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Market Insights

November 2024

Wealth Investment Office

Post U.S. Election

Back to Business

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No more pundits, attack ads or mudslinging. Goodbye polls and blessedly, good riddance to betting markets and political sentiment driving markets, it's back to business. In our most recent Portfolio Strategy Quarterly we wrote: *"Despite all the political noise, however, we think the financial market will likely continue to be driven mainly by what happens to the U.S. economy — unless, of course, we encounter another U-turn during the transfer of power"*. Clearly, the people have spoken in the United States, and this will not be an issue. As the old saying goes, knowing is half the battle and we now know the results, and there is no ambiguity. As Benjamin Graham so eloquently said:

"In the short run, the market is a voting machine but in the long run it is a weighing machine".

Meaning, in the short-term markets are driven by sentiment while in the long run markets are driven by something you can measure; financial results.

As we have written on a number of occasions the best way to navigate the current environment is to stick to your process, adapt to what's in front of you, and make sure you own a well-diversified investment portfolio. We do expect to see ongoing spikes in volatility, though, over the next few months.

Where we are at

While we always manage portfolios at the margin and adapt to what is in front of us, it's key to remember the importance of not getting distracted by the noise of this election and the importance of sticking to your process, to adapt to what is in front of you, and make sure you own a well-diversified portfolio. While we are surprised by the size of the mandate, we are not that surprised by the result. Last November when we published our ***The Year Ahead: 2024*** document we covered the possibility of a second Trump administration, and have referred to this many times since. Going into this election our Wealth Asset Allocation Committee adjusted the outlook for Fixed Income to modest underweight and for Equities to modest overweight. A Trump administration is good for equities, less so for bonds and the recent WAAC changes reflect that. The most important factor for financial market is the overall economic landscape; GDP growth, employment data, the strength of the consumer, inflation, corporate earnings, and rates.

Back to the point, what might we see from here, now that we know Donald Trump will be the next President of the U.S.? Figure 1 provides a broad analysis of potential impacts as the final votes are counted in the Senate and the House:

Figure 1: Expected impact of a Republican administration

	Trump	
Expected Impact	**Republican Sweep**	**Divided Senate/House**
U.S. Stock Market	Positive	Positive
Bond Yields	Higher (++)	Higher (+)
Yield Curve	Steepen	Steepen
Sectors that may benefit:	Cyclicals (Financials, Industrials, Energy), Crypto	Cyclicals (Financials, Industrials, Energy), Crypto
Sectors that may underperform:	Clean tech, Companies that are exposed to tariff risk, (high dependency on goods imports)	Companies that are exposed to tariff risk (high dependency on goods imports)
Factors that may perform well:	Value, Small-cap	Value, Small-cap

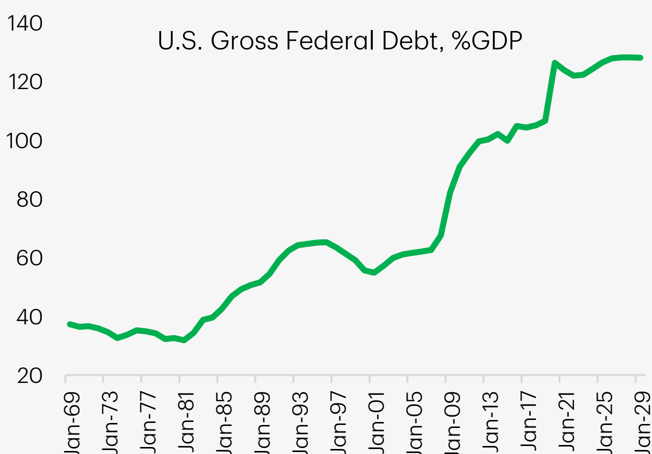
Source: Macrobond, Wealth Investment Office, as of November 4, 2024

What does this mean for fixed income?

For fixed income markets, expectations are higher bond yields for longer, given fiscal spending and high debt levels in the U.S. Neither candidate spoke about fiscal prudence, so high debt levels are likely here to stay for a while. The growing debt burden, combined with concerns about ongoing large U.S. fiscal deficits will likely lead to a larger term premium in bond markets in the coming years (Figure 3).

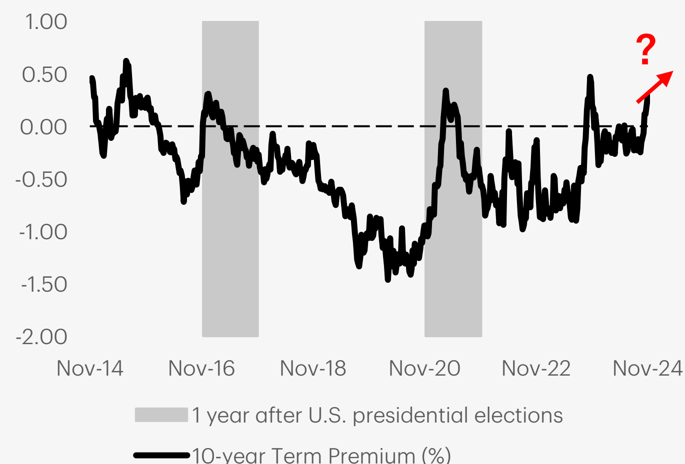
Given expected volatility for yields, we strongly favour actively managed government bonds or interest rate duration that taps into tactical opportunities.

Figure 2: U.S. Federal debt accumulation is on an unsustainable trajectory



Source: Macrobond and Wealth Investment Office as of November 6, 2024

Figure 3: Larger term premium in bond markets



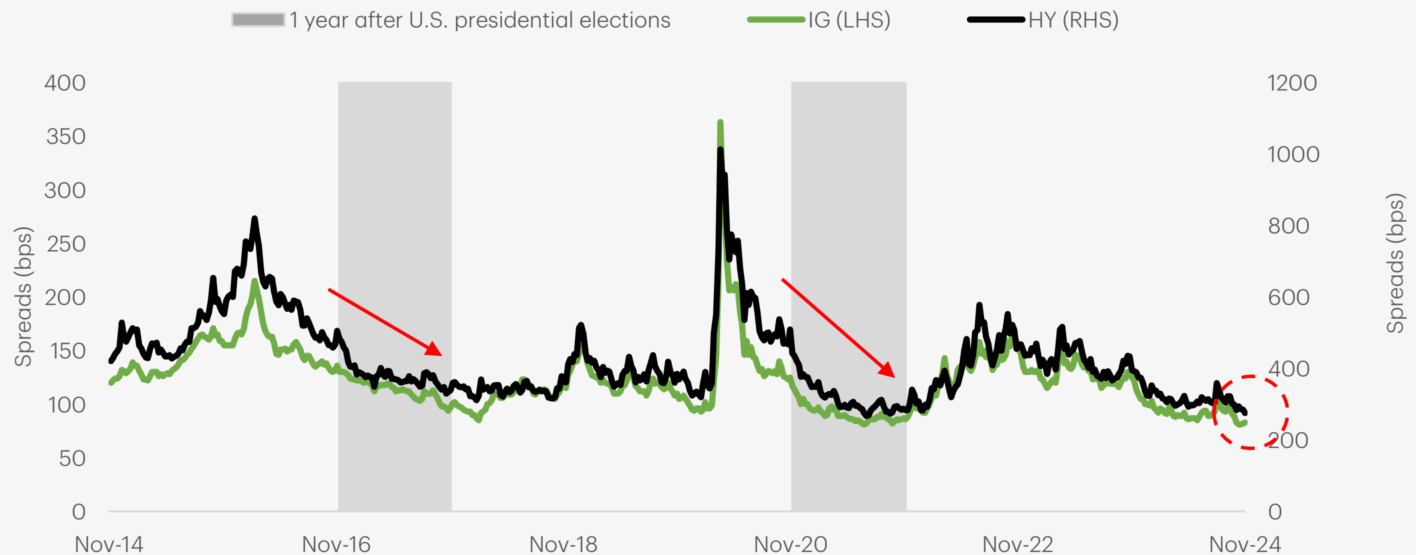
Source: FactSet and Wealth Investment Office as of November 5, 2024

As for credit markets, it seems highly unlikely for a credit rally to transpire due to historical expensive valuations and tight spreads (Figure 4).

We prefer short-dated Canadian IG bonds as they offer very attractive all-in yields with lower interest rate sensitivity and are expected to keep offering better forward excess returns than the longer maturity corporates.

What does this mean for equity markets?

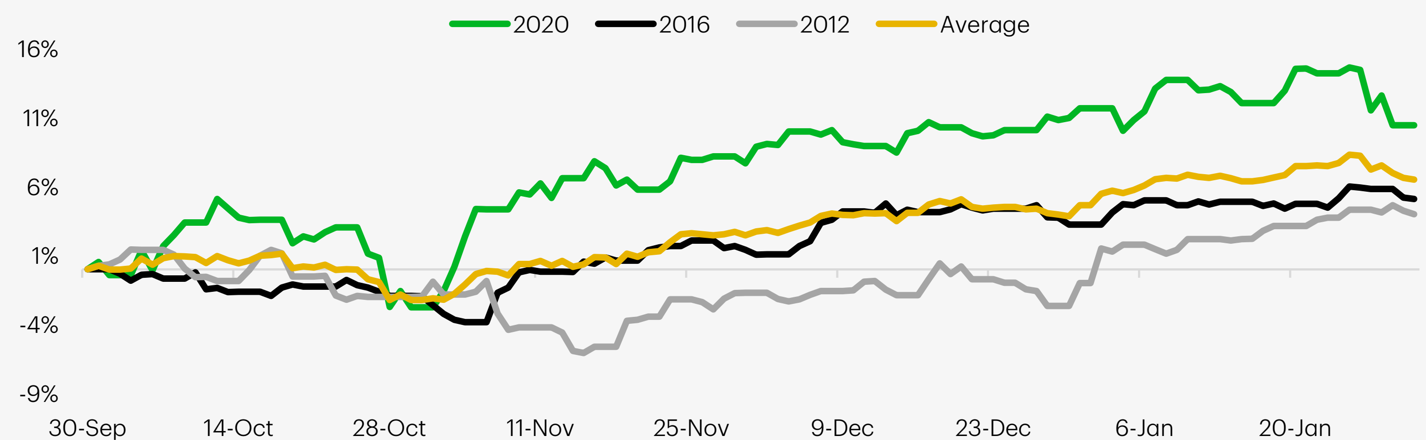
Figure 4: Historically tight spreads



Source: FactSet and Wealth Investment Office as of November 5, 2024

Overall, equity markets are expected to perform well into year end and into the new year. Seasonality is one tailwind that supports this view as corporate buybacks restart and portfolio managers position their books into year-end. Further, in the three presidential elections since the Global Financial Crisis in 2008 (GFC), we have also seen positive stock market direction following election day and into the new year (Figure 5).

Figure 5: S&P 500 October presidential year performance October - January since GFC

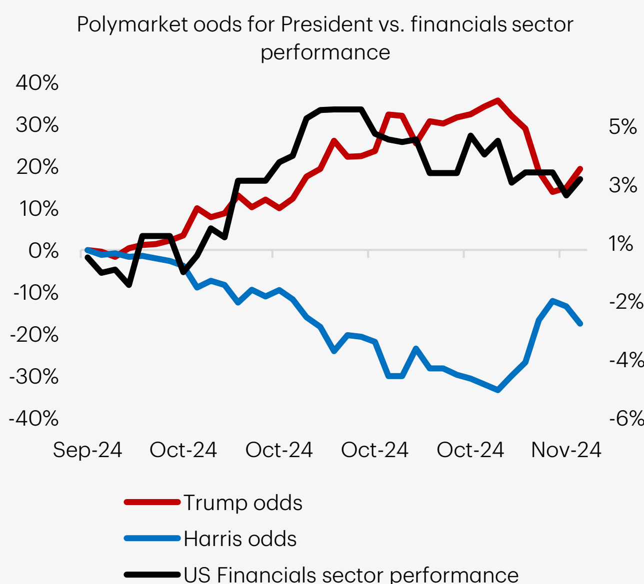


Source: FactSet and Wealth Investment Office as of November 5, 2024

As far as sectors, the market appears to have been pricing in a 'Trump Trade' in how financials stocks have traded in lock step with polymarket.com, which has tracked Trump's odds of victory. The implication being that if Trump is elected president he would favour deregulation for the banking industry and that could allow banks to free up capital and allow for higher leverage, higher returns on equity, and improved profitability, leading to higher valuations.

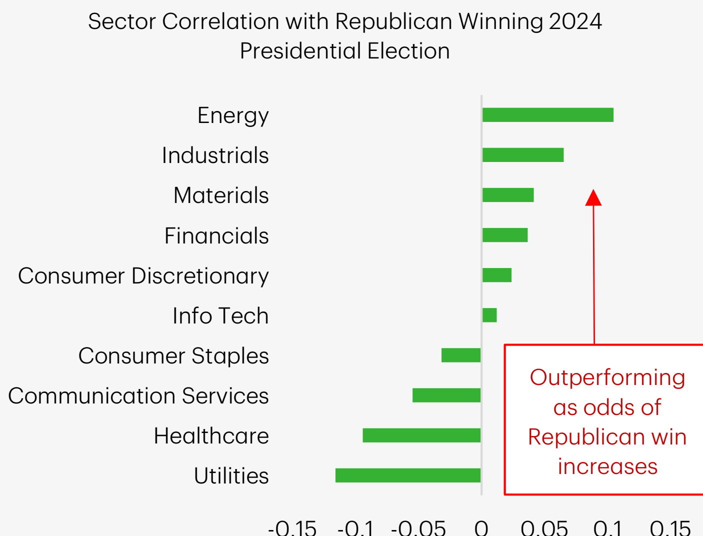
We continue to be overweight U.S. equities and prefer cyclical growth with a particular focus on the semiconductor space in the AI value chain as well as Industrials more broadly. Lastly, small caps will have their moment in the sun but higher rates will be a significant headwind for many companies, as such it is important to be selective in this segment. Figure 7 highlights the stakes by sector and the potential importance of future capital flows based on the Republican win.

Figure 6: 'Trump Trade' in financials stocks



Source: FactSet and Wealth Investment Office as of November 5, 2024

Figure 7: Sector Correlation to a Republican Win



Source: Macrobond and Wealth Investment Office as of November 5, 2024

What about other assets and global impact?

It goes without saying, with a Trump Presidency, tariffs, real or threatened, are a done deal. Trump has proposed a 10-20% tariff across the board. The first downstream impact is high inflation, which could be positive for commodities and the U.S. dollar. There will be a few ripple effects as well. Trump's foreign policy to shift away from the current U.S. allies could mean greater geopolitical risk, which is also positive for commodities and the U.S. dollar.

Without deflationary imports from around the world, supply chains will be rebuilt and the shift of onshoring and friendly shoring will continue. This would benefit both infrastructure and real estate, as investment required could be significant. With control of the Senate and the House, lower corporate and capital gains taxes could intensify this impact and benefit private sector investment in general.

The outcome of the U.S. election could also shift policy in other countries. One prime example is China. Coincidentally, China's congress session is going on during the election week. A Trump presidency likely means China will have to be less dependent on goods exports to the U.S. and focus on its domestic economy. This result could potentially be the last straw for the Chinese law makers to bring the inward looking and consumer focused policy forward. This week provides an important window of opportunities for such policies to be inked at the legislature.

For Japan this result is welcome indeed and will help its ongoing reflation policies. For Europe this is likely bad news with a potential U.S.10% tariff a big headwind to Eurozone company's earnings growth.

Where do we go from here?

I started this article with words of wisdom from Benjamin Graham. The importance of sentiment and short-term trading will fade away over time and, conversely, the importance of a well-managed portfolio will increase over time.

Our positioning and mandates are as follows:

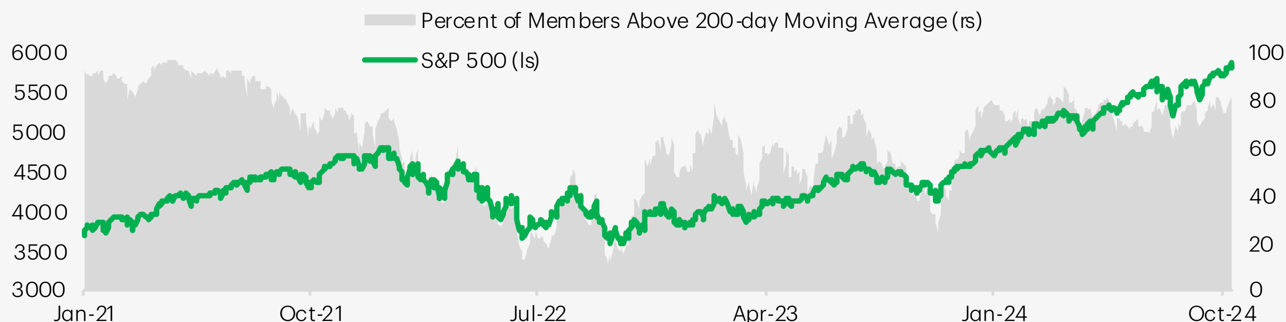
Fixed income (modest underweight):

With the start of the rate-cutting cycle firmly underway in Canada and the U.S., fixed income markets have delivered relatively attractive returns year-to-date. As such, we have shifted our fixed income position to modest underweight. We believe returns going forward will be closely aligned to current yields in the mid-single digits. At the same time, the risk of a more severe economic slowdown looks less and less likely, which may keep returns in the fixed income market more rangebound over the next 12 months. Overall, we believe bonds will continue to provide the benefits of diversification, reduce overall portfolio volatility and preserve capital. However, interest rate volatility will likely continue to be a factor in rates, which keeps us actively managing our fixed income exposure.

Equities (modest overweight):

In keeping with the downgrade to fixed income, we have upgraded equities to modest overweight as the risk of a more severe economic slowdown declines, providing greater confidence in the attractive earnings-growth outlook in the U.S. and Canada. While current valuations are fair to modestly elevated, we believe they are justified given this backdrop of positive economic growth and declining rates. If there's been a U-turn in equity markets, it's that leaders can now be found outside the Magnificent Seven. Contributing to our continued modest overweight position in the U.S. is the fact that breadth has been improving as this bull market extends, with shifts in leadership towards cyclical growth with a particular focus on the semiconductor space in the AI value chain as well as Industrials more broadly (Figure 8).

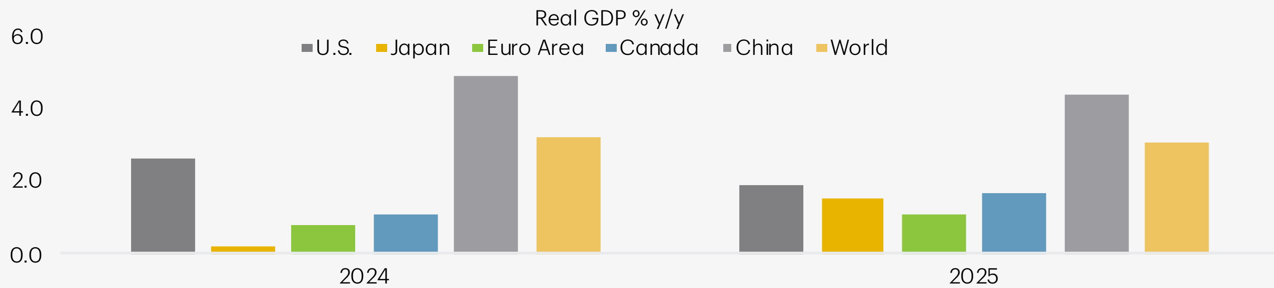
Figure 8: Equity market rally broadening, rotation in play



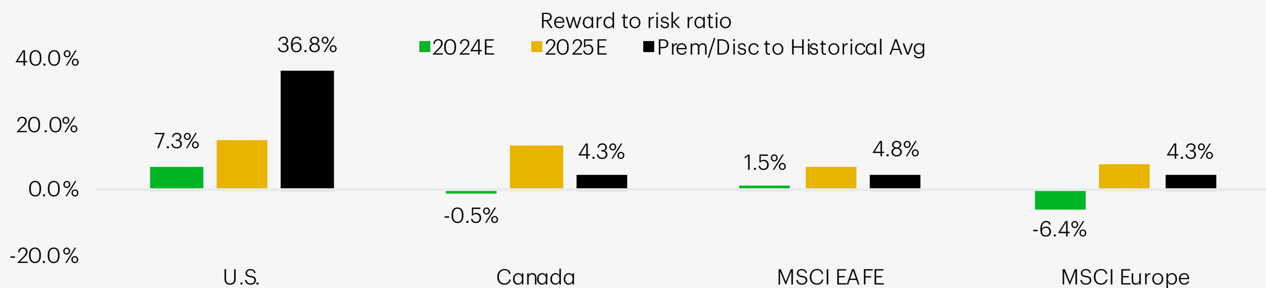
Source: FactSet and Wealth Investment Office as of October 16, 2024

Of the latter, we prefer to tilt towards companies that benefit from the Build Back Better Act, Inflation Reduction Act and The Chips Act, which is to say from infrastructure building as well as the near-shoring / reshoring of manufacturing. The Bank of Canada's significant rate cuts appear to be having the intended effect, with the economy showing signs of stabilizing. Canadian equities are attractive from a valuation perspective, which combined with an improving economic backdrop and attractive earnings outlook, warrant a modest overweight position in Canadian equities (Figure 9). In Canada, we are focusing on dividend growth companies in the Energy sector, and gold mining leaders within Materials. Elsewhere, we also favour Industrials with a focus on Engineering, Procurement and Construction companies and Insurance companies within the Financials sector.

Figure 9: Equity market rally broadening, rotation in play



* China CPI data is the IMF forecast. Source: TD Economics, IMF and WIO, as of September 2024



Source: FactSet and Wealth Investment Office as of October 18, 2024

While valuations remain attractive in international and emerging-market equities, we continue to maintain a modest underweight position given the elevated economic risks in many of those regions.

Alternatives (modest overweight):

We have also increased our overall alternatives allocation to modest overweight. As we noted last quarter, this is a diverse asset class where we are employing risk-mitigation strategies and sub-classes, such as market-neutral, long/short, private assets and commodities. Private-equity exposure offers attractive risk-adjusted returns, and an allocation here provides ballast in a portfolio. We have downgraded private credit to neutral. This largely reflects the tight spreads in many thinly-traded project finance bonds, such as those issued by public private partnerships (P3s), as well as securities privately placed among qualified institutional buyers under SEC Rule 144A or Regulation S. Many of these issues are at levels where we believe the reward for illiquidity risk is too low, (tighter spreads relative to risk-equivalent publicly-traded bonds). There are still many attractive opportunities in global private-credit in areas such as floating-rate, senior secured loans and direct lending. Our position in domestic real estate has moved to neutral given that there are pockets of unlisted real assets that offer secular growth tailwinds.

Commodities (modest overweight):

We live in a world where inflation is more volatile, where geopolitical competition is rising, and where energy transition is ongoing — that is, a world where commodities should fare well. At the same time, commodities provide strong diversification benefits to a portfolio, which is even more attractive in this ever-changing environment. Commodity returns tend to have low correlation to either stocks or bonds. The outlook for gold also remains attractive, supported by lower real rates, heightened geopolitical risk and central-bank buying.

Cash (modest underweight):

In order to facilitate the increased exposure to equities and alternatives, cash has been downgraded to modest underweight. In an environment where rates are declining, the outlook for equities and alternatives is much more attractive than cash.

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