FOUNDED IN	EMPLOYEES	LOCATED IN	ASSETS DIRECTLY UNDER MANAGEMENT	ASSETS INDIRECTLY UNDER MANAGEMENT
1988	**80+**	**10+** COUNTRIES	**US$1.1** BILLION	**US$9.7** BILLION

ICM Monthly Outlook

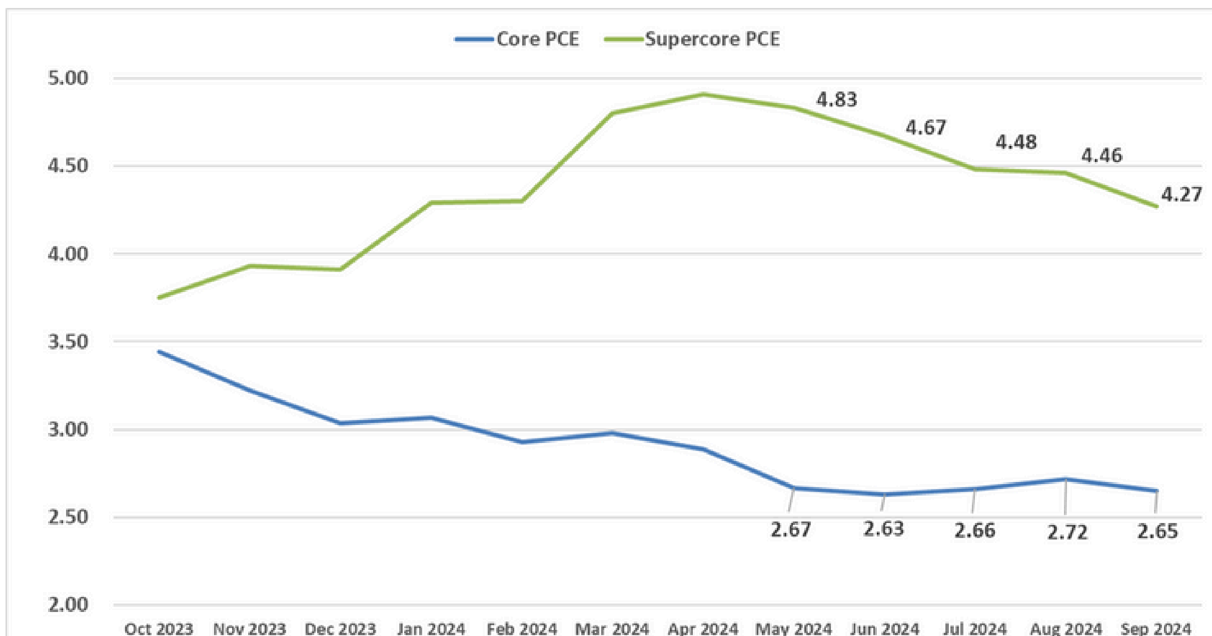
NOVEMBER 2024

Market Review

The US equity market turned full risk-on as soon as the election result became clear. Initially, we saw a relief rally due to the certainty of the outcome, followed quickly by a rally premised on President Trump's expansionary economic policies, tax cuts, deregulation, and expected higher GDP growth in the US. The fact that US equity markets snapped higher so suddenly tells us the result was not priced in beforehand.

The bond market has reacted more cautiously than the equity market to President Trump's giveaway policies. There is a saying that in bonds lies the truth. On the Thursday after the election, the Federal Reserve Bank cut interest rates by 25 basis points, its second consecutive cut. The rate cut was nailed on because of October's weaker than expected non-farm payroll report.[1] The Federal Reserve Bank's decision to cut rates in November was easy based on the final few data points ahead of their meeting. In addition to the weak non-farm payroll report, the Personal Consumption & Expenditure (PCE) report continued to trend toward 2%, as does the Supercore PCE, as illustrated in the following graph.

Inflation Data



Source: US Bureau of Labour Statistics. Core PCE excludes food and energy prices. Supercore PCE excludes food, energy, and housing.

Market Review continued

At the subsequent press conference, the rate cut was irrelevant to the waiting media. The assembled media and analysts were far more preoccupied with the implications of President Trump's victory on the independence of the Federal Reserve Bank. Chairman Powell was stern in his response, stating that he would not resign or allow President Trump to interfere with the board's composition. This allayed investors' fears that he was no longer in charge. We are certain the Federal Reserve Bank's decision making process will remain data-dependent and make adjustments based only on economic data rather than political pressure or trying to pre-empt new fiscal policies. Chairman Powell refused to be drawn on his opinion of President Trump's policies. Chairman Powell was well rehearsed and very reassuring.

Between now and the end of January 2025, investors expect one 25 basis point rate cut. Per Bloomberg's World Interest Rate Predictor model, there is a 68% chance of a 25 basis point rate cut on December 18th. Between now and the December 18th, the Federal Reserve Bank will have two more inflation reports to consider. Over the past two months, fixed income investors have revised upward their expectations for the terminal rate. Last September, investors priced in 10 x 25 basis point cuts in this cycle, resulting in an implied terminal rate of c.2.8%. Today, that implied terminal rate is close to 3.6%, suggesting three or four fewer cuts than previously expected. At this point, we have no reason to believe the Federal Reserve Bank is behind the curve.

Market Outlook

Trump 2.0

Based on the mountain of published analysis so far, it seems the economy kept top billing. Voters punished the Democrats for the ill effects of inflation on their daily lives over the last four years. President Trump has promised to end inflation. US voters will expect him to deliver, but that might be easier said than done.

During his first term, President Trump pushed equity markets higher by cutting the corporate income tax rate to 21% from 35%[2]. He also cut the top rate of individual income tax to 37% from 39.6%.

His second term will be more of the same. President Trump plans to cut corporate tax to 15% from 21% and restore favourable tax treatment for investment. He has also indicated further cuts to individual tax rates, albeit slightly sketchier thus far.

Corporate tax cuts will engineer a boost in corporate earnings, explaining in part the rally in equities already. Higher earnings will recalibrate stock valuations lower over the short to medium term. In the longer term, tax cuts won't boost productivity and it remains to be seen if the lower tax rate will boost the US's competitiveness, but we are inclined to think it will.

President Trump wants to impose 10-20% tariffs on everything produced abroad, which could be inflationary. Lower corporate and individual taxes would boost consumer sentiment, which is also potentially inflationary. President Trump's tax policies may be storing up future problems. Many column inches have been written about President Trump's potentially inflationary policies. Tax cuts, tariffs, deportations, and a continued crackdown on emigration could induce higher prices, resulting in higher interest rates in the long run. President Trump isn't known for fiscal discipline.

The University of Pennsylvania's Budget Model projects reduced tax revenue of $5.8 trillion over the next 10 years, which, it says, will result in the equivalent budget deficit. Aside from the sizable hole in the fiscal budget, President Trump's policies are forecast to stoke inflation again.

Over the short to medium term, US consumers will feel the warm glow of Trump's victory in their wallets, but in the longer term (say 10 years), the country is storing up a problem for future generations. In the long term, a bigger budget deficit must have a negative impact on the cost of credit for the US; US Treasury yields will rise. This will be a gradual effect with plenty of volatility along the way.

To counterbalance the price impact of tariffs on imported goods, Trump will need to drive down prices elsewhere. Ramping up oil and gas production is an obvious target that would have an immediate benefit on gas guzzling US consumers. Less regulation in the energy sector will lower energy prices. Americans are very interested in pump prices and airfares.

Tariffs could reduce economic activity globally, especially in China, if the US imposes 60% tariffs on Chinese imports. Lower demand for Chinese goods will cut oil demand, which, when combined with increasing supply from the US and higher output from OPEC by reversing production cuts, could result in a significant fall in oil prices. Lower oil prices feed into everything. Cheaper oil will boost spending power and potentially counterbalance the impact of tariffs on consumption.

Food inflation will be harder to tame, as food prices are increasingly impacted by climate change, which won't be helped by cheaper oil and gas. Supply chain disruption due to fewer foreign imports contributed to the inflation spike over the past few years and could also return. President Trump must tread a fine line to implement his policies without stoking inflation.

This time, President Trump not only wants to close the border but also deport immigrants. We touched on this in last month's letter. Aside from being a behemoth operation, it would also considerably reduce the labour force, particularly in construction and agriculture, two sectors where the President will least want inflation.

No guardrails

During President Trump's first term, Republicans controlled the Senate 52 – 48 and the House of Representatives 241 – 198 seats. Again, at the time of writing, it looks likely that President Trump will have full control of all branches of the political executive and the US Supreme Court, which has a 6-3 conservative majority.

The only independent holdout is the US Federal Reserve Bank. No surprise, then, that during the Federal Reserve Bank's press conference on Thursday following the election, all reporters wanted to ask about was how secure Jerome Powell felt in his role. President Trump wants more influence over the Federal Reserve Bank. During his campaign, President Trump suggested he should have a role in rate decisions[3]. The Federal Reserve Bank must get used to dealing with President Trump's inevitable outbursts.

Deregulation

We agree with President Trump that there is too much regulation - indeed we have a front row seat. Deregulation explains why cryptocurrency has been going to the moon since the election. That said, we still believe in the benefits of regulation. We hope the baby is not thrown out with the bath water. For instance, the great recession from December 2007 to July 2009 was brought on by light touch regulations of the financial sector that resulted in the global financial crisis. Many social scientists trace the origin of the global homeless crisis to the credit crunch which brough about the financial system's collapse in 2008.

We are most concerned about the impact of deregulation on the environment, AI's impact on humanity, and employee rights. President Trump tends to fire people who disagree with him.

Protectionism and tariffs typically lead to favouritism, corruption, and smuggling. US manufacturers will clamber for favouritism from the Trump government to supply products that were previously imported but are now too expensive due to tariffs.

Market Implications

There **i**s **n**o **a**lternative (Tina) to investing in the US right now. The US is the fastest growing economy in the world and at the forefront of growing industries, especially technology. Notwithstanding the poor non-farm payroll report in October that was impacted by two hurricanes and a strike at Boeing, we believe the bulk of the economic data from the US supports the case of no landing or a soft landing at worst.

As a result, we remain constructive on US corporate bonds and expect spreads to stay around today's levels at least through the first half of 2025. We also remain constructive on equity markets. We believe the current more-expensive-than-average valuations are justified based on President Trump's policies, or at least the market's perceived benefit of his policies through the first half of 2025, primarily his tax and deregulation policy. It remains to be seen how effective he will be in implementing everything, albeit he has a clear runway with all three branches of the executive on his side.

We are less constructive on European equity and credit markets. Risk premiums in Europe feel tight against a backdrop of weaker economic data and Europe's increased vulnerability from President Trump's victory. Europe will likely ramp up defence spending to counterbalance the perceived lack of military cover from the US. It now looks naïve of Europe to have sub-contracted its defence to the US for the last 40 years. Clearly, Europe should have invested more heavily in defence in

case Uncle Sam could not be relied upon. Ten years ago, it would have been considered far-fetched to suggest a redrawing of political alliances as Trump has planned.

And finally

The US has elected a strong-man leader, a type that has become prevalent worldwide lately, for instance, in China, Russia, Hungary, the Philippines, Israel, and Brazil. President Trump's election will be a disaster for the Ukrainian defence against Russia's war. President Trump will suffocate Ukraine's war effort by starving it of arms, essentially handing Russia a victory and a permanent corridor through Donbas to the Black Sea, at a minimum. President Trump will embolden Israel's offensive on Hamas, Hezbollah, and potentially the Iranians. And finally, President Trump might acquiesce to China's seizure of Taiwan. The reign of the strong-man leader will intensify. I am fearful it's a leadership style that will become even more prevalent as others learn the modus operandi. Possible candidates exist in France, Italy and Germany.

And you know what? There's a saying that things are never as bad as we fear but never as good as hope. Here's hoping.

Conor Spencer
13 November, 2024

Source Data: ICM, Bloomberg as of 31 October, 2024.

[1] https://www.bls.gov/news.release/empsit.nr0.htm
[2] https://budgetmodel.wharton.upenn.edu/
[3] https://abcnews.go.com/Business/trump-role-setting-interest-rates-economists-bad-idea/story?id=112773679

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