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2024 US elections come into view

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- Investment returns during US presidential election years have been favourable for equity and credit investors outside of recession years. This is consistent with our optimism on both asset classes amidst the current economic expansion.

- The election landscape today favours former President Donald Trump, who leads in a majority of “battleground” states that either leading candidate will need to secure to win the White House.

- Barack Obama’s recovery from low popularity and weak polling in 2011 to hold on to the White House in 2012 provides a potential campaign template for President Biden in the run-up to election day in November 2024. A further easing of inflation will be key, combined with policies that engage women and young voters.

- US fiscal challenges are being overlooked in the 2024 US presidential campaigns and will constrain the eventual winner of the coming election. With the US debt ceiling set to cap bond issuance once again in January 2025, difficult revenue and spending trade-offs will be the first task facing the new US leader early next year, triggering interest rate and equity market volatility.

- Therefore, investors should position themselves to capitalise on the expected strong returns in equity and credit in the run-up to the election and then, entering autumn, focus on managing risk and pivoting to active sector, stock and currency selection moving into 2025 as the prospective winner becomes clear. Gold and inflation-linked bonds should offer attractive protection against potential volatility around the transition into 2025.

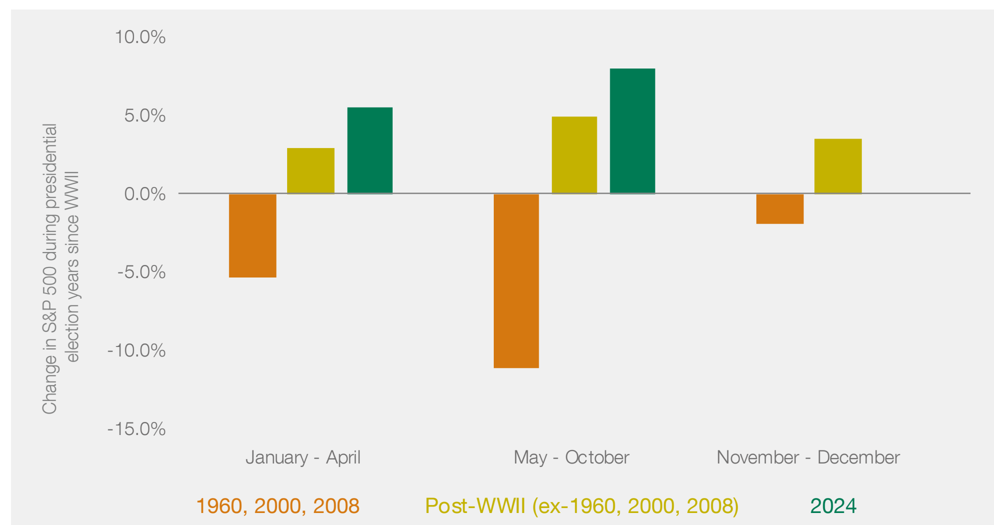
Investing during US presidential election years

Historically, presidential election years have been favourable for equity investors. In the nineteen elections since World War II, in only three years have S&P 500 investors realised negative returns (1960, 2000, and 2008).

Each of those years saw an American recession with the benchmark US index already down by an average of 5% from January–April, laying the groundwork for further losses through their respective year-ends averaging over 12% in the following May–December.

In contrast, in the remaining sixteen election years, in only one year (1956) did the S&P 500 fall going into the November elections. Moreover, even during the 1980 US recession, the S&P rallied nearly 20% going into the election.

NON-RECESSIONARY PRESIDENTIAL ELECTION YEARS HAVE HISTORICALLY DELIVERED STRONG S&P 500 RETURNS



Sources: Standard & Poor's, Bloomberg Financial L.P. and UBP.
Note: 2024 data is through 13 June 2024.

For bond investors, the nature of the inflation regime appears to be key in understanding the trajectory of US 10-year Treasury yields during American presidential election years. During the "Great Inflation" of 1965–1982, benchmark US Treasury yields tended to rise in the January–April period of the election cycle. In the May–October run-up to the November vote, yields stabilised and tended to rebound in the post-election period.

Prior to and following the nearly two-decade Great Inflation battle, Treasury investors saw greater benefits across the entire election year, with Treasury yields, on average, falling throughout the year.

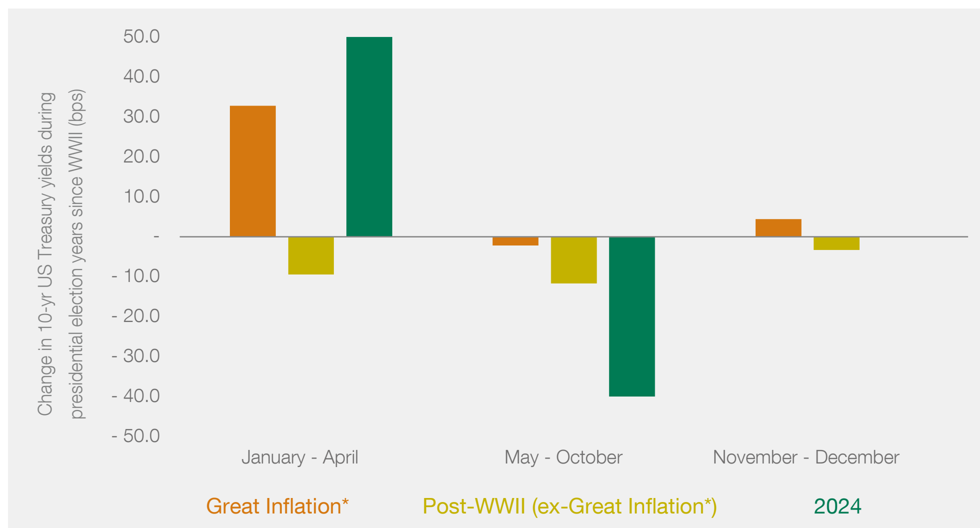
However, credit investors, like equity investors, had to be wary of the economic cycle. Amidst recessionary backdrops in the run-ups to the 1960, 1980, 2000, 2008, and 2020 elections, the spread between Moody's Baa yields and 10-year US Treasury yields widened throughout the presidential election year.

In contrast, in non-recession years since World War II, credit spreads contracted in every presidential election year other than 1948 and 1956, and even then, spreads ended up only 11–12 bps wider by year-end relative to where they began the year.

Therefore, with signs of recession not yet in evidence, with credit spreads tightening and with the S&P 500 already having risen nearly 15% year-to-date, history suggests that equity investors and credit investors should continue to have election-related tailwinds to support returns going into the November election.

However, with the Fed still battling sticky inflation as it did during the Great Inflation, bond investors should seek to moderate their exposure to interest rate volatility and instead focus on high income/carry strategies to drive total returns in bond portfolios (please see *Taking Advantage of Falling Bond Yields*, 13 May 2024).

THE CURRENT STICKY INFLATION REGIME SUGGESTS BOND INVESTORS SHOULD BE CAUTIOUS ON INTEREST RATE RISK



Sources: Standard & Poor's, Bloomberg Financial L.P. and UBP.
* Great Inflation from 1965–1982. Note: 2024 data is through 13 June 2024.

Who might win the 2024 US presidential election?

National polls suggest a tight race, with the incumbent (Biden) trailing his predecessor (Trump) by less than a percentage point in a head-to-head match-up. However, introducing third-party candidates, including US Senator Robert F. Kennedy Jr., widens Trump's lead to nearly two percentage points.

Looking at national polls, though, understates the importance of a handful of states in deciding recent elections. Recall that in the 2016 election, fewer than 80,000 votes (out of a total of 136 million cast nationally) in three states elected Donald Trump over Hilary Clinton. Similarly, in the 2020 election only 44,000 votes (out of a total of 158 million cast nationally) in six states determined the outcome of Biden vs. Trump.

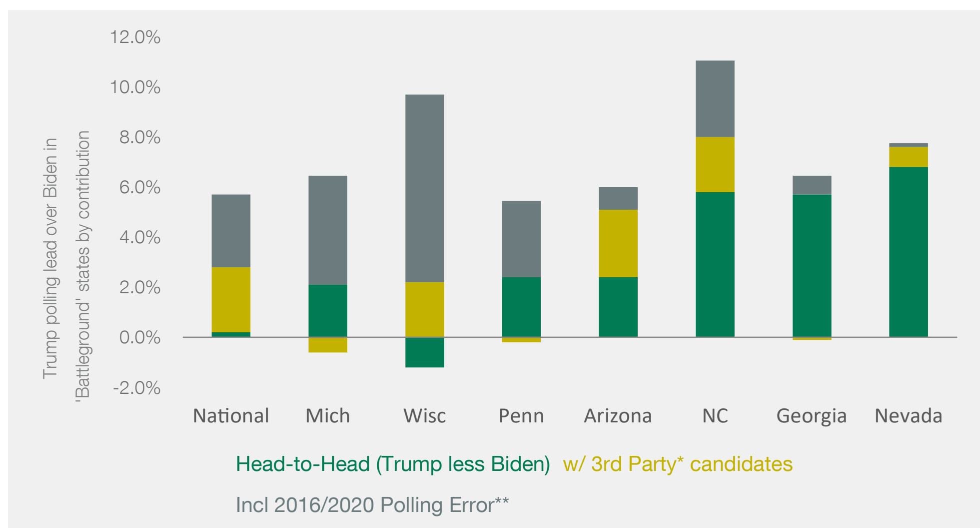
In 2024, pundits suggest that once again a small minority of US "battleground" states will determine the outcome of the US election. The battleground states include three Midwest industrial states – Michigan, Wisconsin and Pennsylvania – in two of which, Donald Trump holds modest polling leads within the polls' margin of error, and four "Sunbelt" states – Arizona, Nevada, Georgia, and North Carolina – where Donald Trump holds average polling leads in excess the polls' margin of error. Admittedly, the Trump lead in battleground states has been waning since the start of the year.

The third-party candidacy of Robert F. Kennedy Jr. is an interesting difference to the 2024 election landscape, as Kennedy is the most formidable third-party candidate since Ross Perot in 1992, who derailed George H.W. Bush's re-election campaign, allowing Bill Clinton to win the White House.

Focusing on Kennedy's ability to impact the outcome of votes in these battleground states, other than in Wisconsin (where Trump's lead is increasing, though still within the margin of error), the introduction of Kennedy and other candidates outside of the Republican/Democratic mainstream does little to change the nature of the Biden vs. Trump match-up (see chart).

Interestingly, following the former President's felony convictions in New York in late-May, the Trump-Biden differential in polling in these key battleground states moved only marginally with undecided/third-party voters declining and migrating in near equal measure to the two front-runners.

FORMER PRESIDENT TRUMP LEADS CURRENT PRESIDENT BIDEN HEAD-TO-HEAD IN 6 OF THE 7 KEY 2024 BATTLEGROUND STATES



Sources: 270towin.com and UBP.* Including Robert F. Kennedy Jr. Jill Stein, and Cornel West.
** Polling error = actual voting result less last poll in 2016 and 2020. Data through 6 June 2024

Another characteristic of both the 2016 Trump victory and his 2020 defeat beyond the narrowness by which both elections were decided was the significant polling error that was evident in retrospect going into election day.

Recall, in 2016, Trump was projected to lose to Hilary Clinton by 3–4 percentage points in the popular vote, eventually losing by only 2.1 percentage points in the popular vote (but obviously winning in the Electoral College) when all votes were tallied. More importantly, state-level polling in key battlegrounds – Michigan, Pennsylvania, North Carolina, and Wisconsin – understated Trump's vote share significantly on polling day.

In 2020, a post-election review of 2020 pre-election polls from the American Association for Public Opinion Research noted that, as in 2016, polling understated support for Donald Trump. However, beyond this, their after-action analysis indicated that polling error was, "…the highest in 40 years for the national popular vote and in at least 20 years for state-level estimates of the vote."

Taking into account the polling error in the past two elections changes little to undermine (or enhance) the Trump polling lead in the American Sunbelt. However, critically, the significant polling errors in Michigan, Wisconsin and Pennsylvania, ranging from 3 to as many as 8 percentage points in 2016 and 2020, leave open the possibility that the former president's lead across all battleground states is much larger than headline polling might suggest and more importantly outside the margin of error.

Looking beyond polling, President Biden faces a popularity challenge according to Gallup. The company, which has been surveying presidential popularity since 1937, notes that looking at polls in the 13th quarter of a typical 16-quarter presidential term, no president since at least Dwight D. Eisenhower in 1956 has had a lower job approval rating than Biden's 38.7% six months prior to re-election.

While perhaps unsurprising given the political divisions in the US in recent years, since 1956, only President Barack Obama was able to overcome a net unfavourable approval rating (i.e. below 50%) at this stage of the election cycle and hold on to the White House in November. Jimmy Carter, George H.W. Bush, and Donald Trump all succumbed to their respective unpopularity.

Pre-election domestic policy: how Biden might channel Obama's 2012 re-election campaign

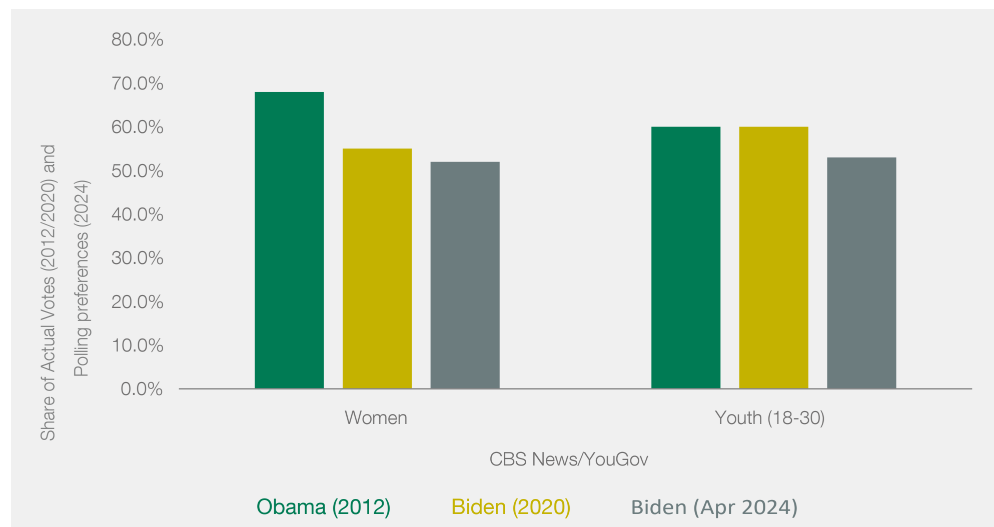
Looking at his 2012 re-election campaign, President Obama achieved what no one else before him managed to do: overcoming net unfavourability with the American public to capture the White House for a second term.

With the 2012 the incumbent seeing job approval as low as 45% in the year before the election, an improving economy allowed Obama to draw even in polls with the Republican candidate Mitt Romney by March 2012, according to Bloomberg News.

By August, President Obama saw his poll ratings rise to 52% vs. Romney's 45% in both CNN and Reuters polls as his job approval rating climbed above 50% for the first time since the early days of his term in 2009.

Inflation eased over the summer of 2012, from over 3% at the beginning of the year to below 2% by the summer, while unemployment, which had peaked at nearly 10% in Obama's first year in office, fell from 9% in late 2011 to below 8% going into election day. Perhaps as important, new job creation stabilised at near 200,000 per month through 2012 following job losses in both 2009 and early 2010.

PRESIDENT BIDEN IS SEEKING TO SHORE UP SUPPORT WITH WOMEN AND YOUNG VOTERS



Sources: Pew Research Center, CBS News/YouGov, Politico.com and UBP.

With unemployment in 2024 well below that seen in the run-up to the 2012 election and job growth similarly tracking at near 200,000 per month through much of 2024, Biden appears to be seeking to recreate the 2012 Obama resurgence in 2024 should he be able

to realise similar declines in inflation from over 3% currently to below 2% like that which helped President Obama regain the confidence of the electorate about his economic policies.

Undoubtedly, the Biden administration is focused on getting inflation to continue to decline going into the election, as evidenced by the announcement of a release of one million barrels of petrol to keep prices from rising meaningfully going into the summer driving season.

The Biden administration is nevertheless providing additional fiscal incentives to various voter blocks. Military personnel will not only see 4.5% base pay increases in 2025, but junior enlisted service personnel will see their minimum base pay rise by as much as 20% in 2025, appealing to younger, lower-income demographics.

Similarly, the Biden administration may seek to further rekindle its popularity among younger voters, which saw more than 80% favouring Biden over Trump in 2020, as he promised student loan forgiveness as part of his campaign platform.

With the US Supreme Court having stalled the Biden student loan forgiveness plan, the President has instead taken a piecemeal approach, forgiving USD 144 billion of the original programme's targeted USD 430 billion in student loans to date.

With Biden and Trump offering a continuation of the current foreign policy trajectory, social policy focuses in the run-up to the election may offer Biden differentiation compared with Trump, just as Obama was able to secure versus Romney in 2012.

Recall, in 2012, 67% of women voters flocked to Obama, as reproductive rights and equal pay were key social issues at the time. Similarly, with the US Supreme Court having overturned Roe vs. Wade (a prior ruling constitutionally protecting abortion) led by Trump-appointed justices in 2022, special elections and 2022 mid-term elections saw Democratic governors win in Arizona, Pennsylvania, Michigan and Wisconsin with reproductive rights as a key platform.

New measures easing restrictions on marijuana similarly look to appeal to a younger voting demographic for the sitting president.

On balance, given the historically low favourability ratings of President Biden, his administration has already begun stimulative policies in an attempt to shore up his support among key voting blocks. This should be a tailwind to growth, and, further afield, potentially inflationary pressure, especially looking into 2025.

Fiscal challenges facing the next US president

While both candidates for the White House in the 2024 election are focusing on the priorities of the electorate, comparatively little attention is being paid to the growing debt burden and the increased interest payments incurred by the US federal government as outlined in *The Rise of Fiscal Dominance* section of our 2024 Investment Outlook (please see Investment Outlook 2024, *Back to the Future*, November 2024).

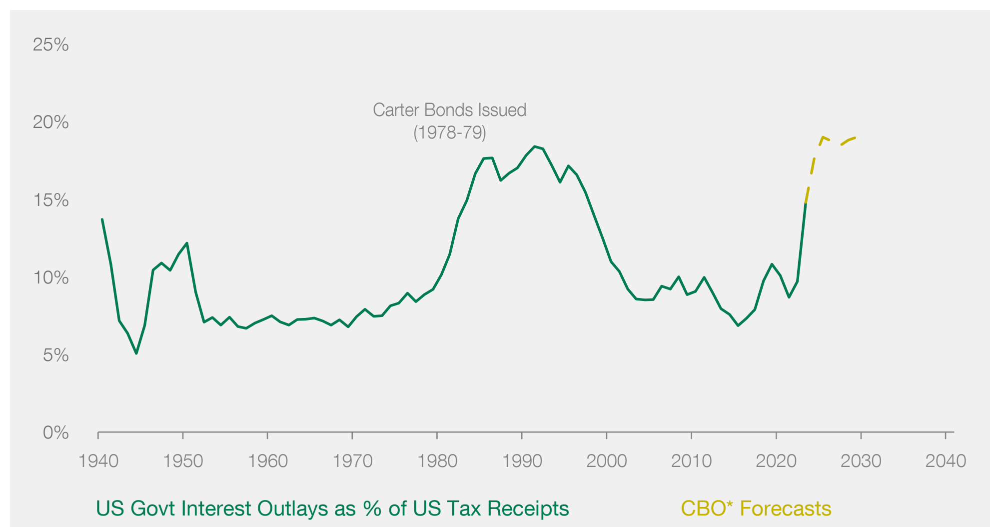
The US federal government's debt-to-GDP ratio reached 120% in 2023, hitting the level last seen following years of wartime spending in 1945. Compounding this problem are interest rates at levels last seen at the dawn of the century, leaving interest costs as a share of tax revenue forecast to reach their highest levels since the early 1980s.

Though the long history of US fiscal profligacy without incident brings some investors comfort, International Monetary Fund research highlights that such overindebtedness has been, "…at the root of many crises experienced by member countries…" that have required IMF intervention.

Typically, in such instances, the IMF-prescribed programmes have focused on "strong belt-tightening" and "structural reforms". A 2023 analysis from the non-partisan Committee for a Responsible Federal Budget highlights the political and economic challenge in reducing US deficits. The Committee estimates that it would take a 27% across-the-board cut of US federal spending to balance the budget.

Indeed, in the case of the United States, the IMF itself and US officials have recently cited the growing US debt burden as a concern. The non-partisan, US Congressional Budget Office director warned as recently as February 2024 that, "…rising interest costs […] pose a risk to [US] economic stability," with current interest outlays by the US Treasury reaching 15% of tax receipts, levels last seen in the early-1980s following the fiscal largesse under President Reagan.

THE US DEBT SERVICE BURDEN IS APPROACHING LEVELS LAST SEEN IN THE EARLY-1980s



Sources: US Congressional Budget Office, Bloomberg Financial L.P. and UBP.
* US Congressional Budget Office.

This challenge takes on particular urgency in 2025, as the debt ceiling agreement struck in June 2023 is set to expire in on 1 January 2025 when it will be frozen at the level reached at the end of 2024. At that point a new Congress will grapple with either a second-term President Biden or Trump to strike a budget agreement.

Recalling the debt ceiling events of 2021 and 2023, once the ceiling was triggered limiting the US Treasury's ability to issue new debt, bond investors saw 10-year Treasury yields rise by as much as 60 bps as the US government enacted "extraordinary measures" in both years. Fortunately, in both episodes, equity markets remained flat and were not pressured by the debt ceiling issues.

Global investors will recall that this set-up mirrors the circumstances facing the UK in autumn 2022. With a new prime minister, a hastily deployed and poorly communicated fiscal programme followed, which paired tax cuts with increased spending. This triggered debt sustainability concerns, resulting in a sharp rise in UK gilt yields and a sharp weakening of sterling.

Given the current political division in the United States, dramatic budget cuts or tax increases of the extent suggested by the Committee for a Responsible Federal Budget seem unlikely to pass a divided US Congress to solve America's problem. That said, we have seen two notable periods where the executive and legislative branches of the US government have come together in the past.

Former Federal Reserve Chair Alan Greenspan, in an earlier role, was able to secure bipartisan tax increases, benefit reductions, and a change in the retirement age to restore solvency of the US social security system, which once again faces exhausting its reserves by 2035 according to its trustees.

Similarly, under former Presidents George H.W. Bush and Bill Clinton, the early-1990s saw bipartisan tax increases (combined with falling defence spending) result in multi-year budget surpluses in the United States by the turn of the century.

Consequently, despite the political divide, the US government will face fiscal pressure, and without credible progress towards reining in this problem, potential pressure from bond markets may result.

A DRAFT TEMPLATE OF THE BIDEN APPROACH TO DEFICIT REDUCTION

While seeming to be an insurmountable obstacle, the 2022 Inflation Reduction Act has provided a draft template which, it appears, a second Biden administration would follow as it faces this challenge.

While most recognise the over USD 400 billion in incentives towards energy security and climate change investments contained in Biden's signature legislative achievement, few focus on the revenue-raising targets of the Act.

It should be remembered that the Act was designed to realise a net deficit reduction of over USD 300 billion over a decade driven by higher corporate taxes (including taxes on stock buybacks) and cost savings from negotiating prescription drug pricing by the government-funded Medicare programme.

Effectively, the Act redirected tax incentives from legacy companies (paying corporate income tax) and pharmaceutical companies (benefiting from pricing power in sales to the government) towards more favoured sectors of the economy (energy security and climate).

Indeed, at his 2024 State of the Union Address, President Biden doubled down on this framework, proposing to partially roll back the 2017 Trump tax cuts to 28% and to raise the minimum corporate tax to 21%. Moreover, the proposal seeks to quadruple the tax on stock buybacks, encouraging corporates to instead, "…invest in growth and productivity."

The Biden proposal also seeks to focus on taxing capital more closely to that of income by removing the preferential tax rate on capital gains and taxing at the marginal income tax rate. The administration also stakes new ground on taxation, seeking to levy a 25% tax on unrealised capital gains for households worth in excess of USD 100 million. A portion of these proposed tax revenues are designed to reduce taxes for low- and middle-income households.

Like in the Inflation Reduction Act, President Biden's proposed budget seeks to enhance tax collection from legacy beneficiaries of recent economic gains (corporates and wealthy individual taxpayers) and redirect a portion of those revenues to low- and middle-income households.

Should the Biden State of the Union plan make its way through Congress, investors may face weakening corporate profits as the fiscal tailwind of recent years eases and effective tax rates rise. Bond markets may breathe a sigh of relief, though given the low historical inflation-adjusted bond yields, we suspect they will have little capability to fall in such a scenario.

With a Biden victory appearing less likely at time of writing, any Biden win would likely result in modest USD weakness, as some of the assumed Trump victory's USD strength is unwound. Currencies with high beta to US growth dynamics would likely appreciate, and by corollary this will weigh on the USD – initially at least; the likes of the CAD, MXN and the EUR would do well in this regard, while the CNY is likely to see only limited moves.

Beyond this initial repricing, the market will likely shift its attention to the wider monetary policy outlook, and assuming that the inflation backdrop continues to normalise, this should result in potential Fed rate cuts and a modest weakening in the USD in the months following a Biden victory.

Since 2016, the USD has illustrated a weakening correlation with the US's twin deficits (fiscal and current account). The fiscal impulse from aggressive tax cuts and infrastructure spending has been beneficial for the USD on the whole. However, these effects are unlikely to persist indefinitely. Increasing concerns regarding US debt sustainability have become more pronounced, and this is likely to result in higher longer-term bond yields and increasing term premia. Depending on the composition of future deficits (spending and financing), we anticipate that the wide deficit will be less cyclically positive for the USD than has been the case over the last seven years.

OUTLINES OF A TRUMP 2.0 ECONOMIC POLICY ARE ONLY JUST TAKING SHAPE

Implicitly recognising the growing fiscal constraints he may come under as the next US president, Donald Trump has focused on extending and making permanent his 2017 tax cuts which are scheduled to expire in 2025, rather than making similar promises as he did in his 2016 campaign to reduce taxes further.

Worryingly, estimates from the Congressional Budget Office (CBO) on the trajectory of the US deficit appear to assume that, even *with* a partial expiration of the 2017 tax cuts,

the US debt service burden will increase to close to 20% of tax receipts by the end of the decade.

Should the Trump tax cuts be made permanent without associated spending reductions, we estimate that the US debt service burden would begin to move into unchartered territory. The last time it reached similar levels in the Reagan-era defence spending and tax reforms, a sharp rise in real interest rates was required to fund the US deficit.

Though few details about a second-term Trump tax/economic policy have been outlined, Trump has once again proposed tariffs, not only on China but also wide-ranging tariffs on all imports.

Looking at the Trump tariffs from his first term, the Tax Foundation, a non-partisan tax policy organisation, estimates that the tariffs imposed on the equivalent of USD 380 billion in trade (at the time imposed) raised approximately USD 80 billion in tax revenue.

While a large amount of revenue, it pales in comparison to the nearly USD 1.5–2.0 trillion annual deficit the CBO estimates looking through the next decade, suggesting that just as under a second Biden administration, a second Trump administration would also face difficult choices as regards fiscal spending and tax policy as early as 2025.

Unlike the Biden administration, which has outlined winners and losers in their proposed redistribution of now limited federal spending (see above), a second Trump administration has only indicated a desire to unburden industry from the increased regulatory oversight imposed under the current administration.

In particular, the traditional energy sector, which has seen its favour wane in support of the new and renewable energy efforts of the Biden administration, may see regulatory hurdles ease, including the 2024 pause on liquified natural gas (LNG) export authorisations, despite the US's leading role in supplying Europe following the sanctions on Russia .

In the event of a second Trump presidency, the USD is likely to appreciate aggressively in the run-up to the election, assuming that polls remain skewed towards a Trump victory. A rise of around 5% in the USD index is feasible. The implication is that a large part of any USD appreciation is likely to manifest itself before rather than after the election.

The prospect of increasing tariffs on all imports into the US will benefit the greenback, as it will likely raise risks of domestic inflation – initially at least – resulting in a "higher-for-longer" stance for US interest rates. These increased tariffs have negative implications for those currencies with high beta to US growth dynamics. This is particularly relevant for the CAD, CNY, MXN and, to a lesser extent, the EUR.

Beyond this, the scope for further aggressive USD appreciation is rather limited in our view. Trade-weighted USD exchange rates are around 11% higher than the levels which preceded the first Trump presidency, meaning that material USD appreciation is less likely than before. Any positive surprise effects will be far less impactful this time around.

While unclear which, if any, of Biden's or Trump's proposals would make its way through Congress in 2025, what Biden's State of the Union proposals and his 2022 passage of the Inflation Reduction Act, as well as Trump's early outlines of economic priorities, highlight is that US spending, be it under a Republican or a Democratic president, will be increasingly constrained and the executive and legislative branches will need to make trade-offs and pursue redistribution just to maintain current aggregate levels of spending.

For investors who have benefited from across-the-board declines in effective corporate tax rates boosting corporate earnings and housing tax rates underpinning the American consumer since 2017, these trade-offs and redistributions may mean dispersion in profitability and stock/bond performance across sectors and companies should increase in the years ahead.

Should a second Trump administration seek to expand the current deficit and debt burden on the US economy and mimic the communications missteps of the former, it may face a "Liz Truss"-style reprimand from bond and currency markets as early as 2025.

Investment strategies going into the run-up to the 2024 US presidential election and beyond

As highlighted above, historically, US presidential election years have been good for equity and credit investors and, against an inflationary backdrop, more challenging for long-dated bond investors.

With the Biden administration likely to continue to deploy fiscal and monetary tools in support of economic activity in the run-up to the November 2024 elections, we expect historical tailwinds for equity and credit markets to remain favourable for investors over the summer.

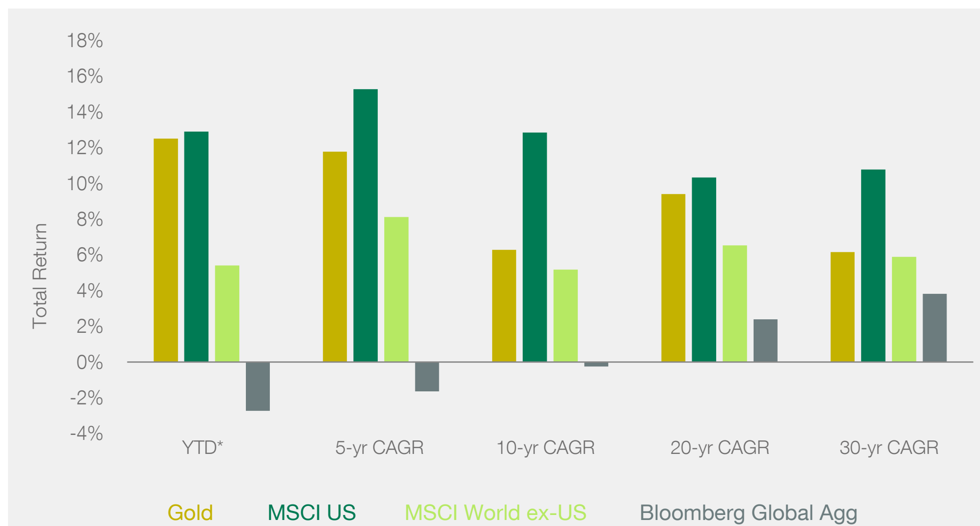
Indeed, with the Biden administration already showing signs of seeking to replicate the 2012 Obama campaign strategies to recover from polling and popularity weakness six months prior to election day, the final semester before November 2024 has the potential to replicate the nearly 12% rally in the S&P 500 from May 2012 to that just prior to the Obama victory in November 2012.

During this period, investors positioned for an earnings-driven equity rally can simultaneously begin building positions to protect against the uncertainties that will build up in 2025, irrespective of who wins the White House in November.

The fiscal challenges facing whoever wins the White House in November 2024 likely mean 2025 presents more meaningful investment and economic uncertainty than the current year.

As outlined in our 2024 Investment Outlook (*Back to the Future*, November 2023), we anticipate that fiscal uncertainty with a new presidential administration would bring about both economic and geopolitical costs which would favour gold.

GOLD HAS DELIVERED GLOBAL EQUITY-LIKE RETURNS GOING BACK 30 YEARS, CONSISTENTLY OUTPACING BONDS AND NON-US EQUITIES



Sources: MSCI, London Bullion Market Association, Bloomberg Financial L.P. and UBP.
* data through 13 June 2024

Indeed, despite the more resilient economic backdrop seen in Western economies year-to-date and a "higher-for-longer" rate regime in the United States, gold's 12% return year-to-date has outpaced both non-US global and nearly kept pace with US equity returns through mid-June. More surprising for many investors will be the fact that gold has outpaced global equities in the pandemic/post-pandemic era (from 2020 to mid-June 2024) and that over the past two decades of economic and geopolitical uncertainty, gold's 9.4% per annum return has outpaced the 6.5% per annum return on global equities. We expect gold to continue to offer similar qualities amidst policy uncertainty looking well beyond 2025.

With either a second term for the current Biden administration or the former Trump administration expected to maintain the deglobalisation foreign policy focus since 2017, the fallout of an accommodative Biden administration seeking re-election combined with the fiscal challenges facing the new administration, investors may have to continue to face renewed interest rate and inflation volatility in the years ahead.

Despite this, US inflation-linked bonds are pricing in expected inflation over the next five years that has only been lower in the deflationary period from 2008–2020. As a result, Treasury Inflation-Protected Securities (TIPS) offer investors asymmetric protection against the prospect of more sustained inflation or inflation volatility in the years ahead that could accompany the ongoing reshaping of the global economic and political landscape.

On balance, while the landscape ahead remains complex, the run-up to the November election should continue to offer investors attractive risk-reward opportunities in equities and credit, as incumbent politicians increasingly seek to placate an anxious electorate.

However, investors should simultaneously begin to prepare portfolios for the more uncertain and riskier backdrop that may emerge in 2025, where the tailwinds of fiscal support may falter and interest rate and inflation volatility may return to challenge equity and bond investors alike.

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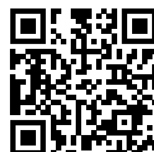

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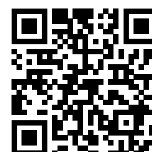

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