Investment Insight

Putting the US election into perspective

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For Financial Advisers to use with their clients

Key points

- Taking profits on Global Financials, Germany
- China still attractive even after recent gains
- Low inflation means lower interest rates

The victory of Donald Trump's Republican party shows that few can accurately predict political outcomes. Elections matter less than you might expect with no real difference in historic returns between Republican and Democrat eras. Future returns are more strongly led by starting valuation levels - returns being higher when markets were undervalued than when they were overvalued.

A key insight about elections is that they are a dangerous time for investors because there is a strong temptation to overreact to campaign rhetoric and the excitement and emotions of a change in leadership.

Right now, there is simply too little that is known about the new administration and its ability to wield power. Don't forget that President elect won't be in office until 20 January 2025, his new team is still being formed and a slim majority in the Senate or House of Representatives would complicate the passage of legislation and act as a significant restraint.

What do we know so far about the incoming US government?

A high priority will be extending corporate and personal tax cuts that are due to expire at the end of 2025. Tariffs will increase but probably less than threatened on the campaign trail. The new president is expected to use Executive actions (that do not need to pass through Congress) to reduce regulation such as scrapping tighter vehicle emission standards, freeing up federal land for drilling and trying to expedite approvals for energy infrastructure. So overall, lower taxes, higher tariffs and more industry friendly regulation are in store.

The details will matter in understanding whether the changes are significant enough, and long lasting, to change the absolute and relative attractiveness of asset classes and markets. We are hunting for excessive share price moves that open up attractive longer-term opportunities when pessimism is overdone.

The uncertainty makes it even more important to anchor investment decision making to realistic assessments of fair value and using deviations from fair value as a guide to opportunities. An example is an asset we currently hold in portfolios: higher quality US smaller companies. They have been significant performers since the election but remain good value because of how cheap they were before, as flagged by our Morningstar Equity Research colleagues. To boot they also help smooth portfolio returns by balancing the exposure to more defensive assets because they benefit more from economic booms and hence an aggressively pro-growth policy agenda.

The other notable development was the UK government's recent budget that will increase spending, taxation and borrowings. The tax impact on savers and investors is not a topic for this letter but is clearly impactful and one of the many reasons why great financial advice is so valuable.

Our colleagues at Morningstar DBRS note that the fiscal loosening is set to provide a boost to the economy in the near term. The lasting economic benefits may be minimal unless the increase in public investment more than offsets any reduction in employment, profits and potential output from the tax changes. Unlike the Truss mini-budget, checks and balances remain in place and there is dedicated spending on public investment accompanied by emerging policies aimed at supporting higher ongoing economic growth. The market reaction was a moderate rise in gilt yields and no broad-based sell off in the Pound(1). We still view gilts as higher quality government bond market that is fairly valued at current yields.

Left in the shadows this month is the 0.25% cut in interest rates in UK and US. With current rates still well above prevailing inflation rates, there is scope for a further reduction in interest rates. The bottom line here is that cash is becoming a relatively less attractive asset and bonds a relatively more attractive asset.

(1) Source: Morningstar Direct, as of 12/11/2024

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