Red Sweep: Trump the Sequel

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It was a sweep. While Kamala Harris had been gaining in some polls in the last week, the U.S. chose to give Donald Trump a second term. Republicans now control the Presidency as well as the U.S. Senate, while leading in House seats. The policy implications are profound. This opens the door to a host of Trump/Republican policies to be enacted both domestically and internationally.

From a market perspective, promises of corporate tax cuts will likely be positive for stocks. A back-of-the-envelope calculation shows about a five percent increase in S&P 500 earnings per share from Trump's proposal to cut corporate taxes from 21% to 15% for companies that produce goods in the United States. Additionally, the prospect of less regulation and potentially more lax antitrust merger enforcement is contributing to the risk-on mood. Some of this was already priced in but net-net a few points of upside will still be gained.

Of course, tax cuts add to a nation's deficit. While neither Democrats nor Republicans have been fiscally disciplined over the last few decades, Trump's plans would further increase the already high six percent deficit-to-GDP ratio for the world's largest economy. John Maynard Keynes, one the 20th century's greatest economists, would surely not award them a gold star for increasing the nation's debt in a time of economic expansion.

In part to offset this impact and replenish the U.S. Treasury's coffers, Trump has said he would impose a 10% or 20% tariff on all imports across the board and a specifically high China rate between 60% and 100%. The U.S. National Retail Federation warned that double-digit price increases would happen for several imported consumer goods like toys and clothing. In the end, tariffs are nothing more than an indirect tax on consumers, which additionally serve to lower economic growth. The impact is exacerbated if they engender a tit-for-tat trade war. This is almost certain to ensue as the European Union has already warned.

From a Canadian perspective, Trump's promise to "rip up" the United Sates-Mexico-Canada Agreement ("USMCA"), the successor to the North American Free Trade Agreement ("NAFTA"), when it expires in 2026 will add risk to our very trade-dependent economy. That being said, the first Trump term only resulted in cosmetic changes to the continental free trade agreement. So, one can hope the result will be similar this time around. But hope is not an investment strategy. In the end, this result could further pressure the beleaguered loonie and could hurt some of our most export-dependent industries. On the flip side, the S&P/TSX remains very undervalued in our view and many of our large public companies have shown an ability to prosper through different political and economic regimes.

Bond "vigilantes" have already started pricing in the deficit and inflationary aspects of the winner's policy proposals and mid- to long-term interest rates have moved up significantly in step. While still early, this may reduce the flexibility of the Federal Reserve to normalize its policy rate.

The bottom line is that the new political order in the U.S. adds clear uncertainty to Ukraine, global alliances, and trading partnerships. The silver lining, however, is that the North American economy is still far from recession and household wealth both in Canada and the U.S. sits at record highs. Our team has identified many high-quality stocks and bonds which can weather volatility and lead to outsized gains for patient long-term investors.

As always please contact your BMO Private Wealth professional if you have any questions, and to discuss your portfolio and specific security recommendations.