Commentary

A New Chapter: Economic Implications of Trump's Second Term

- Risk of contested election eliminated with Trump victory.
- Bond yields and stocks are rising as investors react to a Trump second term.
- Investors should curb their optimism/pessimism and stay focused on their investment goals.

Following a long and contentious election season, Donald Trump was declared the winner, making history as the first president since Grover Cleveland in the late 1800s to be elected to non-consecutive presidential terms. We understand that elections can be very emotional and polarizing, but we remain focused on the economic and investment implications.

Trump campaigned on themes focused on the economy, including tariffs, immigration and tax policies; specific details on these initiatives and priorities will emerge as we near Inauguration Day in January. The extent to which tariffs are implemented, the level of immigration limits, and the magnitude of the changes to our tax policy are uncertain, but the likelihood is high. A potential risk of these policy initiatives is that inflation moves higher. Economic growth estimates for 2025 could see upward adjustments, with an economic environment of deregulation that could boost growth, and inflation adjustments might move higher.

However, even if we do see a boost in inflationary pressures, it may not materialize until 2026. In Donald Trump's first term, tariffs and tax reform were also major policy initiatives, but we never saw an inflationary spike. This time, inflationary risks might be higher as service inflation remains elevated relative to pre-pandemic levels, and the size and scope of new tariffs could be larger. The Federal Reserve (Fed) may not cut interest rates as much as expected if they see signs of inflation reigniting.

The early market reaction is likely twofold. First, markets are pricing out the possibility of a contested election, where there is not a clear winner. This was the biggest risk to markets. Secondly, markets are adjusting to the Trump victory. While bond yields are likely rising partially due to this relief rally, they are also rising around the possibility of higher inflation and higher-than-expected rates in the future. Bond yields surged after the election and the strong likelihood of deficits remaining high also adds upward pressure to bond yields. The stock market is also rallying about this relief and Trump's victory, with small cap stocks and economically sensitive value sectors such as Financials, Energy and Industrials leading the gains, indicating that economic growth prospects may still be strong.

Investors are digesting the election outcome and potential implications. How it all plays out over the next presidential term is uncertain. It's important to remember that the U.S. economy is $29 trillion in size and our labor force employs nearly 160 million people. The 500 large-cap corporations in the S&P 500 generate 40% of their revenue outside of the U.S. A new administration results in a new political environment, but corporations have shown resiliency over time as they adapt to policy changes. The data backs this up. In the 19 post-WWII 4-year presidential cycles, the S&P 500 posted positive returns 17 times, with an average annualized return of 11.9%. Returns have been strong under both political parties.

With elevated valuations in large cap growth stocks, investors may benefit from broader portfolio diversification. Returns could broaden away from the high growth tech darlings to value, mid-caps, and small caps. Active management could excel in an environment of widening breadth and increased market volatility. It is important to stay focused on your own financial goals and avoid being too bullish or pessimistic based on political views. There are broader economic forces at play than who is President of the United States. As always, please consult your financial professional for guidance during these times.

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Glossary

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