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POLLS APART

Navigating America's divisive election

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FOREWORD

Elections challenge investors' ability to maintain a calm, dispassionate view like nothing else, and nowhere exemplifies this better than America when it chooses its president. As Donald Trump prepares to take on Kamala Harris, our task is to cut through the emotive and partisan debates that dominate the headlines and focus on why it matters to the markets and therefore to you as investors.

Since Trump's election in 2016 and the pandemic and war in Ukraine that followed, both Republicans and Democrats have broken decisively from the 'neoliberal' economic consensus – favouring free markets and limited state intervention – that had prevailed for decades previously. Both have embraced positions which are more protectionist (especially with respect to China), more tolerant of large fiscal deficits, and more accepting of the state playing an active role in directing investment. These broad features of the investing landscape look like they are here to stay whatever the election result. Yet the two parties agree on little beyond these general principles. This is no new consensus.

We've scrutinised the parties' policy offerings, the constraints they may face in enacting them, and assessed what the implications would be for economic growth, inflation and financial markets. On the contents page you can find links to all the policy areas covered in this report, so there's no need to read every section if you're short of time.

Uncertainty is high as we wait for America to go to the polls, but we hope we can provide some helpful insights and some reassurance that – at least when it comes to your investments – this election isn't everything.

Visit our online Election Hub to see what the latest polls are saying, and for more details about policy proposals as well as areas not covered in this report at www.rathbones.com/rathbones-election-hub-financial-insights-2024-elections

MIND THE POLICY GAP

As we head into what is perhaps the most uncertain US election in living memory, Republicans and Democrats are poles apart on significant areas of policy. These include corporate tax, energy policy, immigration and much more. That's a key reason why this election looks more consequential for investors than the typical contests of the past few decades. The gap between the parties' offerings has grown, and the breakdown of the previous economic consensus has expanded the options they're willing to consider in implementing their plans.

At the highest level, former President Donald Trump's proposals appear more inflationary than those of his rival, Democratic Vice President Kamala Harris. The government's budget deficit would probably be larger than otherwise given Trump's tax plans. Labour supply would be restricted as his 'America First' agenda restricts immigration.

At the highest level, former President Donald Trump's proposals appear more inflationary than the alternative of his rival, Democratic Vice President Kamala Harris

Much more aggressive action on trade is possible, even if his proposed 'universal tariff' isn't implemented in full. Trump's suggestions on the dollar and the makeup of the Federal Reserve (Fed) would also add to inflation risks, but they are likely to prove hardest to implement. This inflation risk is another reason why this election matters, given the context of how strong price pressures have been recently. It is also a risk to US government bonds, which we'll comment more on later.

Otherwise, Trump's platform contains a very significant positive offset for the US stock market in the form of corporate tax cuts. He's also proposing deregulation for certain sectors, though the effects of these proposals on stocks are more ambiguous and probably smaller. However, the risks to equities *outside* the US, which generally won't benefit from these changes, appear greater. They may be more vulnerable to Trump's proposed changes on the trade front.

Uncertainty runs through it

A key thread running through our analysis is the immense uncertainty which still surrounds the election. Given the likelihood that a Harris victory would largely maintain the status quo, this report will focus mainly on what a Trump presidency could mean for your investments.

We should not forget the bigger picture either — the trends in the global economy and markets beyond the direct control of any individual politician. The election isn't everything.

First, there's uncertainty about the result. Harris was the favourite at the time of writing, but only just. Her average lead in the polls is much smaller than Biden's lead in 2020. It's smaller than Hilary Clinton's was in 2016 too. The contests for the House and Senate are extremely close too, and may not go the same way. The results there will have a huge bearing on what the new president is able to implement.

Second, even once the result is clear, there are more question marks than usual about how campaign-trail rhetoric will translate into policy. In areas like trade, it can be hard to distinguish negotiating ploys from genuine policy proposals. This makes it hard to gauge investors' response to the result, particularly as their preference between the parties is likely to vary from issue to issue.

It's vital that we're aware of the risks, which we spell out below. But we must also be realistic about our ability to foresee precisely what will happen. As always when it comes to elections, we should not forget the bigger picture either – the trends in the global economy and markets beyond the direct control of any individual politician. The election isn't everything. All of this suggests we should take care not to premise our portfolios too heavily on any single election outcome.

What the polls say

The situation in the US is nothing like the recent UK election, where Labour maintained a huge polling lead throughout the campaign. The polls are extremely tight, and the lead has changed hands. There's also a significant chance that the winner of the presidential race fails to take both the Senate and House with them, limiting their ability to enact their agenda.

Prediction and betting markets had moved in Trump's favour after Biden's struggles in the first debate, and again after the attempted assassination of Trump. But they have swung back since Biden dropped out, leaving Kamala Harris his presumptive replacement. You can find out what the latest polls are saying in a dedicated section of our Election Hub at www.rathbones.com/rathbones-election-hub-financial-insights-2024-elections

Room for manoeuvre

A big caveat is needed here: the polls are far from conclusive given their tendency to move as election day approaches, and their typical margin of error. In post Second World War elections, the average state poll has shifted by more than eight percentage points (pp) in the four months before the vote, more than enough to wipe out either candidate's advantages in key 'battleground' states – where party allegiances are evenly divided.

Harris replacing Biden arguably adds to the possibility of the polls moving (in either direction) this time around, as voters become more familiar with the new candidate. The polls themselves are far from perfect. Differences of more than 2pp between the final polls and election result are routine.

In the following sections, we explore the key policy areas with the potential to have consequences for your investments.

Harris replacing Biden arguably adds to the possibility of the polls moving (in either direction) this time around, as voters become more familiar with the new candidate

CORPORATE TAX

Republicans and Democrats have directly opposite proposals in this area, with the former considering cuts and the latter favouring increases. In isolation, the Republican plan is likely to be much better received by the stock market, given its potential direct positive impact on post-tax corporate earnings.

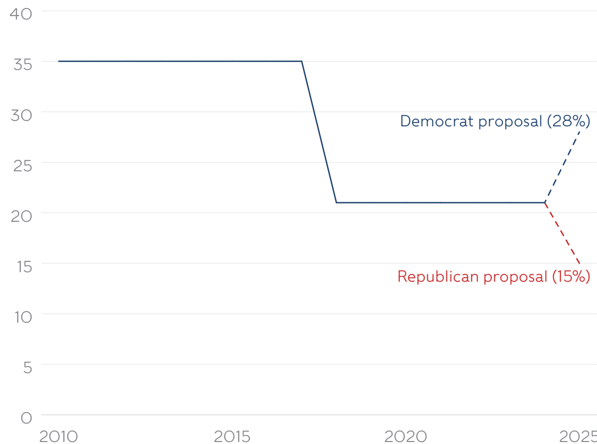
For context, one of the flagship pieces of legislation during Trump's term as president was the 2017 Tax Cuts and Jobs Act (TCJA). The act made sweeping changes to the tax system, including a reduction in the headline rate of corporate tax, from 35% to 21%. The TCJA is due to expire at the end of 2025, so a decision needs to be made about what happens next. The Trump campaign has proposed not only making the TCJA tax cut measures permanent, but going a step further with a reduction to just 15%.

In contrast, Democrats have been highly critical of the TCJA, arguing that it disproportionately benefited wealthy individuals and corporations at the expense of the middle class. They have proposed a partial roll back of the corporate tax cut, raising the headline rate from 21% to 28% along with increases to various other minimum corporate tax rates. Figure 1 shows the diverging future paths of the respective tax policies.

Figure 1: US corporate tax rate (%)

Company earnings are likely to rise under the Republicans and fall under the Democrats as a result of their tax policies.

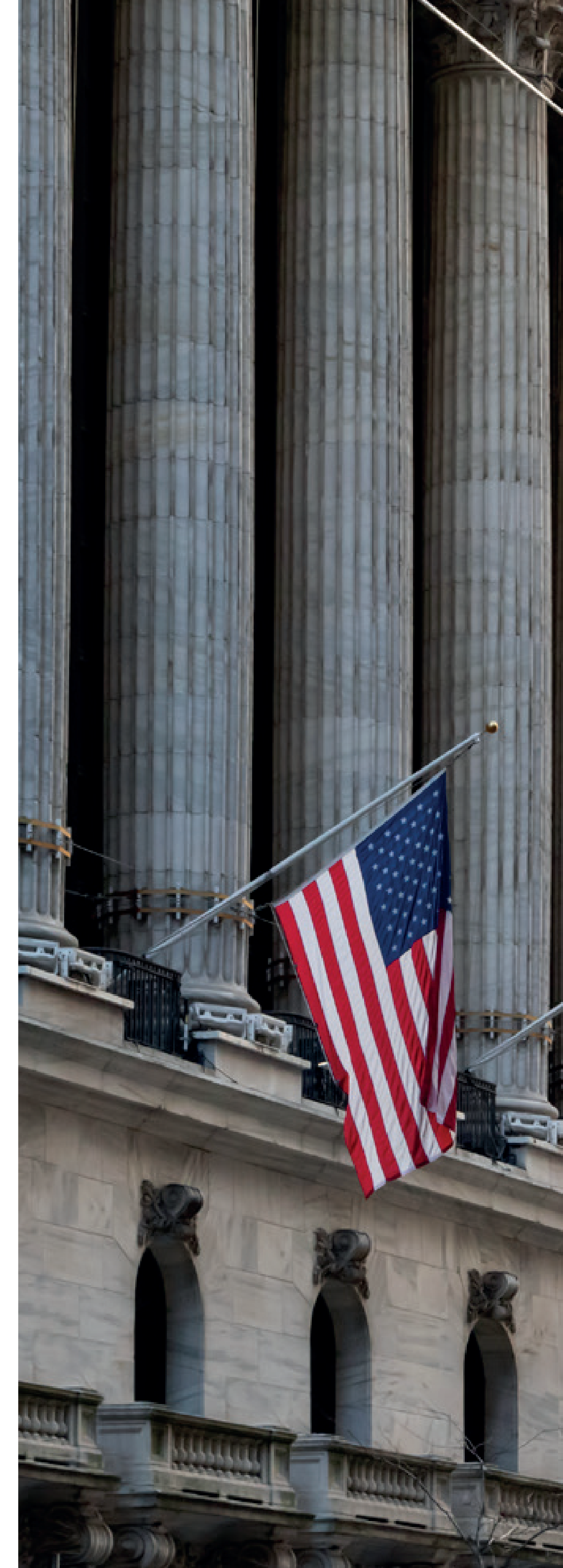
Source: LSEG, Rathbones; as at end August 2024



We estimate that the Republican proposal would increase annual post-tax earnings by 8% for a company paying the headline rate of corporate tax, while the Democrats' proposal would *reduce* post-tax profits by about 9%. Given the long-term growth rate of earnings is 7% in the US, that's more than a full year's worth of typical growth in either direction.

Investment implications of Trump's proposed tax cuts

- Could be positive for US stocks, initially providing a stimulus.
- Could be positive for growth, though the long-term impact would be more uncertain.
- Would widen the deficit.
- Negative for US government bonds, raising borrowing costs for consumers and businesses.



GEOPOLITICS

In our 2024 report *Peace of Mind in a Dangerous World** we emphasised the inherent unpredictability of the largest geopolitical shocks. They're influenced by factors beyond the direct control of any US President, including decisions taken in Moscow, Tehran and Beijing.

Trump and his running mate JD Vance have implied that they would support a ceasefire in Ukraine involving it ceding territory to Russia, a non-starter under the Democrats. And they have regularly criticised the level of support the US provides to Ukraine and to NATO. However, Trump has taken a much more confrontational line in the Middle East.

He has consistently expressed full-throated support for Israel (a particular contrast to Harris, who has been more forthright than Biden in calling for a ceasefire in Gaza). In 2017, Trump controversially moved the US embassy from Tel Aviv to Jerusalem, breaking with decades of US policy. The following year, he withdrew the US from the Joint Comprehensive Plan of Action (JCPOA), also known as the Iran nuclear deal. The US subsequently reimposed sanctions on Iran. Since then, Iran has ignored restrictions on its nuclear program and accelerated its enrichment of uranium.

This has arguably added to the risks of a major regional conflict – one of the key risks flagged in *Peace of Mind in a Dangerous World* – given Israel's red lines on Iran's nuclear development. Relations between the US and Iran deteriorated even further after Trump authorised the assassination of a senior Iranian general, Qasem Soleimani, in 2020.

There's a school of thought that Trump's dovish stance on Russia could materially reduce geopolitical risk globally, but we are sceptical. Defence spending could also rise under a Trump presidency for structural reasons. The first is necessity. Defence spending has been in decline for decades, and looks unsustainably low in light of recent events. The other main reason is that the dovish views of Trump and his running mate Vance are not the consensus in the Republican party.

Investment implications of Trump's foreign policy

- Risk of a geopolitical shock isn't any lower under Trump, despite his dovish stance on Russia.
- Such shocks are driven mainly by things out of the President's direct control.
- Defence spending could rise to address a long-term decline, as most Republicans would favour.

*rathbones.com/peace-mind-dangerous-world

TRADE POLICY AND CHINA

The US trade war with China, which began under the Trump administration in 2018, is likely to continue regardless of the election result. Both parties now view China as a strategic rival which doesn't play by the rules on trade. The Biden administration has generally maintained the China-related trade measures imposed under Trump, has added more of its own, and has imposed additional restrictions on investment. However, there is still a gulf between the parties' proposals.

While the trade war to date has focused mainly on strategic goods and on China specifically, Trump has proposed going a lot further. He has talked about imposing a 'universal tariff' of 60% on *all* Chinese imports and of 10% on all imports from the rest of the world. While that seems unlikely to be implemented in full, the threat of higher tariffs is another reason to think that victory for Trump would add to inflation risk. It's also a risk to US and global equities, especially those listed in China.

Some context helps to illustrate the scale of the change Trump is suggesting. The first few years of the trade war saw the US impose tariffs on about two-thirds of Chinese imports (compared to almost none before it started) at various rates. The average rate on all Chinese goods was about 19%. The Biden administration has essentially stuck with those measures and announced further increased tariffs on a handful of 'strategic' goods. These increases are significant for the goods concerned, but they apply to a small subset and don't shift the average rate much.

While the trade war to date has focused mainly on strategic goods and on China specifically, Trump has proposed going a lot further

Trump's proposed 'universal' tariff would therefore mark a significant shift. It would more than treble the average tariff rate imposed on imports from China, from about 19% to 60%. It would also mark a clear change in approach to the rest of the world. Average tariff rates on the world *excluding* China have remained very low, at around 3%. That would rise to 10% under Trump's new plan, so again more than trebling. Together, these changes would deliver a very large increase in average US tariff rates by historical standards, back to 1940s levels (figure 2).

This sharp increase in average tariff rates would probably have a significant one-off inflationary effect. It would almost certainly hurt GDP growth too. How much will depend on how the revenue generated by higher tariffs is used, the form of any retaliation from overseas,

and how the Fed responds. There's a very broad range of independent estimates, from a hit of 0.5% of GDP to a much larger impact (of more than 2% of GDP at its peak) in a full-blown global trade war.

Given the scale of the potential impact on inflation and growth, it's important to emphasise that there's considerable doubt about both Trump's willingness and ability to implement his 'universal' tariff plan. It's possible that the proposals are more of a bargaining tool, designed to extract concessions from China or to compel NATO countries to increase their defence spending rather than to be implemented in full. It's also possible that opposition in Congress and corporate lobbying will significantly water down any eventual changes.

Investment implications of Trump's tariff plans

- Inflation could be pushed higher and the economy weakened in the short term.
- By how much depends on the degree of retaliation and how tariff revenue is used, as well as the Fed's response.
- Could be negative for US stocks and government bonds, and potentially even more so for some overseas equities.
- But there is considerable doubt about both Trump's willingness and ability to implement his plan.

Figure 2: Average US tariff rate on all goods imports (%)
Trump's proposed 'universal' tariff would more than treble the average rate imposed on imports from China, which would have a one-off inflationary impact.
Source: FRED database, St. Louis Federal Reserve; latest annual figures

DEBT AND THE DEFICIT

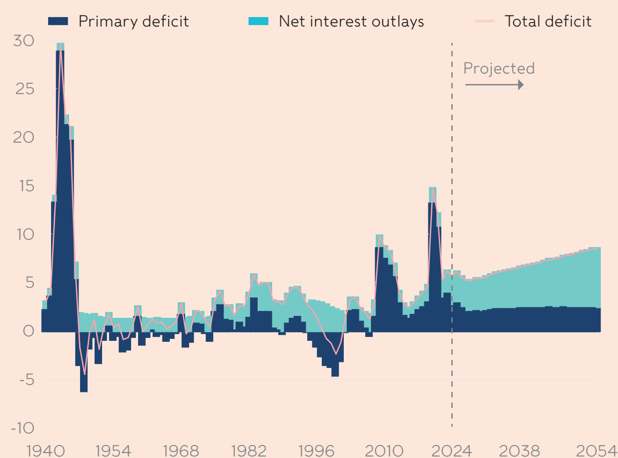
Large fiscal deficits (in simplified terms, government revenue minus spending) and high levels of outstanding public debt relative to the size of the economy appear to be here to stay regardless of the election result. During their presidencies, both Trump and Biden have overseen unusually large peacetime deficits (even outside the extraordinary circumstances of the pandemic).

Neither party has put any emphasis whatsoever on fiscal consolidation during this campaign. The risks to the outlook for government finances, and therefore to US government bonds, are probably greatest if Trump wins the election. But the precise effect will depend enormously on which of his proposals he's able to enact.

For context, the US budget deficit was 6.2% of GDP in 2023, compared to 3.1% in 2016 and an average of 3.7% over the past 50 years. The ratio of outstanding debt to the size of the economy (excluding the Federal Reserve's holdings) stands at 97%, the highest since just after the Second World War.

The Congressional Budget Office projects that, on current spending plans, the deficit will remain large as net interest payments continue to increase (figure 6). This means debt will reach new record highs relative to the size of the economy in the next decade, continuing to climb thereafter. In these circumstances, markets might be much less forgiving of fiscal loosening than they were in the late 2010s.

Figure 3: US deficit as a proportion of GDP (%)
Forecasts suggest the US debt will reach new record highs relative to the size of the economy in the next decade, then continue to climb.
Source: Congressional Budget Office, latest annual figures; primary deficit = current spending minus tax revenues and net interest outlays = interest paid in excess of interest received



We think the risk of rising debt levels is greatest under Trump because of the specific political constraints he faces. During his time in office he was able to persuade his party to support corporate tax cuts. He'll be able to restrict immigration, which also tends to make the fiscal arithmetic more difficult by lowering the ratio of tax-paying working-age people to children and the elderly in the population thereby limiting the economy's potential growth rate.

At the same time, he'll struggle to gain support for his full tariff proposals (which would increase tax revenues by about 1% of GDP if enacted) and his intention to repeal the Inflation Reduction Act's huge clean energy subsidies (see the industrial and energy policy section below).

Investment implications of rising debts and deficits

- Trump's plans to cut corporate taxes could strengthen growth in the short term.
- However, inflation is likely to be higher, and government bond yields (a benchmark for borrowing costs) could go up in response to a widening deficit.
- Growth would then likely weaken in the longer term, restrained by higher rates and the potential for future government belt tightening.

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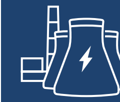


INDUSTRIAL AND ENERGY POLICY

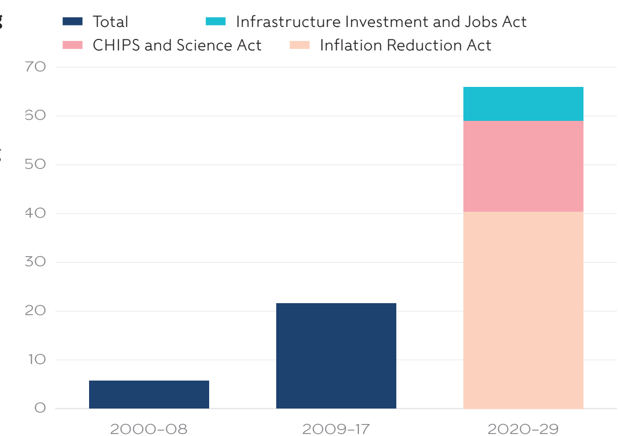
Industrial policy (the government directing and supporting investment in strategic parts of the economy) has experienced a renaissance around the world recently, driven by geopolitical competition as well as the need to build resilience to shocks like the pandemic or climate change. Both the Democrats and Republicans have supported the shift to a more activist role for the state in the US, so industrial policy looks set to stay. However, there are also clear differences in the strategic sectors the two parties care most about.

Biden's presidency has seen the passage of three acts which represent a step change in US industrial policy after decades on the margins. The 2021 Infrastructure Investment and Jobs Act, the 2022 Inflation Reduction Act and the 2022 CHIPS and Science Act together account for more than $2 trillion in funding through public and private spending over the next 10 years.

These acts have focused on several areas including: rebuilding and improving US infrastructure; supporting US semiconductor production and leadership in advanced technologies; and addressing domestic energy security and climate change. Figure 4 below shows the significance of the increase in spending on climate change alone.

Parts of Biden's industrial policy agenda have received significant bipartisan support and might therefore remain untouched regardless of the election outcome.

Figure 4: US Federal spending on climate change ($bn, annual average)
Three acts passed under Biden's presidency resulted in a substantial increase on spending on measures addressing energy security and climate change.
Sources: The Economist, Credit Suisse; as at end August 2024

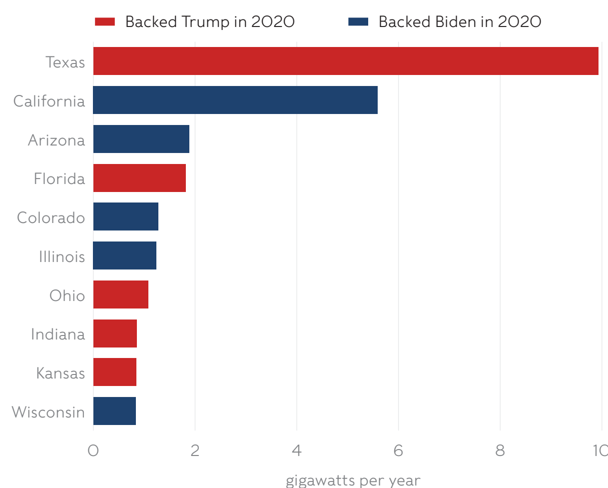


In contrast, the misleadingly named Inflation Reduction Act (which is first and foremost a landmark piece of climate legislation, providing huge grants and tax credits for investment in electric vehicles and clean power) was universally opposed by Republicans in both the Senate and the House. It has also been criticised repeatedly by Trump, who may try to repeal it should the Republicans win control of Congress.

Trump intends to change the direction of US energy policy fundamentally if elected, rowing back on the Biden administration's support for clean energy and goals for 'net zero' carbon emissions. Parts of this agenda could be implemented easily by executive order, such as leaving the Paris Agreement and UN climate bodies, or rescinding Biden-era orders restricting fossil fuel leases on federal land.

Other elements may prove much harder, even in the event of a Republican 'sweep' of the House and Senate. Even though congressional Republicans universally voted against the passage of Biden's Inflation Reduction Act, many may be unwilling to vote for its repeal. The key reason is that funding for clean power from the Act has disproportionately benefited Republican areas of the country (figures 5 and 6).

Figure 5: Clean power installations in the top 10 US states in 2023
Funding for clean power following the Inflation Reduction Act has disproportionately benefited Republican states.
Source: American Clean Power; according to 2020 presidential election

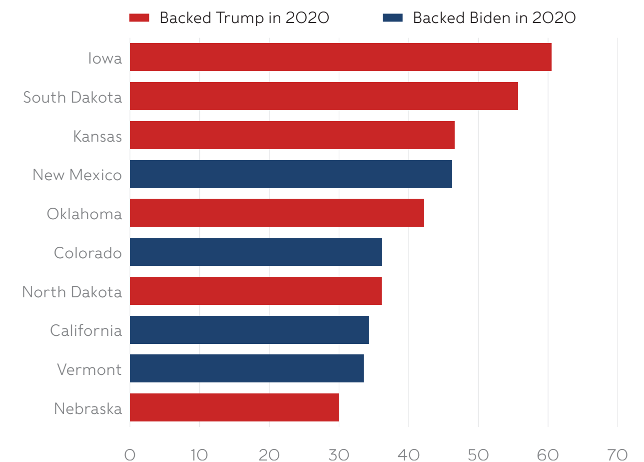


Remarkably, more than 80% of all utility-scale wind, solar and battery projects currently under development are in Republican-held congressional districts. Republican Texas, famed for its oil industry, installed more than twice as much clean power capacity as any other state in 2023. Most of the states generating the highest share of their electricity from renewables are Republican too, including Iowa, South Dakota and Kansas.

In this context, it's still possible that a Republican administration would chip away at *parts* of the Inflation Reduction Act's climate provisions, notably the tax credits for electric vehicles (EVs) which Trump has railed against. But many Republican lawmakers have strong incentives to vote against a broader repeal, and EV incentives account for only about 6% of the Inflation Reduction Act's total climate-related investment.

Many Republicans may be unwilling to vote for repeal of Biden's clean energy policies: More than 80% of all utility-scale wind, solar and battery projects currently under development are in Republican-held congressional districts

Figure 6: Wind and solar share of electricity generation in the top 10 US states (%)
In particular, Republican states make up the largest share of clean energy generation.
Source: American Clean Power, according to 2020 US presidential election



Although it might sound strange, it's plausible that a Republican-controlled Congress would simultaneously support the deregulation of the fossil fuel industry which Trump favours, while maintaining most of Biden's clean energy subsidies. This could be framed as matching Trump's ambition to have the "lowest-cost energy and electricity in the world" and supporting his aim of "American energy independence". Trump's policy towards the fossil fuel industry is summarised succinctly on his website: "DRILL, BABY, DRILL".

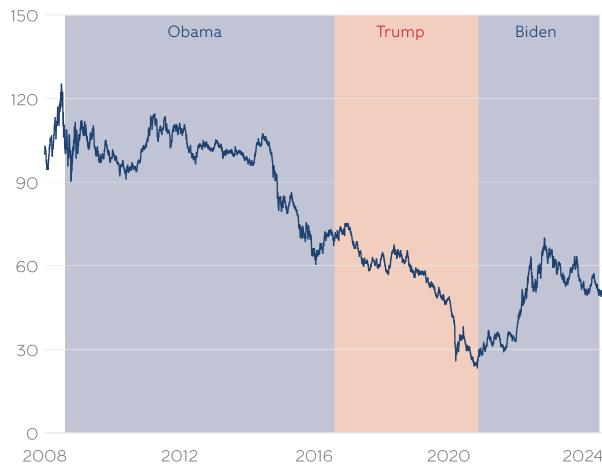
Trump's policies could put some downward pressure on global oil prices as US production expands, but this shouldn't be overstated. The US accounts for about 20% of global oil production, compared to more than 50% for OPEC and its allies, so production decisions outside the US can matter much more. So can changes in demand, which depend heavily on the health of the global economy (removing EV subsidies in the US would also generate some additional demand).

When it comes to natural gas, Trump's policies could weigh on *global* prices, but might have the opposite effect on *US* prices. The latter are artificially low because of the restrictions on exporting which Trump would scrap. Finally, the share prices of US fossil fuel producers might benefit at the margin as their production rises, but again this could easily be outweighed by other things. The sector's underperformance under Trump previously, and subsequent outperformance under Biden, is a reminder that regulation alone is far from the most important driver. It's risky to take a strong view on the sector based on the election alone, as figure 7 shows.

Figure 7: US energy sector returns vs overall market (January 2008 = 100)

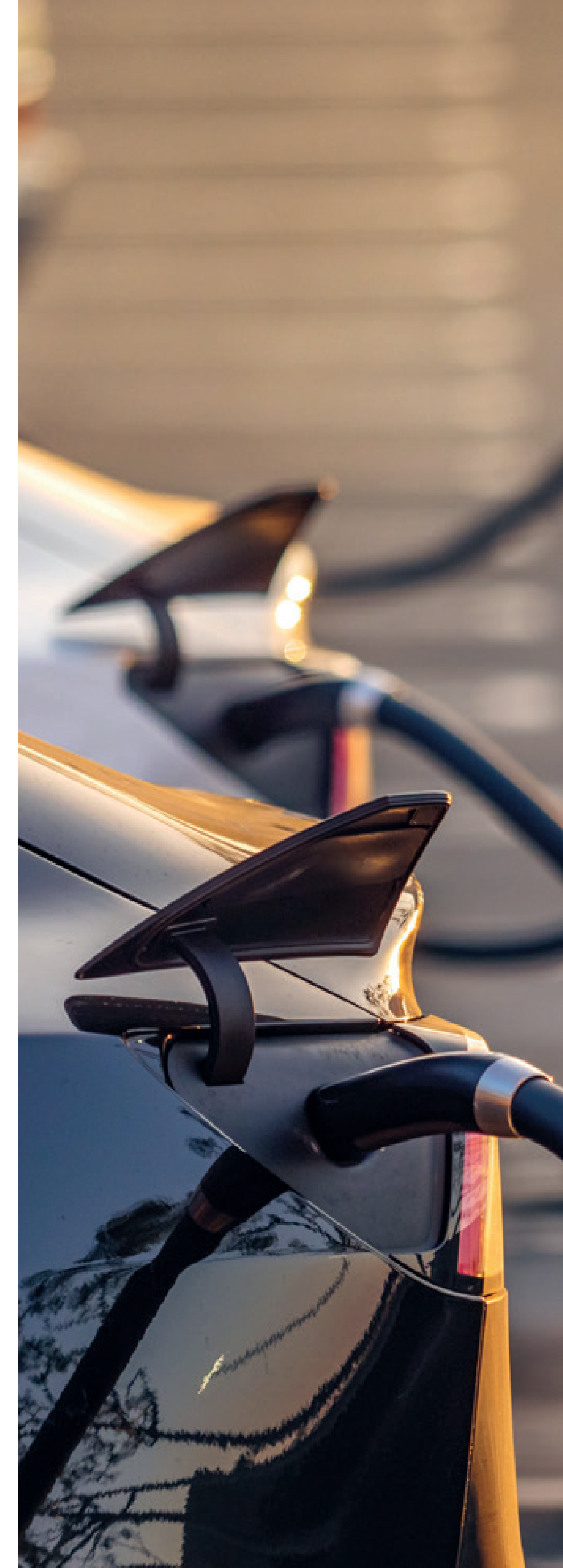
The energy sector's underperformance under Trump and then outperformance under Biden reminds us that regulation alone is far from the most important driver.

Source: LSEG, Rathbones; as at end August 2024



Investment implications of Trump's energy policy

- It would hurt specialist EV manufacturers but might benefit other auto producers.
- Inflation might be lower in the short term if oil prices fall due to increased US production.
- Ignoring climate change risks higher inflation in the longer term, which would be negative for bonds.
- Growth would be only marginally stronger in the short term and weaker in the long term if climate change is unaddressed.
- While potentially positive for US energy stocks, Trump's previous time in office shows this could be outweighed by other factors.



IMMIGRATION

Net migration to the US is likely to be significantly lower than if Trump wins the election. The experience of his presidential term – when net migration fell sharply even before the pandemic (figure 8) – and his pledges on the campaign trail recently suggest that both legal and illegal immigration would decline if he were victorious.

Admittedly, the Democrats' approach has toughened recently. In a departure from decades of protocol, Biden announced in June that people crossing the US-Mexico border illegally will be ineligible to claim asylum until the rate of crossings is much lower. However, there's still a huge difference between Democrats and Republicans on this issue.

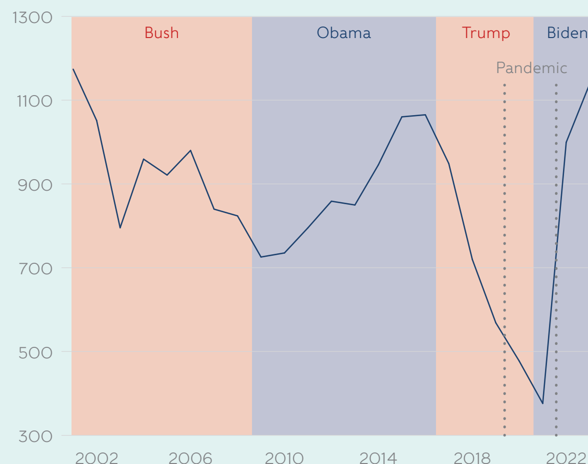
Biden also recently announced easier paths to citizenship for undocumented immigrants married to US citizens, an apparent attempt to pre-empt possible deportations under a second Trump presidency.

Meanwhile, Trump has proposed a range of measures which will either reduce immigration or the ability of immigrants to work in the US. This matters to the economy because immigration makes a big difference to the supply of labour. A key reason why the US economy has recovered faster than most other advanced economies after the pandemic is that its labour supply bounced back rapidly from its covid-induced slump.

Figure 8: Net international migration to the US (000s)

Based on what happened during his first presidency, net migration is likely to fall if Trump wins the race to the White House.

Source: Brookings analysis of US census data; as at end August 2024



After falling by 3 million in 2020, the US labour force has subsequently expanded by 9 million, with more than half of that increase due to foreign-born workers. That rise eased the acute labour shortages in certain sectors which emerged as pandemic lockdowns were lifted.

Significantly lowering net immigration would reduce the growth rate of the labour force, and therefore the potential growth rate of the economy. But the scale of the effect is hard to quantify. Both immigration and the number of immigrants working are measured imperfectly. Productivity growth could be lower too if the US becomes less accepting of the 'brightest and best' globally, although again that's hard to quantify.

Restricting immigration sharply would probably generate some upward pressure on wages and inflation too. Sectors like agriculture, construction, transport and healthcare, where foreign-born workers play a particularly large role, would feel the greatest impact. But modelling by Oxford Economics suggests that the aggregate impact on inflation might be small. Fewer foreign-born workers in the US would reduce demand as well as supply. The acute shortages in many of those sectors immediately after the pandemic have now faded.

Investment implications if net immigration falls

- Inflation could be higher, as it would be harder to fill shortages in the labour market, but there would be some offset from reduced demand.
- Slower population growth limits economic potential and puts more strain on government finances, which could be negative for government bonds.
- A reduced potential growth rate of the economy could be a long-term negative for US equities.
- Lower immigration would also limit firms' ability to hire talent from abroad.

THE DOLLAR

On the campaign trail, Trump has complained about the strength of the dollar compared to other currencies including the Japanese yen and Chinese renminbi, while some of his economic advisors are reportedly considering (unspecified) ways to weaken the greenback. JD Vance has talked openly about 'devaluing'. But pushing down the currency may prove easier said than done. The most readily available tools to weaken the dollar aren't very effective.

That's especially true with other elements of Trump's agenda, such as higher tariffs and looser fiscal policy, likely to work in the opposite direction. More powerful tools to push the dollar down exist, but the barriers to deploying them are far higher and they could have significant unintended consequences.

Trump regularly complained about the dollar's strength in public when he was in office and took some largely symbolic actions, including formally labelling China, Vietnam and Switzerland as currency manipulators. That would be easy to do again, but there's little evidence that it made any meaningful difference the first time around. The dollar strengthened considerably in 2018-19 after the passage of his tax reform (which probably contributed to the Fed raising interest rates in that time) and the start of the trade war with China.

Another option which wasn't tried last time would be to sell dollar-denominated assets from the Treasury's Exchange Stabilisation Fund for foreign currency. The Secretary of the Treasury and President can do that without recourse to Congress. But the Fund lacks the firepower to make much difference in foreign exchange markets (where more than $6 trillion changes hands on average each day).

A far more powerful option would be for the Fed to act. It isn't subject to the limitations of the Exchange Stabilisation Fund since it can in principle create as many dollars as needed to sell for foreign currency. It could also in theory lower interest rates to reduce the appeal of holding dollars and drive the currency's value down. But the central bank won't do that of its own accord. Any such move would therefore require compromising its operational independence. As we explore in the section below, the hurdles to that happening are high (albeit not completely insurmountable).

A weakness of all these options is that they are unilateral. If the US sought to gain a competitive advantage with a weaker currency, there would be little to stop other countries responding in kind. They could match US interventions in foreign exchange markets with equivalent moves of their own,

potentially cancelling out any downward pressure on the dollar.

The most successful example of intervention to weaken the dollar in the era of floating exchange rates is the 1985 Plaza Accord, a *multilateral* agreement which saw the US, France, West Germany, Japan and the UK agree to cooperate to manage their exchange rates. The dollar plunged thereafter, as shown in figure 9. But the circumstances today are quite different to the ones which gave rise to that agreement.

What can Trump do to weaken the dollar?

— The tools immediately available to the president would make little difference, and multilateral agreement seems unlikely.

— A more radical option of Fed action to weaken the dollar would require compromising its independence. The next section explains why the barriers to that happening are high.

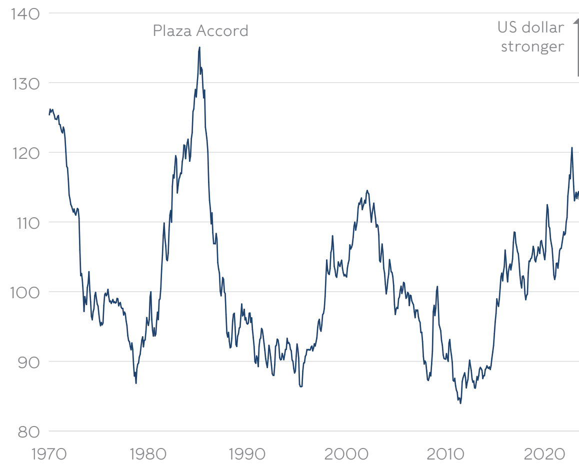


Figure 9: Dollar exchange rate index (trade weighted, adjusted for inflation)
The value of the US dollar plunged following the Plaza Accord in 1985 but any intervention in the future is unlikely to have the same impact.
Sources: LSEG , Rathbones; monthly figures to June 2024

FEDERAL RESERVE INDEPENDENCE

When he was in office, Trump was far more willing than any other recent president to attempt to influence the policy of the Federal Reserve (Fed), America's central bank. His recent statements, including threats to replace Chair Jerome Powell, suggest that this would continue if he were re-elected.

While his previous attempts to sway the Fed made little difference, and there are significant legal safeguards to its independence, there's a chance that could change in a second Trump term. The likely outcome of a more politicised and less independent central bank would be unsuitably loose monetary policy, resulting in higher inflation and greater economic volatility.

Although Trump picked Jerome Powell to lead the Fed in 2017, it wasn't long before he publicly rued his decision. Trump openly criticised monetary policy setting, arguing for far lower interest rates and the resumption of quantitative easing. He called Powell an 'enemy', and privately discussed the possibility of firing him.

Yet Powell remained in post, and there's little evidence that Trump's comments made much difference to policy. Trump's attempts to affect the composition of the Fed board didn't get far either. The Republican-controlled Senate rejected three of his nominations, at least two of them on the grounds that they lacked the requisite expertise and would undermine the central bank's independence.

This experience suggests that even a Republican sweep at the election would not necessarily change much. It's legally uncertain whether the President could dismiss Powell before his term expires in February 2026. Either way, Powell's replacement would have to come from the Fed board, with Senate approval required for nominations. In other words, for central bank policy to become much more politicised, the Senate would probably have to acquiesce.

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It wasn't willing to do that last time, reflecting the consensus that independent central banks are important in maintaining economic stability – although that doesn't completely rule out the possibility. A politicised Fed is therefore probably a 'tail risk' (one with a very small chance of happening, but with a substantial impact if it did), should Trump win the election and the Republicans take the Senate.

History has not judged political influence over monetary policy kindly. In the most recent US example, President Nixon pressurised Fed Chair Arthur Burns to keep monetary policy loose ahead of the 1972 election, referring privately to "the myth of the autonomous Fed". Burns, who later spoke of "the anguish of central banking", acquiesced. The economy temporarily boomed, Nixon won re-election in a landslide – and the stage was set for the runaway inflation of the 1970s.

Investment implications of political influence on the Fed

- Artificially low interest rates may lead to stronger growth in the short term, but this would be short lived as rates would eventually need to go back up to deal with higher inflation.
- These inflationary pressures would be negative for government bonds.
- Though artificially low rates may be positive for US stocks in the short term, over the longer term higher inflation and more volatile growth would be negative.

THE BIG PICTURE

Taking all of these potential policy changes into consideration, what does the US election mean for you as an investor? What's the overall conclusion? Three key points stand out:

1 Elections rarely change the broader direction of markets.

The first and overarching main point is that we should remember the bigger picture. Making judgements about sectors based on the election alone can be dangerous, with the experience of Trump's time in office demonstrating that legislative changes aren't everything. Sectors with tailwinds from deregulation can still underperform substantially if other things go against them. Trump's agenda arguably favours fossil fuel producers and traditional (internal combustion engine) car manufacturers – but it alone won't decide their fate.

2 A trump victory would probably be inflationary – bad for bonds.

Second, victory for Trump (particularly if the Republicans control Congress) would probably contribute to higher inflation and greater risks for US Treasuries. Several of his policies add to the risks on that front. Arguably none substantially reduce them.

3 Equities could benefit in the short term from tax cuts.

Third, the impact on US equities is less certain (with different policies working in different directions) but could plausibly be positive in the short to medium term. That would probably be the case if Trump enacted his planned corporate tax cut, but didn't follow through with his 'universal tariff' and preserved the independence of the central bank. However, the risks to equities *outside* the US (especially in China) appear greater. They would not benefit in the same way from lower US corporate tax rates, and they are probably more vulnerable to any changes on the trade front.

ADDITIONAL INFORMATION

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