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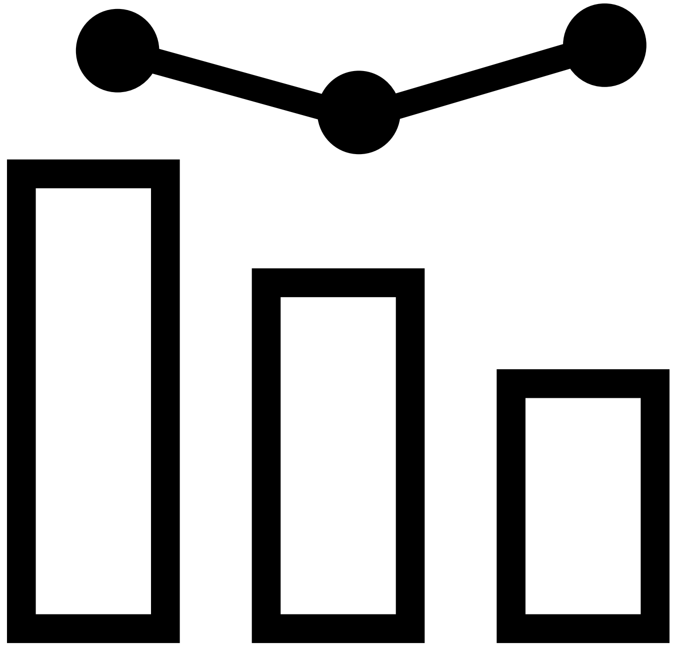

Market, trends & themes

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Trump or Harris: place your bets?

Since the last time we focused on the US presidential election, last spring, the race for the White House has changed dramatically. After a disastrous election debate for President Joe Biden in June and a failed attack on Donald Trump in July, the Republican candidate appeared to be heading for an election victory in November. That picture completely tilted when the Democrats swapped Biden as presidential candidate for Kamala Harris, the current vice president. After a flawless Democratic party convention and a successful debate for Harris with Trump, she took a clear lead in the polls. However, she now seems to have lost much of this lead, so that the expected result on 5 November will ultimately remain as 'too close to call' as it was six months ago. Meanwhile, it has become more clear what both presidential candidates stand for on the economic front, so this seems like a good time to look at what a Harris or Trump presidency could mean for the US economy, and hence for investors.

From 'Reaganomics' to 'Bidenomics' to 'Trumponomics'

While the outcome of the presidential election remains unclear, it has become clearer that, at least in economic terms, Americans have a real choice to make. First of all, Donald Trump's ideas in certain respects do not appear to have changed that much since his first term in office. These ideas were to some extent based built on Reaganomics, the dominant policy line of Republican presidents since the early 1980s, which is characterised mainly by a combination of lower taxes and deregulation. Where Trump clearly distinguishes himself from the usual Republican approach is on international trade. While Republicans traditionally support free trade, Trump is actually a proponent of economic protectionism. As in other policy areas (including immigration, for example), he is showing himself to be considerably more extreme in the current campaign than he was four years and eight years ago. For example, Trump now wants to apply import duties of 20% on almost all imports to the US and tariffs of 60% on imports from China. Incidentally, protectionism is not an unknown phenomenon for the US: in the 19th and the first half of the 20th century, tariffs were one of the pillars on which the US economy was built.

Whereas Trump's economic ideas are at least partly based on Reaganomics, Harris's plans build on the economic policies of current President Biden. This policy, now also known as Bidenomics, appears to be significantly inspired by the New Deal economy of Biden's distant predecessor, Franklin D. Roosevelt. Under the New Deal, in fact the dominant economic line in the US from the early 1930s to the early 1980s, there was a major role for government in the economy: relatively heavily regulated, with high taxes for businesses and households with higher incomes, and lower taxes and subsidies for the middle class and people on lower incomes.

Trump or Harris: What difference does it make?

All in all, Trump's plans, especially his tax plans, may provide an additional growth boost to the US economy in the short term, but in the long term, the impact of his protectionist ideas looks to be very detrimental to international trade and thus to the global economy, including the US economy. A tariff war with China, for example, would hit the US economy like a boomerang, and would probably lead ultimately to higher prices (or a new wave of inflation) as the main outcome for US consumers. Harris's plans are less outspoken, and therefore probably less decisive for the US economic growth and inflation outlook.

It should be noted that, in addition to the obvious differences in economic policy plans, there are also many similarities between Trump and Harris. This of course receives less attention, especially during a campaign, but it looks very likely that Harris, as president, would adopt many of the measures from Trump's term in office as well as many of Biden's policies. For example, President Harris would maintain much of Trump's 2017 tax cuts, she is no longer opposed to oil and gas production in the US through fracking and also promises stricter policies on immigration and China. To a certain extent, Trumponomics has thus become more or less mainstream even without a second term of office for Trump. For presidential candidate Trump, this has mainly led to him being even more extreme about, for example, tax cuts ('corporate income tax cut from 21% to 15%'), immigration ('deporting' instead of just 'stopping') and import tariffs ('tariffs are the greatest thing ever invented'). To what extent this is primarily campaign rhetoric and he would be more pragmatic as president of course remains to be seen.

US debt: 'he who shall not be named'

With all the differences and similarities, the biggest common denominator in economic terms seems to be that both Trump and Harris's plans are going to cost the US government more money than they generate. In other words, the budget deficit (already 6-7% of GDP) will increase rather than decrease. This is particularly problematic in view of the already very substantial public debt, which, according to calculations by the Congressional Budget Office, now stands at 100% of US GDP and will reach 125% of GDP in 10 years if policy remains unchanged. With Harris's plans, US public debt is expected to increase further, to about 133% of GDP, and to 142% of GDP with Trump's plans. Since a relatively large part of the US government budget is devoted to more or less fixed ('mandatory') expenditure (in particular on social security, care for the elderly, defence and, increasingly, interest payments on government debt), the US government is heading towards a possible debt crisis in the long term without sharp spending cuts and/or structural reforms. Without intervention, the current social security system ('Social Security') and care for the elderly ('Medicare/Medicaid') will in any case be in danger of going bankrupt in 10-12 years' time. Neither candidate has put forward even an approach to solving this during the campaign.

While both Trump and Harris treat debt as the Lord Voldemort of the US economy, it is certainly relevant for investors, certainly in the longer term. With the unique position of the US (and the US dollar) in the world economy, a debt crisis such as happened in Greece in the 2010s may not be directly foreseeable, but in the long term the deteriorating debt position of the US may undermine the attractiveness of US government bonds as a safe haven for investors. The first signs of this will probably appear in the form of higher yields on US government bonds. This increases the likelihood of a stagflation scenario in the US economy, especially with Trump's economic plans, but to a lesser extent also with Harris's. Such a scenario is in principle unfavourable for both US Treasuries and US stocks. However, Trump's plans for lower corporate taxes could offset this effect for US stocks in the near term.

A Democratic president looks better for investors, but why?

In addition to whether a Trump or Harris presidency would be more or less favourable for investors, there is also of course the question of whether it matters much in general whether a Republican or a Democrat becomes president. The short answer to this question is yes, and contrary to the widely held view that Republican presidents are more pro-business, and thus will be better for the stock market, actually the opposite is true. As early as 2003, research into US equity returns over the previous 75 years showed that the US stock market performed significantly better under Democratic presidents than under Republican presidents, with a differential in returns of almost 10 percentage points per year. A more recent version of this study comes to a similar conclusion, but notes that the differences have narrowed in recent years. This is then confirmed if we compare the returns on the S&P500 index under Trump and Biden. The average annual equity return in the Trump years was about 13%. This is very similar to the return in the Biden years, naturally with the caveat that Biden still has a few months to go as president.

The researchers did not yet have a good explanation for the outperformance under Democratic presidents in 2003, which is why they called their article "The Presidential Puzzle." Several researchers looked at this puzzle in the subsequent years. The most plausible explanation so far, expressed in a 2017 survey, seems to be that the perception of risk among voters (and investors) is a crucial factor. The theory is that when risk appetite is low, such as during an economic crisis, voters tend to elect a Democratic president because they expect more 'social security'. This risk aversion under Democratic presidents translates into higher risk premiums, and thus higher returns, on equities.

Economic growth, but also inflation, higher under Democratic presidents

On average, higher equity returns under Democraticic presidents suggest that things should improve economically. The study mentioned above shows that this is indeed the case: in the 1930-2015 period, economic growth among Democratic presidents averaged 4.9% per year and among Republican presidents 'only' 1.7%, a statistically significant difference. In any case, this trend has continued in recent years. During Republican Trump's presidency (2017-2020), average economic growth was 1.2% and so far 3.5% per year under the Democrat Biden (2021-2023). Incidentally, under Democratic presidents, not only economic growth but also inflation appears to be significantly higher on average than under Republican presidents, which is also reflected in the Trump/Biden years: under Trump, inflation in the US was around 2% on average, but over 5% so far under Biden on an annual basis.

Of course, it should be noted that the figures for the years since 2017 are heavily influenced by the coronavirus pandemic. This erupted in the final year of Trump's presidency, triggering a recession that significantly reduced average economic growth under Trump. The subsequent strong recovery in growth in 2021 came in Biden's first year in government, which significantly improved average growth rates during his term. The inflation wave of 2021-2023 also seems to be largely due to the coronavirus pandemic, as well as the consequences of the Russian invasion of Ukraine in 2022 (particularly for energy prices).

A well-run economy argues for Harris...

These observations also illustrate the limitations of the studies mentioned on the basis of historical statistics. It is striking that many changes of presidential watch have coincided with economic and/or financial crises: the coronavirus pandemic in 2020, the credit crisis in 2008 and the collapse of the 'dotcom' bubble in 2000, to name but a few examples. The question is to what extent these crises are attributable to the then sitting presidents, or whether it is more a case of 'time and chance happen to all'. Or, as British Prime Minister Harold Macmillan said when asked what concerned him most as Prime Minister: "events, dear boy, events".

Another interesting question is to what extent the previously mentioned hypothesis that risk perception among voters determines the outcome of the presidential election has predictive value for this year's election result. The US economy is still running at an above average pace at the moment, unemployment remains historically low and the stock market is reaching new record levels almost every day. This indicates a high risk appetite among voters, and the theory is that this should help the Republican candidate. There is another stock market wisdom to contradict this: when prices on the US stock market rise in the three months leading up to a presidential election, the incumbent's party benefits, and vice versa. Given that the stock market has done well over the past quarter, the Democratic candidate should benefit.

... but inflation fears play into Trump's hands

There is however a caveat to this 3-month stock market performance indicator. The only time it hasn't worked in the last 50 years was in 1980, when stock prices rose in the run-up to the presidential election, but incumbent (and recently turned 100) President Jimmy Carter lost the election. US voters were then battered by sky-high inflation in previous years, and a majority responded to Republican presidential candidate Ronald Reagan's question "Are you better off today than you were four years ago?" in the negative. Even now, high inflation in recent years seems to be a factor for many voters, potentially putting Harris at a disadvantage. One may point out that inflation in the US has already fallen back towards 2% and that wages are rising faster than prices, but the question is whether this chimes with the experience of the voters.

All in all, it looks as though we will not know who will be the new US president until 5 November, or even days (such as in 2020) or weeks (such as in 2000) later. The question of how the political relations in the US will be after the elections is even more difficult to answer, since not only a new president, but also a new House of Representatives and a new Senate will be elected on 5 November. Currently, the Republicans have a small (and dwindling) majority in the House of Representatives, and the Democrats have a minimal majority in the Senate, but according to current polls, this situation could be reversed after November 5. At any rate, it now looks more likely that we will have a divided government instead of a unified government in which the same party provides the president and has a majority in both houses of Congress. A divided government has certainly been the rule rather than the exception in recent decades, although new presidents often start their first term with a unified government. This was true not only for Joe Biden in 2021, but also for Donald Trump in 2017, Barack Obama in 2009 and Bill Clinton in 1993.

'Place your bets', or wait and see ...?

Whereas US (equity) investors seem to have a statistical preference for a Democratic president, the preference for a divided government over a unified government is even clearer, at least on the basis of historical data. The idea here is probably that the process of checks and balances in divided power relationships ensures that overly extreme policy intentions cannot be translated into action, or put in a less politically correct way: that politicians are mainly harassing each other instead of the business community.

In addition to a divided government, a Kamala Harris presidency may seem more attractive to (equity) investors in the longer term (or at least less risky) than a second Donald Trump presidency, partly in view of both candidates' economic plans (and historical statistics). On the other hand, if Trump takes office, US companies (and stock prices) could benefit in the short term from his plans for lower taxes and less regulation. For bond investors, the large and rising US government debt (under both Trump and Harris) poses a threat, especially in the longer term. In the coming weeks, increasing volatility is also a risk, especially if the election results remain unclear for a long time or, as in 2021, even lead to civil unrest. With all the uncertainty, however, there still seems to be one certainty: on 20 January 2025, the 47th president of the United States will be inaugurated, as has been the case for 46 (or actually 45) presidents since 1789.

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