INVESTMENT PERSPECTIVES

NOVEMBER 2024 — SPECIAL ELECTION EDITION

Key Takeaways —

- Term Two: What might the president-elect try to accomplish through executive order or legislative process?
- Time will tell if current market narrative morphs into policy reality.
- Post-election stock market gains: Is it Trump or just the trend?

IT'S OVER (ALMOST)

Mark Luschini, Chief Investment Strategist

Finally, after a long and irregular campaign season, Donald Trump was elected the 47th President of the United States, marking only the second time in history that a candidate won two non-consecutive terms in the White House. One would have to go back to the late 19th century to find the Democrat, Grover Cleveland, as the other. Also settled is the composition of the Senate, which has flipped to a Republican majority. The House of Representatives, on the other hand, has yet to be settled as many states' districts are still working through the arduous process of tallying votes. Some political strategists handicapping the House race expect Republicans to retain control, giving the party a clean sweep of the White House and Congress. That could have implications for legislative policies that greatly differ from those at the top of the list should Democrats win a majority of seats in the House. We will have to wait beyond this publication's release before we know the complete configuration of the government that will oversee the country's business come January.

Investors and political pundits alike have pounced on the prospective policy ramifications and interpretations for the capital markets. While it is too soon to be certain as to how much and what might be done through executive order and/or the legislative process, having had the precedent of a Trump administration while he served as the 45th President from 2016 to 2020, we can surmise a few of the likely tendencies of his office.

- The President will probably need a majority in the House to extend the Tax Cuts and Jobs Act (TCJA) set to expire at the end of 2025. Otherwise, it will require compromise with Democrats. That may subject pieces of the legislation to be traded for those priorities the Democrats hold and modify some of its tax or business-benefitting components. A Republican majority in the House might also enable lawmakers to use the budget reconciliation process to deliver on some of Trump's campaign promises regarding reduced taxes on Social Security income, tips, and overtime pay.
- A couple of sectors could see benefits from regulatory relief without the need for legislative support from Congress. The natural gas industry could be helped as the pause on LNG exporters is lifted. Financials could gain operational efficiencies, leading to margin improvement and increased M&A activity. Industrials and Autos could gain from onshoring and protectionist policies. The defense sector could get a boost as geopolitical risks foster President Trump's support for an increase in spending on National Security. Small company stocks could prevail if interest rates subside and Trump's domestic-focused, pro-growth agenda leads to further positive economic activity.

A potential worry is the imposition of trade tariffs that could jar the geopolitical landscape across allies and adversaries alike. In addition, the cost passed through the supply chain to the consumer could lead to higher inflation and sap demand if applied indiscriminately. That should be of particular concern to the Trump administration since the toll from rising prices, a cumulative increase in the general level by 20.5% since 2021, was an important factor for voters who expressed unhappiness with their financial situation.

With the outcome of the presidential election consummated so promptly, financial markets moved violently to discount the prospects of another Trump term. The positive reaction in the stock market was the rationale given expectations of tax cuts (or at least an extension of the TCJA) and deregulation, as both are favorable for equities. Tariffs will gain importance once the sequencing of the Trump agenda becomes apparent. Until then, unless undermined by some exogenous event, the U.S. economy is poised to continue to grow at a solid pace and help support the stock market's advance by way of rising corporate profits this year and similarly expected for next.

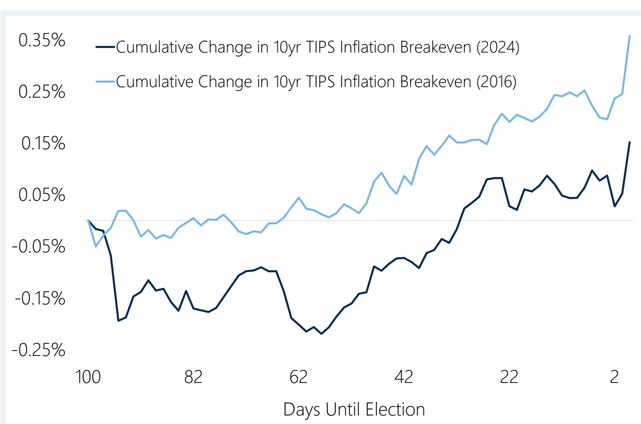
TRUMP BOND MARKET NARRATIVE: THE SEQUEL

Guy LeBas, Chief Fixed Income Strategist

"A post-election bond selloff: In risk assets, we saw aggressive selling overnight, only to be met with just-as-aggressive buying when European and U.S. markets opened up on the morning of November 9. In the interest rate sectors, a sharp risk-off rally overnight gave way to heavy selling during daylight hours. Ten-year Treasury yields—a convenient benchmark, though an incomplete description of the markets—rose by 0.20% on Wednesday, one of the more violent moves on record, and a rout that left all semblance of technical support levels in the dust. It's too early to get a handle on the movement in municipal bond interest rates since those markets trade less frequently, but it appears that prices have fallen roughly in line with those of Treasuries on the first post-election trading day. Corporate bond prices performed similarly, in line with those of Treasuries."

It would be understandable to assume these comments referred to the 2024 Presidential election. They do not. The above paragraph is a quote from our commentary the day after Donald Trump's first electoral victory in 2016. While the levels of interest rates are quite different (we were roughly 2.30% on 10-year Treasury yields as opposed to 4.50% today), the direction and magnitude of the price action are eerily similar. Just as in 2016, 10-year Treasury yields have risen in response to Trump's election by about 0.20% at the highs. And just as in 2016, risk assets, as measured by stocks or credit-sensitive bonds, performed very well relative to the interest rate markets. And just as in 2016, inflation expectations are on the rise.

Chart 1: Change in 10yr Inflation Expecations Similar in 2024 as in 2016



Source: Janney ISG; Bloomberg

At the time of publication, we remain in the narrative-driven phase of the market response. The economic narratives post-election will primarily be those we addressed in our pre-election fixed-income rundown. One of those narratives was that the most likely set of Trump policies—tariffs and slower growth in the workforce—add inflation risk. We can see that reflected in financial markets. Not only long-term interest rates, which are sensitive to inflation risks rising, but also more direct measures of inflation risk are rising as well. Inflation breakevens, a traded measure of the difference between inflation-protected and non-protected bonds, rose roughly 0.10%–0.15% in the aftermath of the election.

It will take some months until we see more than just a narrative in the markets. First, there are more than two months between election day and the time the Trump administration has control over policy. Even assuming an optimistic timeline, it will take several more weeks to confirm senior officials and get the new government moving. Then, policy formulation and implementation bring us into early spring 2025 before we have a concrete idea of what features of Candidate Trump's rhetoric make it into President Trump's policies. Finally, it will take anywhere from three to 12 months to feel the first of those policies economically.

In sum, it is incredibly hard for public-sector action to reverse private-sector inertia quickly. While markets will (and already have) priced in guesses as to policy immediately, we still need some time to see whether the current market narrative morphs into policy reality. In the meantime, these higher, longer-term interest rates are the market's way of preparing. We can expect a 10-year Treasury yield in the 4.50% area through early-2025 even as the Federal Reserve continues on its well-defined path of lowering short-term interest rates.

ELECTION UNCERTAINTY RESOLVED

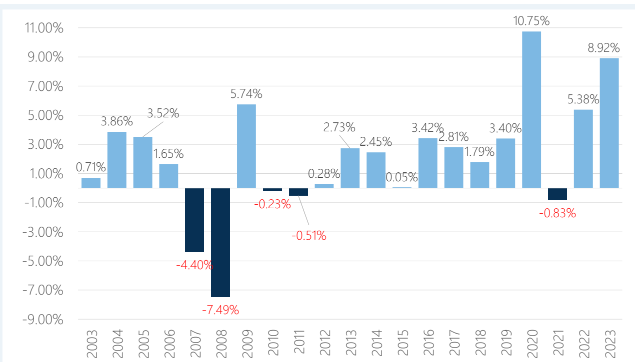
Gregory M. Drahuschak, Market Strategist

The long and contentious presidential campaign came to a close as Donald J. Trump became the 47th President by winning the popular and Electoral College votes (292–226). It was the first time since 2004 that a Republican won the popular vote. Republicans secured control of the Senate and appeared to be on the way to achieving a majority in the House of Representatives. If a sweep is achieved, it will occur for only the ninth time with a Republican in the White House.

The day after the election, the stock market reacted immediately, with the Dow Jones Industrial Average gaining 1508.05 (3.57%) while the S&P 500 was up 2.53%. The Dow Jones Industrial Average, S&P 500, Russell 2000, and Nasdaq Composite set new all-time highs.

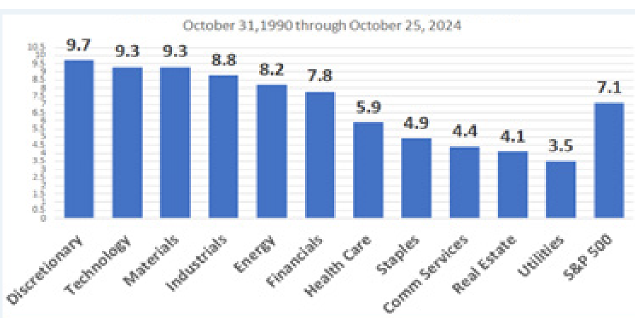
For several months before November 5, a typically reliable stock market-based election indicator decisively was forecasting that the Democratic party would retain the White House, which obviously was wrong.

Chart 2: S&P 500 Last 20 Years in November



Source: Thomson Financial; Janney Investment Strategy Group

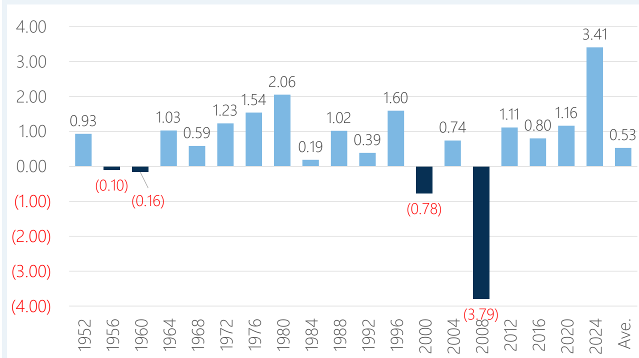
Chart 3: S&P 500 % Average November–April Results



Source: Thomson Financial; Janney Investment Strategy Group

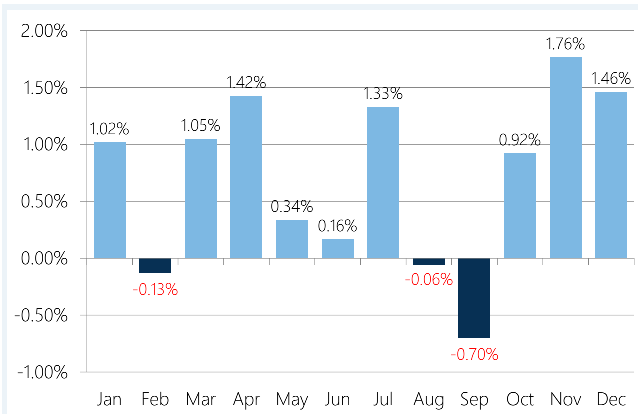
It would be natural to give the election credit for the stock market's strong post-election gain. Still, election or not, November tends to have a solidly positive bias, as the month has produced the best average monthly result in the 1950 - 2024 period. Election years, however, also tend to have a positive bias. In the previous 18 election years, the S&P 500 has only had an average monthly loss four times.

Chart 4: Monthly Average During Election Years



Source: Thomson Financial; Janney Investment Strategy Group

Chart 5: Average Monthly Percentage Results: S&P 500 1950–2024



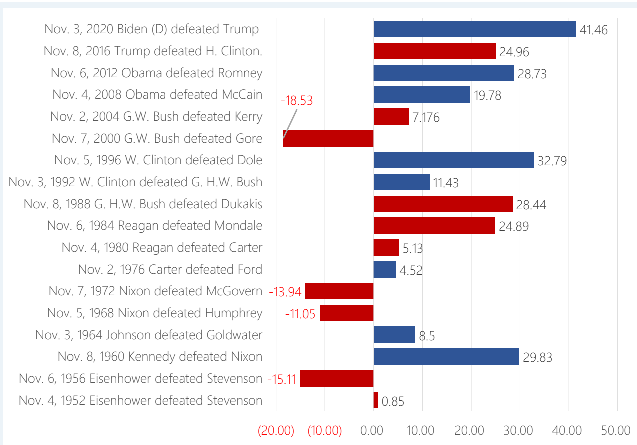
Source: Thomson Financial; Janney Investment Strategy Group

An election sweep is commonly believed to be positive for the stock market, but other executive-legislative configurations have produced better market results.

Looking at average results, the best governmental makeup for the stock market is when a Democrat is in the White House, but Congress is split politically. The next best outcome is when a Democrat occupies the White House, but Congress is under Republican control. This time, a Republican will occupy the White House with a Republican Congress, which historically has produced the third-best outcome.

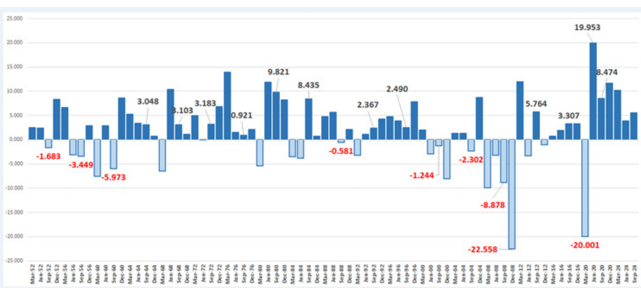
Election post-mortems will permeate the press for months ahead, but the economy and credit policy will remain at the center of the market's attention. The November decision by the Federal Reserve Open Market Committee to lower interest rates again is expected to be followed by a series of rate cuts. A range of economic data continues to offer positive indications for the economy, although recently weak employment numbers suggest watching the employment situation closely. The recent slippage in earnings expectations for 2025 can hopefully reverse, as current earnings expectations leave the market at an elevated valuation.

Chart 6: S&P 500 Change at the End of the Year After the Election



Source: Thomson Financial; Janney Investment Strategy Group

Chart 7: S&P 500 % Quarterly Result in Election Years



Source: Thomson Financial; Janney Investment Strategy Group

Other than the potential for a partial retracement of the post-election rally, market technicals tend to support higher levels heading into 2025.

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