FIDELIS CAPITAL

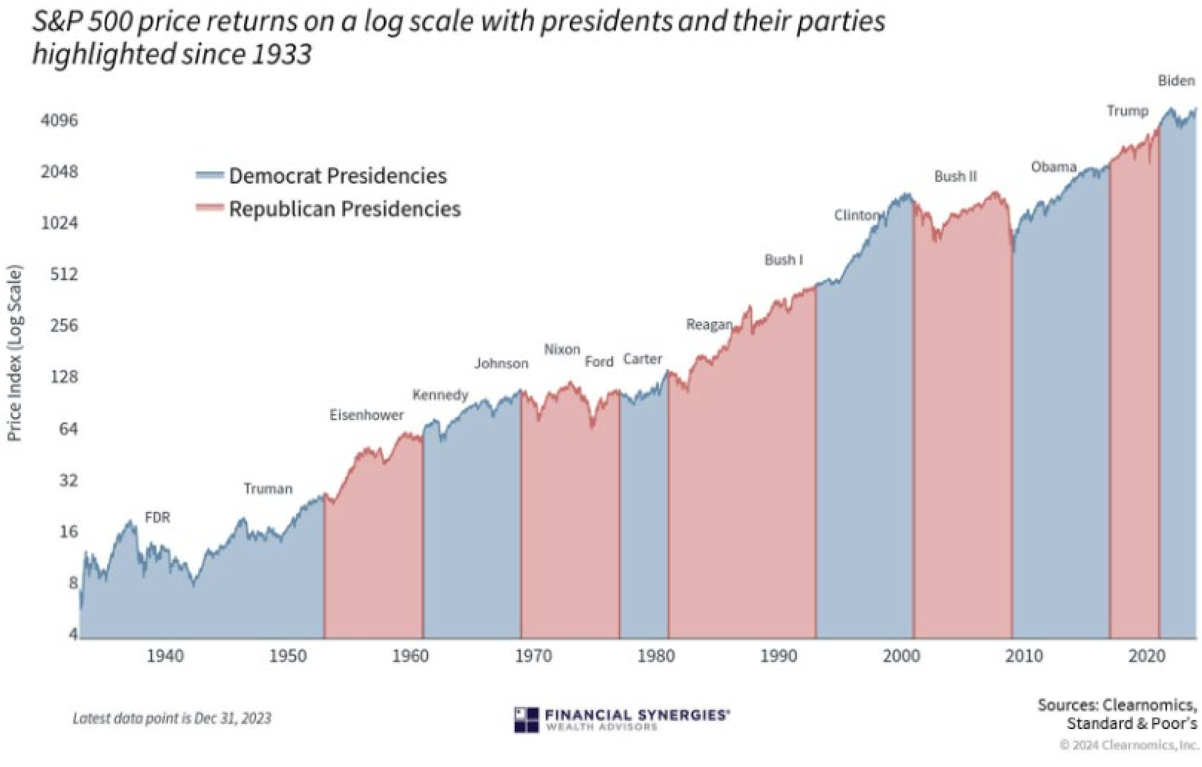
Trump's Second Term: What It Means For Markets

As President-elect Donald Trump prepares for his second term in Washington, he returns with a Republican majority in the Senate and a narrow Republican majority in the House.

The "red sweep" carries potentially significant policy and portfolio implications. However, before diving into our commentary, it is important to step back from election noise and review this outcome on a historical basis.

The Stock Market and Presidencies

The chart below captures S&P 500 price returns since 1933, with blue sections representing Democratic presidencies and red sections representing Republican presidencies. This chart does a good job of visually representing our main takeaway: Historically, regardless of which political party is in the White House, the market performs well.



Domestic Economic Policy

In recent days, the new Trump administration has focused on four main areas of economic policy: tax reduction, deregulation, tariffs and immigration. We see inflationary impulses in three of the four areas.

In an inflationary environment, we would expect the Fed to have a hard time bringing rates down. And while we believe rates are coming down, it may happen more slowly than people expect, which implies higher debt servicing costs for longer. It also implies terminal yields potentially higher than what is currently forecasted. The market has forecasted a cut in rates, but we think this may reduce those expectations.

1 Tax Reduction

Trump's campaign ran on a platform of tax reductions for both individuals and corporations. It is expected that the new administration will pursue an extension of the 2017 Tax Cuts and Jobs Act. Details on how to accomplish this without major reductions to spending, however, are still outstanding. Unless there are off-setting spending reductions in the budget, we would expect a reduction in taxes to increase the national deficit and subsequent Treasury issuance. While inflationary, tax reduction should support economic growth.

2 Deregulation

Deregulation should be positive for the U.S. economy, and in some ways, it may help smaller companies relative to larger corporations. This is because compliance at smaller companies generally requires a higher proportion of cost per employee as regulations are marginally more expensive for smaller companies.

3 Tariffs

Tariffs are generally inflationary but could boost domestic investment, especially in manufacturing and infrastructure. Almost by definition, tariffs make international goods less competitive, which implies maintaining a "home country" bias for U.S. investors.

4 Immigration

Trump campaigned heavily on the basis of reducing illegal immigration. This is likely inflationary as it would reduce the size of the workforce and put an upward pressure on wages. Technological advancements such as AI may offset this by increasing productivity in some sectors.

Global Economic Impact: Inflation

While inflation has been coming down, making further progress may become more difficult due to the nature of the policies above. Potential impacts include:

- Diminished rate cut expectations for the Federal Reserve and other central banks.
- Long-term yields trending higher, which increases borrowing costs for municipalities, corporations and home buyers.
- Stronger U.S. dollar against most currencies with some exceptions.

Portfolio and Planning Considerations

With the above in mind, we are considering the following when it comes to maintaining or changing portfolio allocations.

Equities

- Maintaining quality bias across asset classes is helpful in a high-rate environment, where we think higher-quality companies are more resilient.
    - A persistently higher debt cost will disproportionately affect companies with poor free cash flow. Therefore, a quality bias is appropriate, especially in the small-cap space.
- Technology, Financials and Energy are potential beneficiaries of proposed policies, while Healthcare and clean energy may face headwinds.
- Expect volatility, especially in the bond market, as the Fed's job to control inflation and support full employment may skew back to an inflation bias.
- Tariffs can create headwinds for international investments.
- Given Trump's rhetoric around China, combined with its current economic malaise, we prefer emerging market exposure with an underweight to China.

Fixed Income

- We will likely position portfolios to take advantage of a rising interest rate environment as we move through the new year.
- We will maintain high quality bias as increased debt issuance, specifically in high yield and lower quality, will weigh on markets.
- Any reduction in taxes will marginally reduce demand for municipal bonds. We do not believe the municipal tax exemption is at risk.
- An increase in volatility will negatively impact the mortgage-backed market.
- The increase in mergers and acquisitions activity will benefit equity valuations at the cost of increased debt issuance as M&A activity is typically financed through debt.

Final Thoughts

As we have emphasized throughout this election cycle, avoid letting politics interfere with your long-term goals and objectives. Legislative changes that could impact wealth, estate planning and markets are expected. It is important to remain focused on your long-term goals and objectives.

We are monitoring and reviewing the new administration's announcements and potential policies as information becomes available. If you have any questions, please do not hesitate to reach out to your Fidelis team.

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