stocks).³ And US stocks have tended to do well when the Fed eases but a recession is avoided.⁴

An issue to watch: Bond vigilantes

From my perspective, the big market issue facing the new administration is going to be bond vigilantes — bond investors who threaten to sell or avoid buying bonds in order to protest the policies of bond issuers (in this case, the US government).

There is an expectation that Trump's policies will result in larger fiscal deficits, and bond investors are already showing signs of impatience with US government spending. US Treasuries are no longer seen as the "safe haven" asset class of choice that they once were, and we could see yields rise in a way that makes deficit spending increasingly difficult. Thus far, the rise in yields looks to be mostly related to inflation break-evens, but the fiscal situation is also playing a role; I believe rising fiscal deficits will become an increasingly larger concern for investors.

Conclusion

In summary, we have seen an outsized reaction in markets — likely due to the "positive surprise" of avoiding prolonged uncertainty and realizing a decisive victory by the candidate whose policy platform includes tax cuts and deregulation. However, it does feel to me like the euphoria for US stocks is somewhat overdone and there could be some retracing in the near term, just as we saw in 2016. Ditto for the sell-offs in European and UK equities; I think they are also overblown and there could be some retracing.

It will likely be up to the Fed to help support a sustained stock market rally, so we will want to look to Fed Chair Jay Powell for clues as to what might cause the Fed to slow down or even pause its easing cycle. My base case remains an economic re-acceleration next year for the US and most other major economies, which should be supportive of risk assets. I anticipate small- and mid-cap stocks to be particular beneficiaries of this environment.

With contributions from Paul Jackson and Brian Levitt

Notes

¹Source: Bloomberg, L.P. as of Nov. 6, 2024

²Source: PBS: "Trump favors huge new tariffs. How do they work?" Sept. 27, 2024

³Source: Sources: ICE BofA, S&P Dow Jones Indices, LSEG Datastream and Invesco Global Market Strategy Office, Oct. 31, 1987, to Oct. 31, 2024.

⁴Source: Federal Reserve Economic Database (FRED) and Bloomberg L.P., Aug. 31, 2024.

Based on average S&P 500 Index performance 12 months before and 12 months after the beginning of the past 16 easing cycles in 1970, 1971, 1973, 1974, 1975, 1980, 1981 (two cycles that year), 1982, 1984, 1989, 1995, 1998, 2001, 2007, and 2019.

Important information

All investing involves risk, including the risk of loss.

Past performance does not guarantee future results.

Investments cannot be made directly in an index.

This does not constitute a recommendation of any investment strategy or product for a particular investor. Investors should consult a financial professional before making any investment decisions.

In general, stock values fluctuate, sometimes widely, in response to activities specific to the company as well as general market, economic and political conditions.

Stocks of medium-sized companies tend to be more vulnerable to adverse developments, may be more volatile, and may be illiquid or restricted as to resale.

Fixed income investments are subject to credit risk of the issuer and the effects of changing interest rates. Interest rate risk refers to the risk that bond prices generally fall as interest rates rise and vice versa. An issuer may be unable to meet interest and/or principal payments, thereby causing its instruments to decrease in value and lowering the issuer's credit rating.

The Dow Jones Industrial Average is a price-weighted index of the 30 largest, most widely held stocks traded on the New York Stock Exchange.

The Russell 2000® Index, a trademark/service mark of the Frank Russell Co.®, is an unmanaged index considered representative of the US small-cap stock market.

The S&P 500® Index is an unmanaged index considered representative of the US stock market.

Bond vigilantes is a name given to bond investors who sell bonds in protest against a monetary or fiscal policy they fear is inflationary.

Monetary easing refers to the lowering of interest rates and deposit ratios by central banks.

Inflation is the rate at which the general price level for goods and services is increasing.

A risk asset is generally described as any financial security or instrument that carries risk and is likely to fluctuate in price.

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