ECONOMIC NEWSLETTER

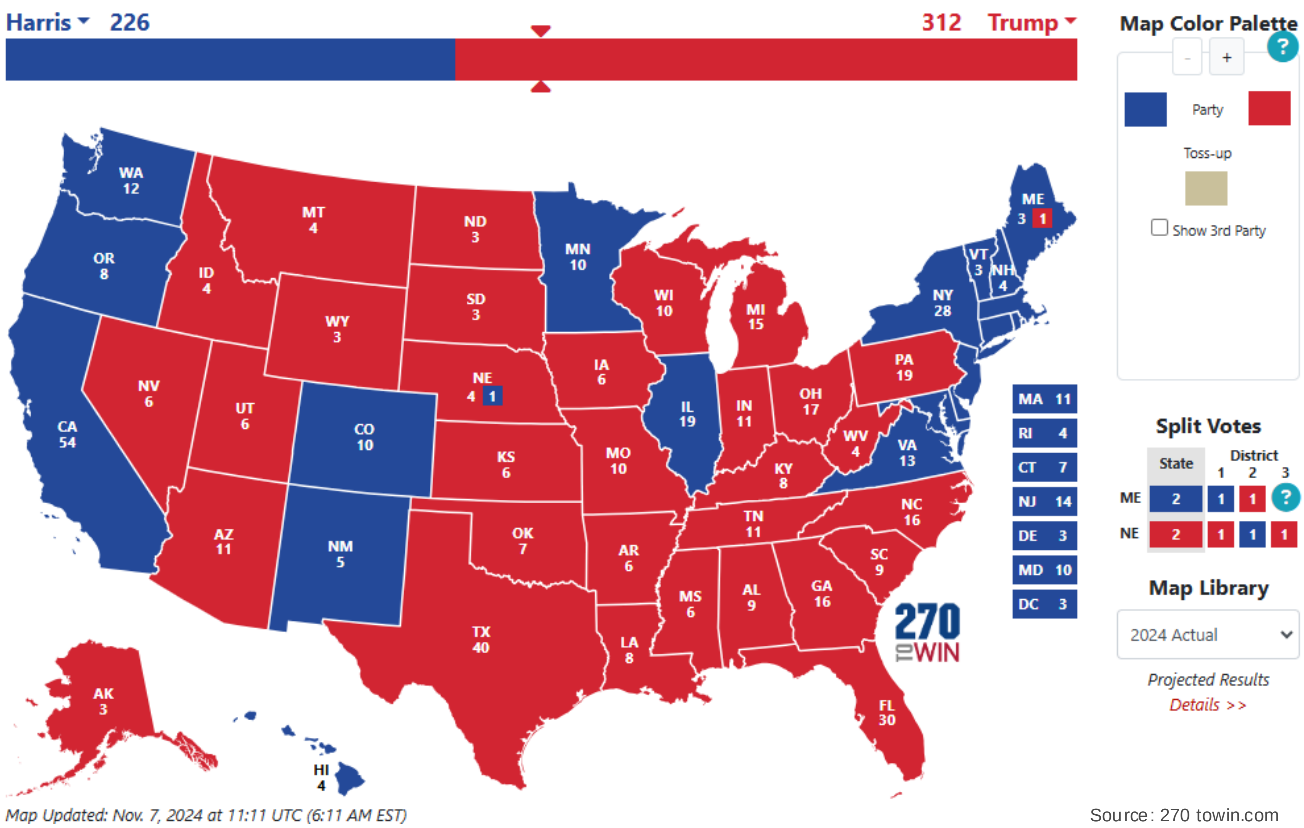
SPEKTRA FINANCIAL SERVICES

TARIFFS, TAX CUTS, AND INFLATION: MARKETS BRACE FOR TRUMP 2.0

Donald Trump has won the U.S. presidential election, defeating Kamala Harris after a turbulent campaign that included two assassination attempts, a criminal conviction, and a last-minute shift in the Democratic lineup after President Joe Biden withdrew from the race.

At 78, Trump will become the oldest president to take office in January, while his vice president, 40-year-old Ohio Senator JD Vance, will be among the youngest to hold that role.

After what had been a tightly contested presidential race, Trump's victory proved decisive over Harris, with the Republican party securing well in excess of the 270 electoral votes required to obtain a majority.



Source: 270 towin.com

US stocks and other risky assets rallied on Wednesday after Donald Trump's decisive election victory, with the S&P 500 and Nasdaq Composite both setting new record highs, jumping 2.5% and 3%, respectively. The small-cap Russell 2000 index jumped almost 6% to its highest in nearly three years. Bond yields rose higher following the election results, underscoring effect Trump's campaign policies could have on inflation.

Donald Trump reshaped the U.S. voter base again this year, drawing increased support from Hispanic voters, young adults, and those without college degrees, gaining votes in almost every part of the country to win back the presidency.

Notably, an exit poll by Edison Research found a 14-point rise in support from Hispanic voters, with 46% choosing Trump, up from 32% in 2020, when he lost to Democrat Joe Biden.

POLICY IMPLICATIONS

A Trump presidency is expected to push for more protectionist policies, leading to a broad and notable rise in tariffs on Chinese goods, in line with his campaign proposals. Trump's previous term saw a similar escalation, with Biden largely maintaining these tariffs, indicating bipartisan support for confronting China's trade practices. Trump indicated further escalations are likely, including possible 60% tariffs on all Chinese imports. This has the potential to spill over into additional international tariffs, although these will likely fall short of the universal tariff numbers suggested during the campaign.

The current proposal will see a 10-20% tariff on all imports, with much higher rates on Chinese goods. Analysts at Pantheon Macroeconomics estimate that a 10% tariff would boost inflation by about 0.8% next year, creating additional challenges for U.S. manufacturers.

If Trump's protectionist agenda places upward pressure on inflation, the US Federal Reserve may adopt a more cautious approach to cutting interest rates, and scale back the projected number of interest rate cuts.

While previous campaign narratives suggested large-scale deportations of illegal immigrants, such measures are unlikely under a Trump presidency. Nevertheless, a moderate increase in deportations is anticipated, along with stricter visa and asylum policies, with local law enforcement playing a role in border security along the southern border. These measures are expected to exert mild inflationary pressure, primarily by driving up wages in the agricultural and service sectors and slightly reducing the overall labour force.

From an economic perspective, investors expect a more business-friendly administration, including tax cuts under the Trump presidency. During a new term, the former president wants to extend portions of the 2017 tax cut that are set to expire next year, and he has called for additional cuts in the corporate tax. While these measures will likely fall short of the most optimistic projections, when combined they could result in a moderate positive fiscal stimulus.

IMPLICATIONS FOR PORTFOLIO POSITIONING

Tariffs can drive inflation by raising prices, potentially dampening consumer confidence and slowing economic activity. A recent study by Goldman Sachs estimates that a corporate tax cut could increase S&P 500 earnings per share by 4%, creating a positive effect on U.S. equities. However, this could also lead to higher government debt, impacting bond markets as debt concerns rise. After the election, U.S. government bond prices declined and yields rose, reflecting these worries.

The new president steps into an economy experiencing solid growth. Although inflation remains above the Federal Reserve's 2% target, it has significantly decreased from the 2022 highs. U.S. GDP growth currently stands at 2.8%, highlighting a robust and healthy economy.

Despite the rhetoric, a Trump presidency will be pro-business and pro-deregulation, which will support economic growth and facilitate earnings expansion. While short-term volatility can be expected in markets, investors will continue to benefit from a diversified exposure to both growth and fixed income assets. Over time, the influence of political parties on markets tends to diminish, as market movements are more significantly driven by the performance of underlying companies and the earnings they generate. Ultimately, the fundamentals of corporate profitability and economic growth exert a stronger and more sustained impact on market direction than political shifts alone.