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focus

US Election 2024:
Stars, Stripes and Stocks

As the US election nears, US political twists and turns will have an increased impact on certain stocks and sectors, and broader markets in general. Given the rapidly changing landscape (and we still have more than three months to go!) and broad range of policy uncertainties, it's understandable if investors feel a little confused and unsettled. It's important to remember, however, that while elections can create short-term market volatility, during these periods of heightened political focus markets typically tend to overemphasise the importance of politics on the market's performance over the long-term. Markets have done well under both Republican and Democrat leadership, including the last eight years under both Presidents Trump and Biden.

FORSYTH BARR

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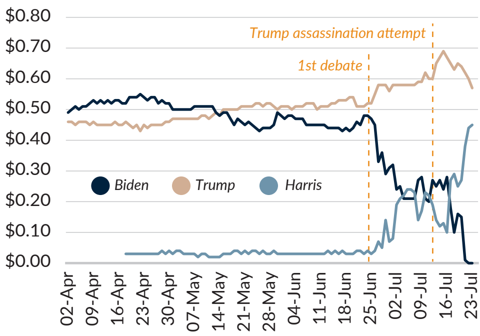
What a difference a month makes

The US election is still several months away but is already generating plenty of headlines. At the start of June, the two leading party nominees for the US presidential election, President Joe Biden (Democrat) and former President Donald Trump (Republican), were neck-and-neck in the polls. That all changed after the first candidate debate raised concerns about Biden's advancing age, and again after the attempted assassination of Donald Trump. Trump pulled sharply ahead in prediction markets and recent political polls. Facing insurmountable pressure from his party, Biden has withdrawn his candidacy.

Biden endorsed Vice President, Kamala Harris, as the new Democratic nominee for President, and she has seen wide-sweeping support from Democratic Party delegates. While she won't officially become the party candidate until pledges of support translate into votes – either at the Democratic National Convention starting on 19 August or alternatively via a virtual roll call anytime – she is widely expected to win the nomination.

While Biden's departure is seen as boosting the Democrats' chances somewhat, Trump still has a decent lead ahead of Harris in prediction markets. Early political polls are showing Harris and Trump are closely tied in popularity – although there's still plenty of water to go under the bridge until election day. Markets are giving serious consideration to what a second Trump presidency could mean for US corporates, and the US and global economies.

PREDICTION MARKET ODDS OF TRUMP, BIDEN AND KAMALA HARRIS FOR PRESIDENT FOLLOWING ELECTION 2024



Source: PredictIt, Forsyth Barr analysis (updated to 23 July 2024)

Key policies to watch

Five key areas to watch in this election that are important from an economic perspective include: trade protectionism, tax policy, fiscal policy, the independence of the Federal Reserve (Fed), and

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immigration.

Trade protectionism: Both sides of the political divide have been increasingly focused on protecting American industries, especially from Chinese imports. President Biden has already raised import tariffs on specific Chinese goods, such as steel and batteries. But Trump has historically been more aggressive than the Democrats on trade protectionism and has proposed a 60%, or higher, tariff on all goods imported from China, and a 10% tariff on all goods imported from other countries (which would include New Zealand).

However, it's plausible that Trump could scale back the extent of tariffs he implements if elected – as we saw following the 2016 election, when the actual tariffs implemented were smaller and more targeted than Trump had originally threatened. But growing protectionism (even in smaller doses) could spark retaliatory trade policies from other countries, which is likely to dampen global trade and therefore reduce economic growth.

Taxes: Trump's 2017 Tax Cuts and Jobs Act reduced the corporate tax rate from 35% to 21% and lowered personal tax rates across the board until 2025. Trump has implied that he will, at the very least, extend the 21% corporate tax rate, and more recently said he wants to lower it to 15%. He would also make the 2017 personal tax cuts permanent. Lower corporate taxes would, all else equal, boost corporate earnings and provide a tailwind for American companies.

Biden's proposals included increasing the corporate tax rate back up to 28% and addressing tax avoidance by multinational corporations. He had pledged to extend personal tax cuts for those earning under US$400,000 p.a., but to let them expire for higher earners. Harris is expected to stick to relatively similar tax policies as Biden.

Fiscal policy: In the background to policy debates and poll headlines, the issue of the high, and rising, US fiscal debt remains an underlying concern. US government debt levels have been in focus recently, due to the rising cost of interest payments on US borrowing – which are now approaching the level of the US's total defence spending or Medicare costs. This is partly because interest rates in the US have risen from ultra-low to normal levels in the last couple of years, and partly because the US borrowed heavily during the pandemic to fund economic stimulus. The US fiscal deficit is expected to rise to US$1.9 trillion this year, and grow to the equivalent of 6.9% of GDP in 2034, almost double the deficit average over the past fifty years, and well above the 3% regarded as prudent in normal economic times. Neither side has put forward a firm plan on how they would manage the deficit back down. Both parties are expected to continue to run sizeable deficits, although their spending ability could be

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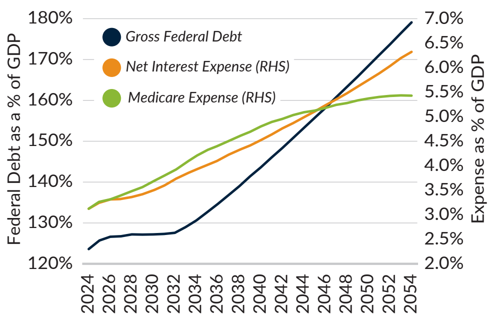
hampered if different parties hold the majority in the two chambers of Congress.

US GROSS FEDERAL DEBT, NET INTEREST EXPENSE AND MEDICARE EXPENSE FORECASTS (% OF GDP)



Source: Congressional Budget Office, Forsyth Barr analysis

Federal Reserve independence: Trump's disapproval of the Fed and its current Chair Jerome Powell (whom he appointed to the role when he was President) have been notable. While Trump has said he will tolerate Powell seeing out his current term (which ends in May 2026), Trump has warned Powell not to start cutting interest rates before the election – for fear that could boost sentiment and give the Democrats an advantage. Markets are pricing the Fed will start cutting rates at its September meeting, ahead of November's election. The Fed is supposed to be politically neutral. Any meaningful political threat to the Fed's independence could result in significant market alarm and potential volatility.

Immigration policy: Both Trump and Biden have prioritised immigration reform but the focus on how to tackle the issues are very different. Trump supports stricter border control and more deportations. Biden had emphasised creating pathways to residency and overall immigration reform. Harris has historically been a strong advocate for protecting rights of immigrant children and ensuring pathways to residency for undocumented migrants. Immigration has helped alleviate labour shortages in the US, and businesses are concerned that overly strict policies could lead to staff shortages and increased wage costs. However, many voters, especially in southern states with high border crossings, see immigration as a major issue.

Trump 2.0 – higher inflation, higher tariffs, higher interest rates

Overall, Trump's proposed lower corporate tax rate is seen by the market as more friendly for US companies, and he is also expected to decrease regulation which could further support US firms. However, Trump's focus on greater trade protectionism and proposed immigration policies could increase inflation and hinder US and global growth. Protectionist policies are also likely to hurt international firms (especially those in China) who currently export to the US.

Trump's policies are widely viewed as inflationary and, if implemented as proposed, could see higher interest rates relative to where they otherwise may have been, which would be negative for US bond prices. Fiscal restraint is expected to be absent regardless of who is in the White House, and debt is likely to increase further under both sides. While Harris still needs to be confirmed as the new Democratic candidate, the general expectation is that she won't dramatically change the broad direction of Biden's campaign policies.

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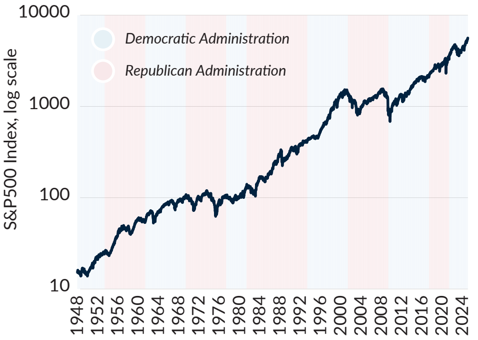
However, the election isn't just about who will be President, almost as important is which party wins control of the House of Representatives and the Senate. A united government will make it significantly easier for whoever is President to realise their policies; conversely a split house will be a barrier. Given how much can still change between what the candidates are promising now, and when the ink dries on new laws and executive orders, investors should be wary of betting on the impact of current policy proposals.

Market fundamentals are what matters most

Historically, financial markets have tended to be more driven by economic fundamentals rather than who is in power or their specific policies. Industry and company-specific factors also contribute significantly to investment returns, such as company competitiveness, investment, innovation, product demand, management and earnings. Despite generating a bit of volatility along the way, stocks have historically done well in election years, regardless of the outcome.

S&P500 INDEX PERFORMANCE (LOGARITHMIC SCALE)



Source: Bloomberg, Forsyth Barr analysis

As the election date nears, maintaining a diversified and well-managed investment portfolio will be key to weathering short-term political and economic uncertainties, and market volatility. Given the numerous uncertainties present, investors should concentrate on their long-term investment goals and leave political bets where they belong – as more of a side flutter.

If at any time you want to discuss investment options and opportunities, your Forsyth Barr Investment Adviser is available to provide you advice and assistance.

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