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Post US elections: We have a clear winner

Donald Trump has defeated Kamala Harris in the US presidential election, with the Associated Press able to declare this victory as early as Wednesday 6 November, European time. US equities rose to new all-time highs, with the small cap segment being the largest winner. Big moves were recorded in currencies and fixed income, with the US Dollar strengthening across the board while US 10-year yields rising sharply to 4.45% reflecting further fiscal slippage. We keep a positive stance on US equities and a cautious view on US duration.

Three observations on the market situation leading up to the elections

1. **Market expectations:** Financial markets had been betting on a Trump victory for the past few weeks, a phenomenon known as the "Trump reflation trade." However, significant doubts emerged over the past week about a potentially tighter race between Trump and Harris.
2. **Election uncertainty:** The biggest risk leading up to this election was the possibility of a prolonged period of uncertainty before determining a winner, potentially resulting in a contested outcome and threats of civil unrest.
3. **Investor caution:** Many investors had reduced risks in their portfolios, either by hedging their exposure or downsizing their positions in equities.

The biggest surprise: The speed of the election result was unexpected and the fact that Donald Trump won the popular vote by such a wide margin. The Associated Press and most international leaders quickly recognised Trump's victory. French President Emmanuel Macron congratulated him at 9:15 am European time, expressing readiness to work together. Ukrainian President Volodymyr Zelensky also congratulated Trump on his "impressive election victory" while expressing hope that the US will play a key role in ending the war.

As clarity emerges, many investors will likely need to reposition themselves by unwinding their hedges and realigning their portfolios. The fear of missing out, or "FOMO" will drive many investors to reposition, potentially leading to more market upside.

Market reactions

- **US Equities:** US equities reacted positively, gaining 2% intraday. The small-cap segment was the biggest beneficiary, advancing by 5%.

- **International Equities:** Reactions were more muted outside the US. Japanese equities reacted positively due to their close military ties with the US and the weakness of the JPY. European equities initially rose, but sector performance diverged. Healthcare, defence, and financial services sectors performed well, while autos and utilities, especially renewables, saw double-digit losses due to fears of reduced Inflation Reduction Act benefits and tariffs. Chinese equities were mixed, with the Hang Seng down but domestic indices almost flat. Despite Trump's vocal stance on China, the upcoming National People's Congress meeting is expected to announce significant fiscal stimulus measures, potentially benefiting Chinese equities.

- **Currencies**: The dollar surged 2-3% against major currencies, reflecting market expectations of Trump's inflationary policies leading to fewer rate cuts and a yield advantage. Gold lost more than 2% as investors may turn to bonds given the rise in bond yields.

- **Fixed Income:** US 10-yearTreasuries saw a massive move, gaining 15-20 basis points to trade as high as 4.45%, with the yield curve "bear steepening." In Europe, Bund yields headed lower, as markets perceive Trump as negative for European growth, increasing pressure on the European Central Bank (ECB) to cut rates further.

- **Volatility:** The VIX index, a key forward-looking gauge of risk in US equities, has dropped from 22% on Monday 4 November to 16% on 6 November. This decline reflects the dissipating uncertainty following the conclusion of the US elections. US bond yields should remain volatile as the future impact of Trump's economic policy on inflation and thus rates is still unknown.

Our Views

- **Equities**: We remain constructive, with an overweight position in US and Emerging Market equities. We have already built positions in quality US small caps and maintain a positive stance. We believe that the rally still has legs, but at current levels, we prefer not to add any further risk by chasing it. Euro Area equities remain a dark spot for now, as we do not think investors are ready to reposition there yet.

- **Emerging Market Equities**: We reinforced our stance with the first leg of Chinese stimulus late September and remain unchanged. We believe the Chinese government will continue to take significant steps to offset the impact of US tariffs.

- **Currencies**: We maintain our positive stance on the USD.

- **Fixed Income**: We are divided. After being underweight duration and avoiding the US 10-year segment, the move from 3.6% to 4.45% is well advanced. We expect fixed income volatility to persist and are cautious about further moves to 4.75%. We remain tactical on duration.

Key risks going forward

- **Congressional dynamics:** If Congress leans Republican, it could add pressure on US long-term rates, giving Trump full power to implement his program.

- **Treasury rates and equity valuations:** The key short-term risk is evaluating the level at which US 10-year Treasury rates will start to hurt equity valuations. The October 2023 move to 5% halted the S&P 500 rally and raised concerns.

- **Inflation and Federal Reserve (Fed) Policy:** Medium-term risks include increased inflation due to tariffs, potentially preventing the Fed from cutting interest rates. Our current scenario predicts the Fed cutting rates to 3.5% by the end of 2025, but a "red sweep" could result in a more hawkish stance. For now, the Fed's policy normalisation should stay the course despite Trump turbulence in its 7 November meeting, where we expect them to cut rates by 25 basis points. The market anticipates Fed rates to go to 3.75% by the end of 2025, this has not materially moved on the election results as the market had already repriced a smaller number of rate cuts over the past couple of months. In contrast, the ECB may need to cut rates more aggressively if European GDP growth weakens significantly. Nevertheless, if the euro currency continues to weaken, it will cause an issue for the European governing council to cut rates more aggressively, especially if new Trump tariffs were to reignite European inflation fears. Furthermore, the sudden break-up in the ruling coalition in Germany will reopen the debate around fiscal austerity and the need to stimulate investment in Europe.

This analysis aims to provide a comprehensive overview of the post-election market landscape and help investors navigate potential opportunities and risks.

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