Ask Forstrong
Will The Trump Risk-On Trade Last?

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Key Takeaways

- Elections matter but economies move more slowly than politics.
- In America, the main takeaway from Trump's victory signals more of the same: higher government spending. Outside the US, the rest of the world is better prepared for Trump 2.0 and will follow through with their own fiscal stimulus.
- Markets are still underestimating the strength of the global growth environment. Broadly this means higher equity prices with risks skewed toward higher inflation and higher bond yields.

Ask Forstrong: What do US election results mean for markets?

Well that was exhausting. But America has spoken: Donald Trump will cruise his way back into the White House, winning the popular vote, the electoral college and gaining ground on the Democrats in 48 of the 50 states in the union. Many who dismissed his 2016 victory as an aberrant moment in American history have some soul-searching to do. Trump, this time, was not only a known nominee but also a highly studied one. The people voted him back in with eyes wide open.

Financial markets, unsurprisingly, have been scrambling to re-price risk. And, on the surface, why not? Trump's return, now accompanied by a compliant Congress, could be an enormous boon for risk assets, which thrive on everything the incoming president promises to supply: tax cuts and large-scale spending while declawing hawkish regulators and even jawboning Fed Chairman Jay Powell to keep rates lower than they otherwise should be. Then toss in Trump's remarkable stamina to stoke animal spirits — a striking contrast to his visibly ailing predecessor (and especially impressive for a 78-year old Big Mac aficionado) — and markets can hardly contain themselves.

But hold on: much of this reaction is knee-jerk. Politics are often over-emphasized in investing. Every election season, Wall Street spends weeks crafting lists of winning and losing sectors based on potential presidential outcomes. Yet here's a splash of cold water in the face of those forecasts: historical asset class returns show no correlation to the President's party affiliation. Obama and Trump could not be more different, yet the best and worst performing sectors were the same under both (tech and consumer discretionary led, while energy lagged). Stocks performed best under a mix of administrations — Reagan (Republican), Clinton (Democrat), Obama (Democrat), and Trump (Republican). Gold, meanwhile, thrived under both Carter (Democrat) and George W. Bush (Republican). There is simply no consistent performance pattern based on whether the President is a Democrat or Republican.

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What Matters?

The reality is that politics are rarely the primary driver for financial markets. Yes, policies matter, and Trump's return will shape the world in notable ways, especially in geopolitics and foreign policy. He could bring significant change in three key areas: seeking a peace deal in Ukraine, pushing for regime change in Iran, and reducing tensions with China — potentially through a "grand bargain".

But economies move more slowly than politics. Macro trends already in place are often difficult to dislodge through policy alone. Looking ahead, what truly matters for investors? In many ways, Trump's victory feels like a pivot point. But in many ways it is not. Trump may have left office in 2021 but his ideas actually stuck around. Trump reshaped consensus on a major issue — trade — to the point where the next administration couldn't, or didn't want to, reverse course. Biden inherited this stance and built on it, leading to the tariffs and subsidies of Bidenomics. The rest of the Western world also followed suit, fueling the rise of protectionism.

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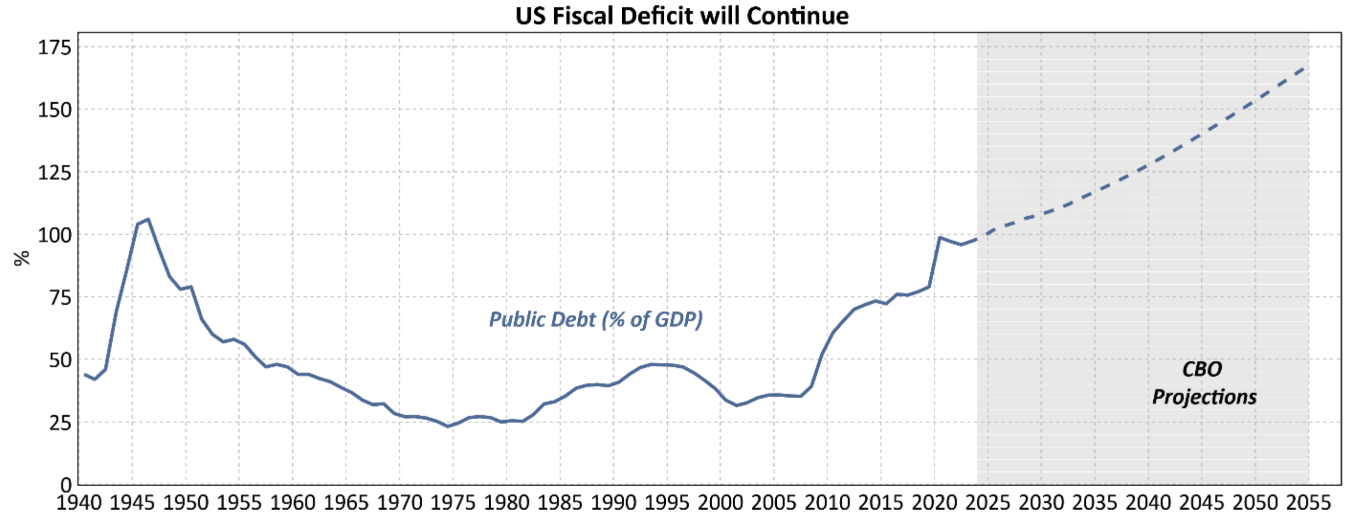
Even more consequentially, Trump shifted public opinion on deficits. His enthusiasm for government spending in response to the pandemic set a precedent that the Biden administration continued. Public indifference to the growing US debt is clear — during campaigning season there was zero political debate on the issue. Today, US net public debt stands at 99% of GDP, on track to surpass the World War II peak of 106% within a few years. Whether we recognize it or not, we've all been living in Trump's world for the past four years.



Sources: Macrobond, Congressional Budget Office (CBO), Forstrong Global Asset Management

What matters for markets here is twofold. First, there is a strong linkage between deficits and corporate profits. Higher deficits equal higher profits. Secondly, fiscal deterioration is inevitable. That means US Treasury bond yields will not return to the low levels of the 2010s.

What about implications for the rest of the world? Trump now tells us that "tariff" is the most beautiful word in the English language. Elsewhere, fragmentation has been the favourite buzzword as the plumbing that underpins global trade — the networks carrying cargo, commodities and information — increasingly becomes politicized. A renewed Trump trade war would inflict even greater damage on international trade.

However, the world outside of America is a far different place than it was in 2018, when Trump started his trade wars. Back then, most countries were caught off guard and uncertain of how to respond. Since then, many have taken strategic steps to build resilience. Some of this includes their own tariffs and controls on critical exports. Some of it includes building alternative trade pathways that bypass the world's largest economy. Defying the growing geopolitical turbulence in the system, global goods trade has fully recovered from the Covid shock and is hitting new highs, while cross-border data flows and services remain robust. That resilience can be attributed to two factors: the adaptability of multinational companies and the emergence of so-called "connector countries" that have chosen to remain politically neutral.

But much of the increased resilience is due to other nations doubling down on their own domestic capacities. China, for example, has made significant strides in achieving its technological development goals over the past five years. With Trump's renewed tariff threats, we can expect other nations to further intensify their efforts toward domestic resilience. This shift likely means more fiscal stimulus, increased support for local companies, and a strengthened focus on expanding industrial capacity.

As in the US, these measures will be bullish for corporate profits over the near-term, as governments prioritize local industries and strategically foster self-reliance. The world is entering an era of "competitive economics," where countries will increasingly race to bolster their own economies, viewing resilience as a competitive edge. This dynamic will redefine global trade patterns and prompt a wave of investment in domestic industries across key sectors.

Investment Implications

Just a few months ago, markets were firmly positioned for downside risks in both growth and inflation. That view has already proven wrong — and it's likely to stay that way, as recession fears are vastly overstated. The case for this more constructive outlook continues to build on several fronts: the lagged effects of monetary tightening are largely behind us, real incomes are still rising, and now, Trump's administration, along with much of the rest of the world, is primed to ramp up government spending.

Conversely, all the risks point to renewed inflationary pressures and higher yields. But that comes later. At this point, investors should not overcomplicate the setup. The global economic backdrop is bullish and continues a longstanding Forstrong theme: markets are under-pricing the growth environment.

While the initial knee-jerk reaction has been to bid up speculative assets tied to the new administration—such as Bitcoin or already-overvalued tech stocks (Tesla's market cap, for instance, now doubles that of the entire global auto industry)—this trend isn't likely to last. Instead, cyclically geared asset classes like banks and commodity-oriented equities are set for a long period of outperformance. Our actively managed, globally focused ETFs provide targeted exposure to the asset classes best positioned to capitalize in this environment.

Tyler Mordy, November 2024

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