14/10/2024

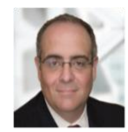
Special Coverage:

Less than one month till the US elections: Update and market implications

Key takeaways

- With the US elections less than a month away, the markets' focus on polls will further intensify. The latest readings show that the race between former President Donald Trump and current Vice President Kamala Harris remains tight. Hence, it is dangerous to bet on the outcome.
- All potential outcomes have pros and cons for markets. A Republican victory could lead to lower taxes and deregulation, but higher trade tariffs could raise inflationary fears and slow down rate cuts, creating an offsetting headwind. A Democratic victory would likely result in less uncertainty regarding global policies and less fiscal stimulus.

Willem Sels
Global Chief Investment Officer, HSBC Global Private Banking and Wealth



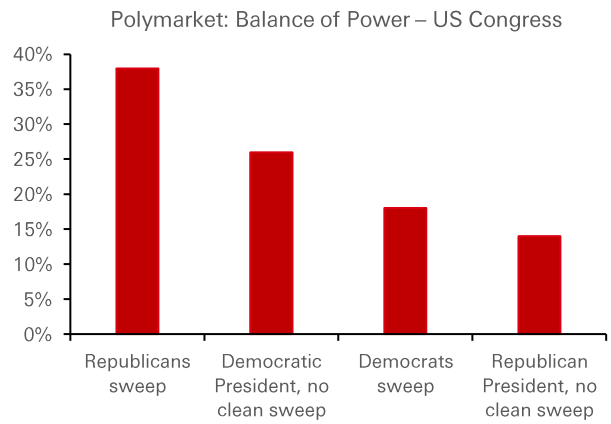
Jose Rasco
Chief Investment Officer, Americas, HSBC Global Private Banking and Wealth

- History shows that volatility tends to increase before the elections but eases when the result is known. Equity markets tend to rise in the 6 months after the elections, regardless of the outcome. We base our investment strategy on earnings, interest rates and growth fundamentals, which remain constructive, supporting our bullish view on US equities. We continue to lock in yields of quality bonds at current attractive levels. Bond performance should be supported by continued Fed rate cuts.

What happened?

- 2024 is the year that half of the world's population will have gone to the polls, and the US elections on 5 November are probably the event with the most significant implications for the global economy and markets.
- Polls continue to evolve, and betting agencies' odds reflect the ups and downs in people's views of what will happen. But actual election victory chances are determined by who gets most of the Electoral College votes, not who has the largest share of the national votes.
- Much will depend on those states where there is no clear majority – the so-called 'swing states', where just a small number of votes could determine which candidate gets the electoral votes. Those states are Arizona, Georgia, Michigan, Nevada, North Carolina, Pennsylvania and Wisconsin.
- We do not think it is possible or wise to invest on the basis of a likely outcome. We point to the 2016 elections, where Democrats won the popular vote, but Donald Trump moved into the white house because of a narrow victory in a few key swing states.
- There are also 34 Senate seats and all 435 seats in the House of Representatives up for election. The current prediction illustrates the broad range of potential outcomes and uncertainty.

There are four potential US election outcomes, with no clear favourite at this stage



Source: Polymarket, HSBC Global Private Banking and Wealth as at 10 October 2024

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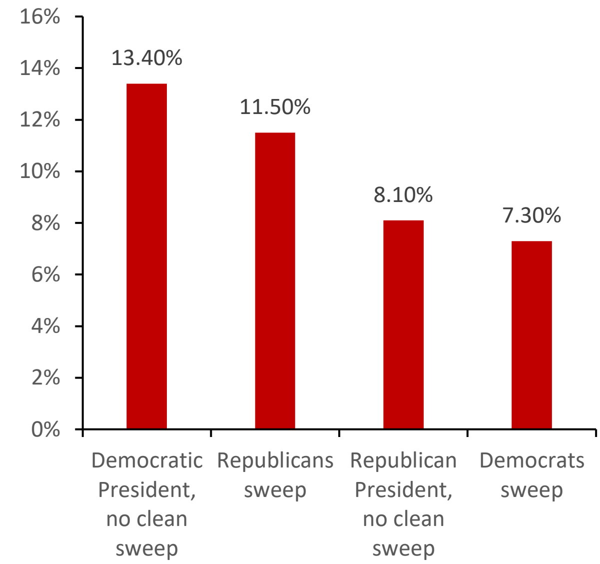
Investment implications

- For the overall market direction, the election result may matter less than is sometimes assumed. Across election cycles, we tend to see higher volatility leading up to the election, but the volatility will ease when the result is known. In the event of a close election result, a recount or dispute could extend market volatility, but only temporarily.
- The US equity market returns tend to be positive in the 6 months after the elections, regardless of the result. Our graph shows the historical annual average returns for the four possible scenarios, highlighting that equities can rally both in case of a Democratic or a Republican president.
- Under a Trump presidency, we would expect fiscal easing for both companies and households as a result of the extension of existing tax cuts. This tends to be positive for equity markets, but the tailwind may be offset by higher import tariffs, which would not only hurt Chinese and European exporters but also potentially raise costs for US companies and households, boosting inflation. In turn, this could lead to slower Fed rate cuts.

Historical annual returns of US stocks under four scenarios



Source: Bloomberg, Factset, HSBC Global Research and Wealth as at 18 September 2024. Past performance is not a reliable indicator of future performance.

- From a sector perspective, we have recently seen that cyclical sectors and those potentially benefitting from deregulation (including technology, consumer discretionary, and financials) have performed well when Donald Trump's polling numbers have improved. However, a reduction in immigration could weigh on sectors like construction and hospitality, as they rely on access to foreign workers, while higher tariffs could increase the cost of inputs for the industrials and consumer discretionary sectors.
- If Kamala Harris wins, there are offsetting factors, too. Continuity with the Biden administration may reduce uncertainty and could be a positive for markets. However, fewer tax cuts compared to a Trump presidency could be viewed as a negative. Climate change-related investments would see policy support, while the effort to re-onshore manufacturing are expected to continue. Whoever wins the presidency, if there is no clean sweep, policies would be less ambitious, reducing the market impact.
- The current market action suggests that investors have been reducing concentrated positions in their portfolios to avoid being wrong-footed on election day. For example, popular overweight positions in technology have been reduced, while investors have been adding to traditionally less favoured utilities and real estate stocks. As previously noted, we have been broadening our sector exposure beyond technology to include US financials, industrials, communications, and healthcare.
- Given the unpredictability of the elections and our view that the volatility is only temporary, we continue to base our investment strategy on other factors, namely Fed rate cuts, solid earnings, and resilient economic growth. These supportive fundamentals continue to warrant a bullish US equity stance. As for bonds, we continue to lock in yields of quality credit. Stronger-than-expected economic data have driven up yields in the past weeks, providing an opportunity to lock them in as cash rates continue to decline.

US election scenario grid

Scenario	Trump wins		Harris wins	
	Republican clean sweep	**Divided government**	**Democratic clean sweep**	**Divided government**
Overview	It would likely result in expectations of fiscal stimulus and tax cuts – policies that markets have historically seen as supportive for global equities, and specifically the US. Risks of trade tensions could be an overhang which could affect the rest of the world more than the US	A split Congress would make a full extension of the 2017 tax cuts less likely and could result in the government focusing on executive orders. A policy focus on tariffs and a potential escalation in trade tensions could weigh on international markets more than the US	A Democratic clean sweep would put into play policy proposals such as corporate tax hikes and strict antitrust laws. Uncertainty about regulation, particularly on big tech and AI, could hit market sentiment	This would imply a status quo scenario, with more limited policy changes
Fiscal policy	More expansionary fiscal policy: extension of 2017 TCJA tax cuts and potentially further cuts to corporate and income taxes. We could also see a stronger push for debt controls and deficit reduction	A full extension of the 2017 tax cuts becomes less likely without a legislative compromise, including Democrats' proposed child tax credit. Expiration of tax provisions deadline could create a "fiscal cliff" dynamic in 2026	Proposals include an increase in corporate tax rate to from 21% to 28% to fund an extension of tax cuts for individuals with incomes below USD400,000 per year, and an increase in child tax credit	An extension of the 2017 tax cuts and an increase in child tax credit could be part of a legislative compromise ahead of the deadline at the end of 2025
Trade and tariffs	A greater focus on protectionist trade policies. The Trump campaign has signalled willingness to introduce a minimum 60% import tariff on China and a 10%-20% universal import tariff on the rest of the world		We would expect trade policy to maintain the status quo. This may include more protectionism, as seen through the current administration	
Foreign policy	Greater uncertainty around China relations. A push towards cutting funding to Ukraine		We would expect little change in the geopolitical status quo	
Immigration policy	The Trump campaign has said that it would look to deport unauthorised migrants, end birthright citizenship, and build more of the US-Mexico border wall		The Harris campaign has said that a higher standard for asylum eligibility and increasing legal immigration numbers via green cards and family visas would be needed	
Regulation	Lighter-touch regulation: fewer antitrust cases and less scrutiny on M&A		Risk of sustained intensity of antitrust and merger reviews, particularly among big tech. We could also see more stringent AI regulation	
Environment	Under a Trump administration, the US would likely slow its energy transition, potentially rolling back the investments being made under the Inflation Reduction Act. Oil investment may increase from already record highs. The US is likely to leave the Paris Accord		There is likely more support for the Inflation Reduction Act, although how much further spending would be committed is uncertain. More likely to take a lead on the energy transition globally	
Key investment implications	• USD typically strengthens in the run-up to the election; clean sweeps offer the greatest scope for upside to persist • Under a Republican clean sweep, bond markets would anticipate a more hawkish Fed outlook • Republican policies could support further US equity outperformance; risks of escalation in trade tensions could drag on the rest of the world • EM outlook could be affected by trade tensions, higher tariffs, or fiscal expansion narrowing the room for rate cuts		• USD typically strengthens in the run-up to the election; clean sweeps offer the greatest scope for upside to persist • A Democratic clean sweep could lead to further bullish steepening of the yield curve • A Democratic clean sweep could result in policies like corporate tax hikes and strict antitrust laws, a possible drag on US equities • Any fiscal consolidation could pave the way for more rate cuts, supporting risk assets including EM	

Source: HSBC Global Research, HSBC Global Private Banking and Wealth as at 10 October 2024.

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