ClearBridge
A Franklin Templeton Company

AOR Update: Election implications for US equities

November 6, 2024

Key takeaways

- Assuming expectations of the Republican sweep hold, the initial impacts of Trump's victory are likely to be consistent with 2016, favoring value, small cap and cyclical stocks, albeit to a lesser degree given a more mature economic backdrop and lofty expectations.
- We believe more favorable tax policies, lighter regulation and increased small business optimism in a second Trump administration should boost the outlook for corporate profits enough to offset headwinds from higher tariffs and bond yields and reduced immigration.
- A resilient economy that could be further bolstered by pro-growth policies should prove beneficial for equity investors, who have historically benefited irrespective of party leadership so long as recessions have been avoided.

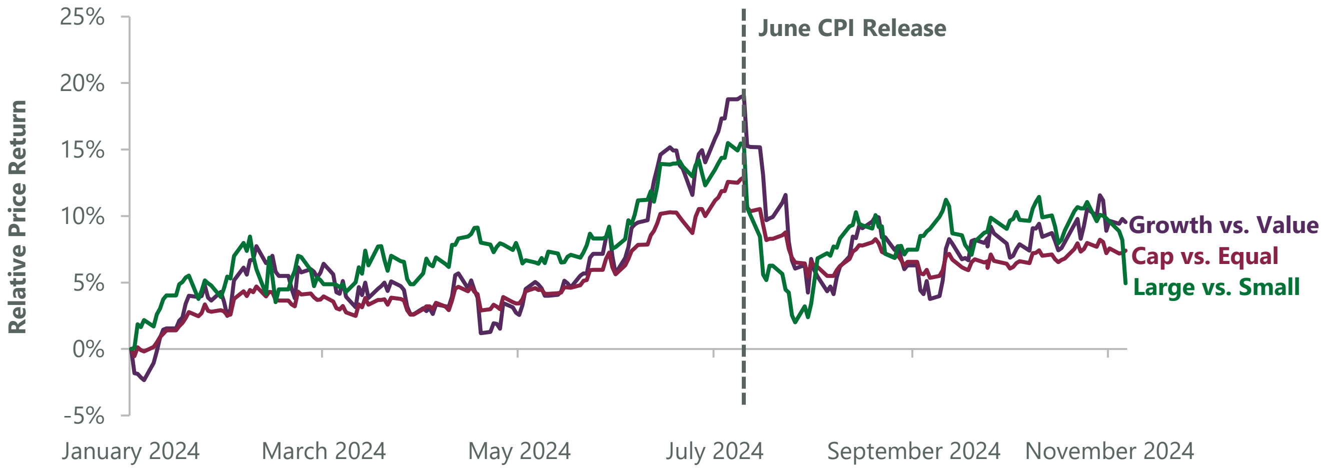
How policy may influence equities and the economy

Donald Trump retook the White House in a strong election night showing for the Republican party, which also regained control of the Senate. The House of Representatives remains up in the air as of publication but appears to be headed toward remaining under narrow Republican control, which would complete a GOP sweep. Much ink will be spilled in the coming days analyzing what drove the electoral results. For equity investors, however, the most important considerations are more about what comes next than about how we got here.

Assuming Republicans maintain a House majority, the initial impacts are likely to be directionally consistent with 2016, albeit to a lesser degree given today's more mature economic backdrop and lofty embedded expectations. Trump's pro-business approach could once again rekindle animal spirits and buoy capital spending, M&A and other forms of investment. For example, the National Federation of Independent Business Small Business Optimism Index jumped by 11.7 points during the fourth quarter of 2016, the largest 3-month bounce since 1980. When combined with a more favorable corporate and individual tax regime, along with a lighter regulatory touch, the outlook for corporate profits appears healthy. These catalysts helped power equities higher both ahead of the election as the chances of a GOP sweep increased, as well as on November 6.

Not all of Trump's agenda is market-friendly, however. Potential headwinds exist, notably from the prospect of increased tariffs, reduced immigration and the potential for higher long-term interest rates. In fact, the 10-year US Treasury rose 16 basis points in the first trading day post-election, continuing a bond selloff that has seen yields rise more than 80 bps since mid-September. The previously mentioned tailwinds have so far been viewed as outweighing the potential headwinds from an economic and corporate profits perspective, but ultimately the specific policy details will have the most influence on the trajectory of earnings and economic growth.

Exhibit 1: The Rotation Has Begun



Data as of Nov. 6, 2024. Sources: S&P, Russell, UBS, and Bloomberg. Note: Mag7 vs. 493 is the UBS Mag 7 relative price return vs. UBS S&P ex Mag 7; Cap vs. Equal is the S&P 500 relative price return vs. S&P 500 Equal Weight; Large vs. Small is the Russell 1000 relative price return vs. Russell 2000; Growth vs. Value is the Russell 1000 Growth relative price return vs. Russell 1000 Value.

Which policies get advanced, the order in which they do, and the degree to which they are implemented will all be important for equity investors. For the overall market, the degree to which stronger corporate profits can offset the risk to valuations from higher long-term interest rates will be crucial. Within the market, however, we believe the leadership rotation that began in early July is likely to continue in the coming months. Stocks' initial response supports this notion, with further gains for many of the recent leaders supporting dynamics such as value over growth, small cap over large, the equal weight S&P 500 over the cap-weighted version, along with cyclicals over defensives.

Over the longer term, the economy tends to trump politics (pun intended) when it comes to what drives equity returns. The Federal Reserve's steps to begin normalizing short-term interest rates in recent months have helped bolster the chances of a soft landing. Pronounced rate cuts typically come as the economy is decelerating but that is not the case today with third-quarter GDP coming in at 2.8%, in-line with the average over the prior three years. This development, coupled with the overall green/expansionary signal from the ClearBridge Recession Risk Dashboard, has further emboldened our optimism on the economic front. There are no signal changes this month, although several indicators improved beneath the surface.

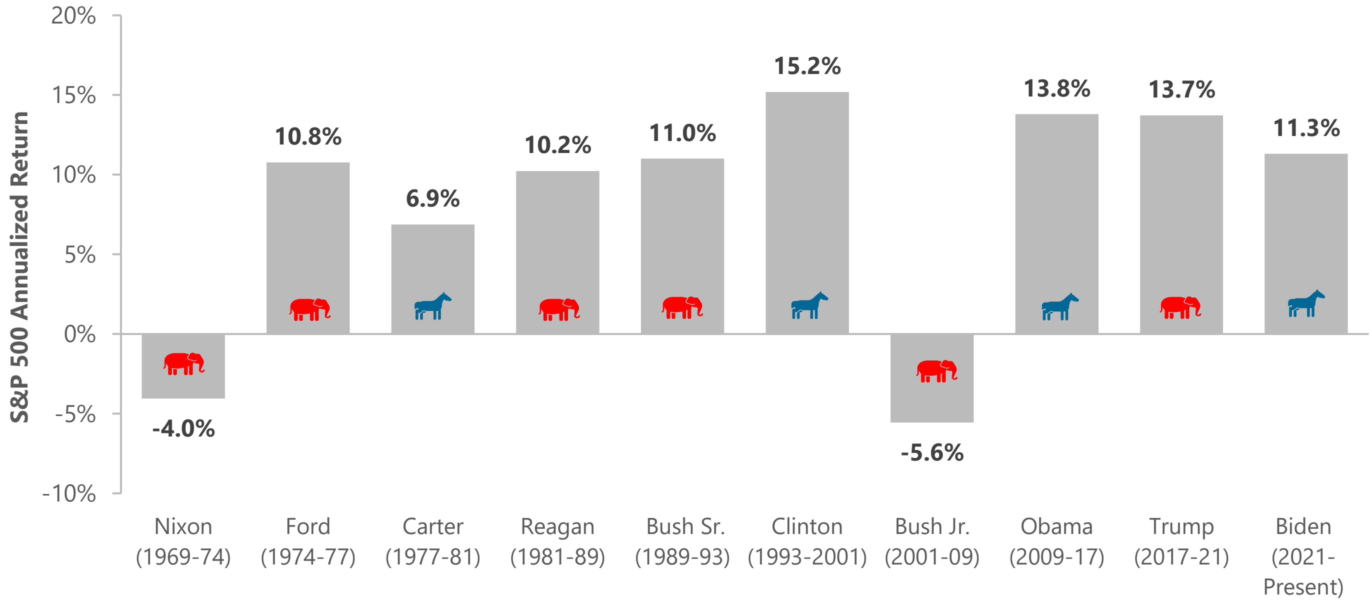
Exhibit 2: ClearBridge Recession Risk Dashboard

		October 31, 2024	June 30, 2024	March 31, 2024
Consumer	Housing Permits	●	●	●
	Job Sentiment	✖	✖	✖
	Jobless Claims	⬆	●	●
	Retail Sales	●	●	●
	Wage Growth	⬆	⬆	✖
Business Activity	Commodities	⬆	●	●
	ISM New Orders	✖	●	●
	Profit Margins	⬆	⬆	✖
	Truck Shipments	●	●	●
Financial	Credit Spreads	⬆	⬆	●
	Money Supply	●	●	✖
	Yield Curve	✖	✖	✖
	Overall Signal	⬆	⬆	●

⬆ Expansion ● Caution ✖ Recession

Source: ClearBridge Investments.

Exhibit 3: It's The Economy...



Data as of Nov. 6, 2024. Source: FactSet.

A resilient economy—that could be further bolstered by pro-growth policies—should prove beneficial for equity investors, given the strong linkage between the economy and corporate profits. Historically, equities have delivered solid returns under leadership from both parties, with eight of the last 10 administrations presiding over positive US equity performance ranging from 7% to 15% annualized. The two presidents with negative returns during their time in office had the misfortune of recessions occurring both early and late in their terms: 1969-1970 and 1973-1975 for Richard Nixon (in office 1969-1974), and 2001 and 2007-2009 for George W. Bush. With a recession unlikely in the near term, history suggests robust US equity performance during the second Trump administration.

Definitions

The **ClearBridge Recession Risk Dashboard** is a group of 12 indicators that examine the health of the US economy and the likelihood of a downturn.

S&P 493 is known as the **S&P 500 Index** excluding the seven technology stocks (Magnificent Seven). The **S&P 500 Index** is an unmanaged index of 500 stocks that is generally representative of the performance of larger companies in the United States.

The **Russell 1000 Index** is an unmanaged, capitalization-weighted index of domestic large-cap stocks. It measures the performance of the 1,000 largest publicly traded US companies in the Russell 3000 Index.

The **Russell 1000 Value Index** is an unmanaged index of those companies in the large-cap Russell 1000 Index chosen for their value orientation.

The **Russell 1000 Growth Index** is an unmanaged index of those companies in the large-cap Russell 1000 Index chosen for their growth orientation.

The **Russell 2000 Index** is an index of domestic small-cap stocks that measures the performance of the 2,000 smallest publicly traded US companies in the Russell 3000 Index.

The **National Federation of Independent Business Small Business Optimism Index** is a composite of ten seasonally adjusted components. It provides an indication of the health of small businesses in the United States, which account of roughly 50% of the nation's private workforce.

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