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iA Global Asset Management

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Trading around Trump 2.0

The U.S. election scheduled for November 5 is still a long way off, and global markets are likely to trade more in response to the Federal Reserve's decisions than to political developments for many months. Still, given the many potentially disruptive policies that could characterize a Trump 2.0 presidency, we thought we'd take an early look at the main issues and, more importantly, several ways to position for them when the time comes.

Why is the next election so important?

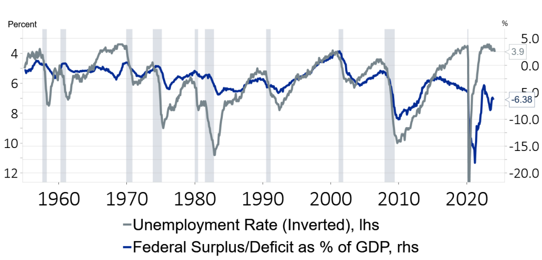
Given that President Trump's proposals diverge from President Joe Biden's in terms of ideas and focal issues, we think a second Trump presidency would involve a significant government overhaul, arguably with greater impact than that of his first term.

Even though one could argue that every U.S. election has the potential for far-reaching economic impacts, the next one might be even more consequential, given the significant expansion of fiscal policy as an economic tool under both candidates.

From the Trump tax cuts of 2017 to the stimulus programs enacted during the COVID pandemic and Biden's Inflation Reduction Act (IRA) of 2022, both Presidents have used fiscal policy more than their predecessors did. In fact, around the time when Trump's tax cuts were implemented in 2017, the historical relationship between the strength of the labour market and the size of the budget deficit began to break down. As illustrated below, the unemployment rate and the budget deficit have diverged over the past two presidential terms.

U.S.: Fiscal policy has lost its countercyclical nature

Budget surplus/deficit as % of GDP vs. unemployment rate



Source: iAGAM, as at 2024 Q1

Highlights

- The next American presidential election could have even greater repercussions than the last, due to marked divergences in fiscal and economic policies.
- The impacts on the Canadian economy may be mixed and will largely depend on trade policy developments.
- While it is too early to take positions, a second Trump presidency would favor the U.S. dollar and U.S. small-cap stocks, but would be negative for bonds.

Outlook on global asset allocation (1-3 months)

APRIL 2024	--	-	N	+	++
ASSET CLASSES					
Money Market			●		
Fixed Income		●			
Equities				●	
Alternatives			●		
RELATIVE EQUITY					
Canadian Equities			●		
U.S. Equities				●	
International Equities			●		
EM Equities			●		
RELATIVE FIXED INCOME					
Government Bonds		●	←		
IG Corporate Bonds			●		
HY Bonds		→	●		
OTHERS					
Oil			●		
Gold				●	
USD (trade weighted)			●		
CAD/USD			●	←	

Moreover, the coordination (or lack thereof) between fiscal and monetary policy matters a lot for investors. We think this issue would be of greater importance in a second Trump presidency, as opposed to a second Biden administration, owing to the likelihood of conflict between Trump and the Fed.

The four main axes of a Trump 2.0 presidency

In considering the main policy axes of a Trump presidency, we tend to think of four main pillars:

1. **Climate policy and the Inflation Reduction Act (IRA):** This key Biden achievement is expected to provide more than $400 billions of funding over 10 years for clean-energy manufacturing and deployment. Even though Trump has promised to repeal the IRA, we think a watering down with changes to funding guidance and spending programs is more likely. Our reasoning is simple: 60% of wind/solar/storage investment and 90% of battery investment are directed toward Republican or swing states.
2. **Potential withdrawal from the United States-Mexico-Canada Agreement (USMCA) and the return of "tariff man":** Trade was a key focus of Trump's first term, and it is natural to expect more of the same in a second term. The question is whether he would again threaten to withdraw unilaterally from the trade deal he himself negotiated, and even whether it would be legal to do so without approval from Congress (this question was never answered in his first term). Note that all three countries can withdraw at any point with just six months' notice, and that the deal must be renegotiated every six years, with the first renegotiation due in 2026.
3. **Tax cuts, or at least extension**: Trump has so far been quiet about taxes, but it is reasonable to expect him to extend individual and corporate tax cuts. The Tax Cuts and Jobs Act (TCJA) is set to expire at the beginning of 2026, and whether it is extended will be a determining factor for the long-term perspectives of the structural deficit.
4. **The United States' role as the global watchdog and the future of NATO**: Even though Trump has not publicly said the U.S. would pull out of NATO, it has been reported that he is inclined to do so, or to at least get out of Europe. A full withdrawal from NATO has become less likely since December 2023, when Congress added to the annual defence policy bill a provision that requires the Senate to approve such a presidential decision.

How would Canada be affected?

Canada's trade relationship with the United States runs deep: 78% of the country's goods exports go to the U.S., or an impressive 21% of Canadian GDP. At the forefront of Canadian exports to the U.S. are energy products (more than 20% of all Canadian exports), motor vehicles and parts (10% of total exports) and consumer goods (slightly less than 10% of total exports).

On these matters, we have a few reasons to be cautiously optimistic. First, the USMCA has a provision exempting the first 2.6 million vehicles imported from Canada, largely limiting potential damage from a change in U.S. trade policy. Second, it would be surprising to see the new president purposely push gasoline prices higher through tariffs on Canadian oil. Third, any watering down of the IRA would probably make investments in Canada's energy sector relatively more attractive.

Still, it goes without saying that any watering down or outright ending of the USMCA would be hugely disruptive, especially if the friendly treatment that Canada benefits from were to expire, and the country's exports became (even temporarily) exposed to a new, flat 10% U.S. tariff. The Canadian government would then most likely answer with tariffs of its own, further weighing on Canadian importers and exporters. The economic impact of such an outcome is generally estimated as a 1% hit to GDP.

Over all, given the importance of the United States as an economic partner, we also need to take into consideration that any policy shift that benefits U.S. growth in the short and medium runs (such as the extension of individual and corporate tax cuts) would also benefit Canadian growth directly or indirectly. A good example of this was the inclusion of a minimum wage clause in the auto sector, which benefitted both U.S. and Canadian production.

On the defence spending front, Canada has been a target of Trump's comment on "delinquent" members of NATO, and pressure to reach the target of 2% of GDP spent annually on defence would mount significantly. The 2023 numbers show that Canada is not too far from the target, at 1.3% of GDP, although it remains to be seen whether the population would support cutting elsewhere to fill the gap. It is reasonable to expect some arm-twisting in the years ahead.

Finally, another area to consider is immigration. A harder stance from the U.S. would once again increase Canada's attractiveness for top talent, adding to the demographic tailwind currently at play (and, incidentally, the pressure on housing).

How can we trade in this scenario?

Tying everything together, we find that the implications of November's U.S. election could be significant. Although we don't recommend positioning for the outcome too early, here are our projections for market responses.

First, a repeal or a watering down of the IRA would probably be negative for equities (less global investment) but positive for bonds (downward revision to global growth and inflation forecasts). On a sectoral level, potential winners would be the Canadian energy sector, U.S. shale and conventional energy, while U.S. clean energy plays would, of course, lose some of their lustre. Finally, U.S. industrials would be net losers, along with engineering and construction firms.

Second, new trade tariffs would be generally inflationary and negative for equities and bonds, although U.S. small cap equities could benefit, given their more domestic focus. On a sectoral level, we note that the U.S. consumer discretionary sector could suffer (higher propensity to import and high price elasticity of demand for the consumer base), as well as the U.S. materials sector, which is sensitive to global trade, given the importance of plastics, packaging and chemicals within the sector. Interestingly, given its domestic focus, U.S. health care could become a winner by omission.

Third, tax cuts would be positive for equities, given stronger demand (individual) and higher profitability (corporate), and negative for bonds, given stronger nominal growth. We would expect cyclicals to benefit over defensives, and energy to be a winner through stronger demand. U.S. small caps could also benefit, given their domestic focus.

Fourth, the NATO situation would most likely be neutral for global equities, although it could be seen as negative for bonds, given the potential for more inflationary pressures coming from massive military spending in Europe. An obvious winner would be the defence sector, although performance has already been robust over the past year and some of the move might already be priced in.

Over all, all these axes seem to be positive for the U.S. dollar, given their domestic focus.

Summary of the main winners and losers in a Trump 2.0 presidency

Four main axes	Winners	Losers
Repeal or watering down of IRA	▪ Bonds ▪ Canadian energy ▪ U.S. shale ▪ U.S. dollar	▪ Equities ▪ U.S. clean energy ▪ U.S. industrials
Trade tariffs	▪ U.S. small caps ▪ U.S. health care ▪ U.S. dollar	▪ Equities ▪ Bonds ▪ U.S. consumer discretionary ▪ U.S. materials
Tax cuts	▪ Equities ▪ Cyclicals ▪ Energy ▪ U.S. small caps ▪ U.S. dollar	▪ Bonds ▪ Defensives
NATO pressures	▪ Defence ▪ U.S. dollar	▪ Bonds

One final note on the interaction between fiscal and monetary policy.

If Trump were to pursue highly expansionary fiscal policy (extended tax cuts and continued high fiscal spending on his priorities), while the Fed kept monetary policy relatively loose, we would expect the yield curve to steepen, with higher yields led by the back end of the curve. This situation would probably tarnish the U.S. dollar, as investors may become less enthusiastic about U.S. Treasuries.

Conversely, loose U.S. fiscal policy, coupled with tight monetary policy, has historically been positive for the greenback.

What are our current views?

We have maintained an optimistic outlook on equities throughout the first quarter, and we continue to do so. The strength of the U.S. equity market has been particularly impressive amid a context of fewer rate cuts being priced in, signs of core inflation reacceleration and shifts within the market. Although three of the Magnificent Seven U.S. large caps had negative returns in the first quarter, other areas of the market have compensated, showing signs of internal rotations. Recent rallies in cyclical sectors also reflect a reacceleration of U.S. economic growth.

Even though the rise in equity valuations may slow in the coming months, we think equities are likely to outperform bonds for the rest of the year, given the positive outlook for corporate earnings.

Our view on fixed income is more neutral, if not slightly cautious. Fed Chair Jerome Powell's emphasis on rate cuts, despite reaccelerating core inflation, signals challenges ahead as the last few miles of disinflation may prove difficult. This context may limit the Fed's ability to cut rates as much as it desires. While high-yield valuations look stretched, we have upgraded our view because we don't see an immediate catalyst for weakness, given the U.S. economic upturn.

Furthermore, the U.S. economy's continued outperformance raises questions about the current restrictive rates and may eventually lead to a reassessment of long-run neutral rate estimates. Although real yields are relatively attractive, bonds at current yield levels can provide an effective hedge against unforeseen shocks. Consequently, we have shifted our view on government bonds to slightly negative.

We also reiterate our positive view on gold. Gold serves as an effective hedge against inflation and has demonstrated resilience despite historical negative drivers. Despite the absence of falling real yields and the strong U.S. dollar, gold has managed to rally. Factors such as continued buying by global central banks in response to Russia's aggression in Ukraine and above-target realized inflation support the strength of gold prices.

Sébastien Mc Mahon, MA, PRM, CFA
Chief Strategist, Senior Economist and Vice-President, Asset Allocation & Portfolio Manager

Alex Bellefleur, MA, CFA
Senior Vice-President, Head of Research, Asset Allocation

Tuyen Tran, M. Sc., CFA
Senior Analyst, Asset Allocation

Market Performance

Total returns as of March 28, 2024, in $CA

	MTD	QTD	YTD	1Y
EQUITIES (LOCAL CURRENCIES)				
S&P 500	3.2%	10.6%	10.6%	34.4%
S&P/TSX	4.1%	6.6%	6.6%	16.6%
NASDAQ 100	1.2%	8.5%	8.5%	44.8%
MSCI World Net	3.4%	10.1%	10.1%	30.3%
MSCI EAFE Net	3.9%	9.8%	9.8%	22.0%
MSCI EM	2.8%	4.3%	4.3%	12.9%
COMMODITIES (USD)				
Gold	9.1%	8.1%	8.1%	13.0%
CRB	2.3%	5.1%	5.1%	-2.2%
WTI	6.3%	16.1%	16.1%	13.6%
FIXED INCOME				
FTSE Canada Universe	0.5%	-1.2%	-1.2%	2.4%
FTSE Canada Long Term	0.3%	-3.6%	-3.6%	1.4%
FTSE Canada Corporate	0.5%	0.1%	0.1%	5.8%
CURRENCIES				
DXY	0.4%	3.2%	3.2%	2.1%
USD/CAD	-0.3%	2.2%	2.2%	-0.4%
USD/EUR	0.2%	2.3%	2.3%	0.5%
USD/JPY	0.9%	7.3%	7.3%	15.7%
USD/GBP	0.0%	0.9%	0.9%	-2.2%

	MTD	QTD	YTD	1Y
SECTORS S&P/TSX				
Financials	3.4%	5.5%	5.5%	21.0%
Energy	7.3%	13.1%	13.1%	25.9%
Industrials	2.9%	11.1%	11.1%	19.3%
Materials	15.4%	5.8%	5.8%	-2.5%
Information Technology	-0.3%	4.8%	4.8%	47.5%
Utilities	2.6%	-1.1%	-1.1%	-4.9%
Communication Serv.	-6.6%	-8.5%	-8.5%	-13.5%
Consumer Staples	-3.1%	4.0%	4.0%	11.4%
Consumer Discretionary	1.0%	4.5%	4.5%	15.1%
Real Estate	2.3%	1.7%	1.7%	6.3%
Health Care	13.5%	18.4%	18.4%	43.1%
SECTORS S&P 500				
Information Technology	2.0%	12.6%	12.6%	52.6%
Health Care	2.4%	8.9%	8.9%	18.3%
Consumer Discretionary	0.1%	5.0%	5.0%	35.8%
Financials	4.7%	12.3%	12.3%	36.0%
Communication Serv.	4.3%	15.8%	15.8%	55.2%
Industrials	4.4%	10.9%	10.9%	29.8%
Consumer Staples	3.4%	7.3%	7.3%	8.2%
Energy	10.6%	13.7%	13.7%	20.6%
Utilities	6.6%	4.6%	4.6%	3.1%
Real Estate	1.8%	-0.5%	-0.5%	16.1%
Materials	6.5%	8.9%	8.9%	21.9%

About iA Global Asset Management (iAGAM)

Rooted in history, innovating for the future.

A magnet for top investment talent, iA Global Asset Management is one of Canada's largest asset managers, with over $100 billion under management across institutional and retail mandates. We help investors achieve their long-term wealth creation goals through innovative investment solutions designed for today's complex markets. We are building upon our historic success, supporting the growth of our core strengths, and exploring innovative ways to meet investor needs. We are rooted in history and innovating for the future. Our experienced portfolio managers use a proprietary investment methodology, rooted in iAGAM's unifying commitment to strong risk management, analytical rigor and a disciplined, process-driven approach to asset allocation and security selection.