Investment Strategy Note

October 2024

OPHIR

How will Trump's win affect the share market?

All eyes have been on the U.S. election, with Trump securing his second term in office. With the Republicans having all but sealed both chambers of Congress, will we see radical reform in the U.S?

In this month's Strategy Note, we look at the performance of the S&P500 following a U.S. election since 1960. We examine Trump's policy agenda and the potential implications on the share market, and more specifically small caps. Since the election, we have seen small caps outperform large caps in the U.S. and we are optimistic that the starter's gun has fired; potentially marking the start of a narrowing of the gap in valuations between large cap and small cap stocks.

On the 5th of November 2024, U.S. voters resoundingly elected Donald Trump as the nation's 47th President.

New governments inevitably bring about change. In most instances new policies are forgotten and business continues as before.

Yet sometimes a new government can attempt radical reform – such as the repeal of the Glass Steagall Act or the implementation of the Affordable Care Act (Obamacare) – that may require a total reassessment of the opportunities and risks facing listed companies.

Not only has Trump won the Presidency, but the Republican Party appears on track to control both the House and Senate. A clean sweep *could* pave the way for Trump to implement radical reform and upend the outlook.

In the lead-up to the election, the tightness of the race resulted in some market swings as the probabilities of outcomes shifted between candidates, but overall, markets didn't see a significant amount of volatility. However, since the election, the Trump trade has been well and truly on.

But do elections really alter the fortunes of equities, particularly when the governing party changes?

And should investors be concerned about the potential impact of the Trump victory on the stock market and other markets?

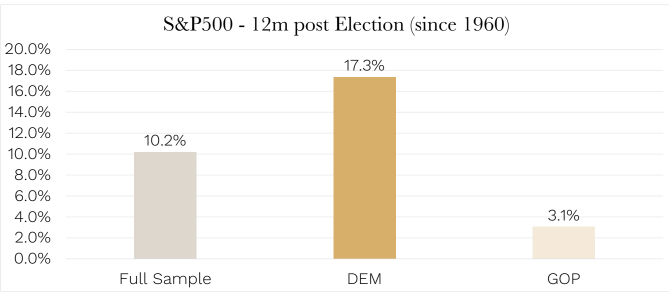
				% change	
	30-Sep	5-Nov	12-Nov	30 Sep - 5 Nov	5 Nov - 12 Nov
S&P 500	5762.5	5782.8	5984	0.40%	3.50%
Russell 2000	2230	2260.8	2391.8	1.40%	5.80%
Bitcoin	64290	69860	90090	8.70%	29.00%
US 10yr	3.78	4.27	4.43	13.00%	3.70%
DXY	100.8	103.4	106	2.60%	2.50%
Gold	2634.6	2744	2598.4	4.20%	-5.30%
Oil	68.17	71.99	68.12	5.60%	-5.40%

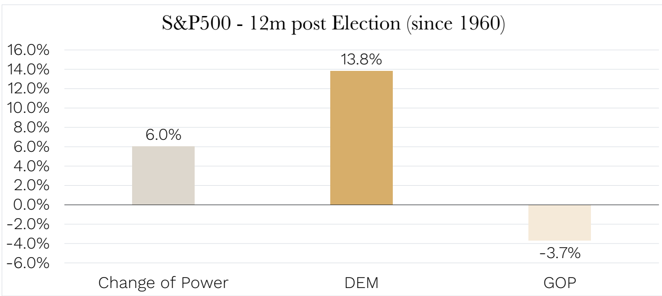
The impact of elections on equities

We looked at how the S&P500 Index traded through each U.S. election since 1960. The period covers 16 elections, with nine Democrat wins and seven Republican victories.

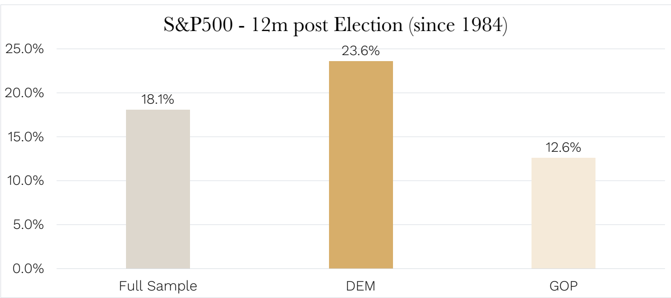
As you can see, on average, the S&P500 rose 10.2% in the first twelve months following a U.S. election. When the government changed hands, the increase in the S&P500 was less material at 6.0%.

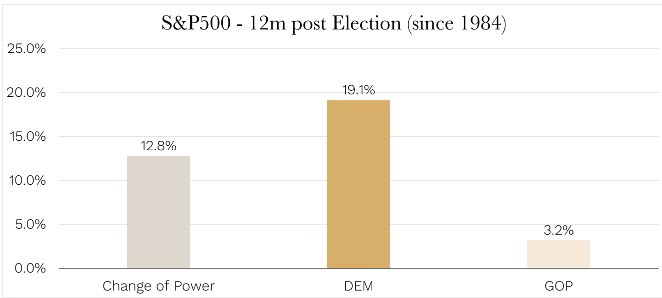
Interestingly, in the first year following a Democratic win, the S&P500 Index has generated stronger returns than a Republican win. This may sound counter-intuitive, as conventional wisdom suggests Republicans are better for markets given their pro-business stance.





As we look deeper into the data, the return profiles following elections since 1984 have been more attractive, with the same Democrats vs Republican trends holding true.

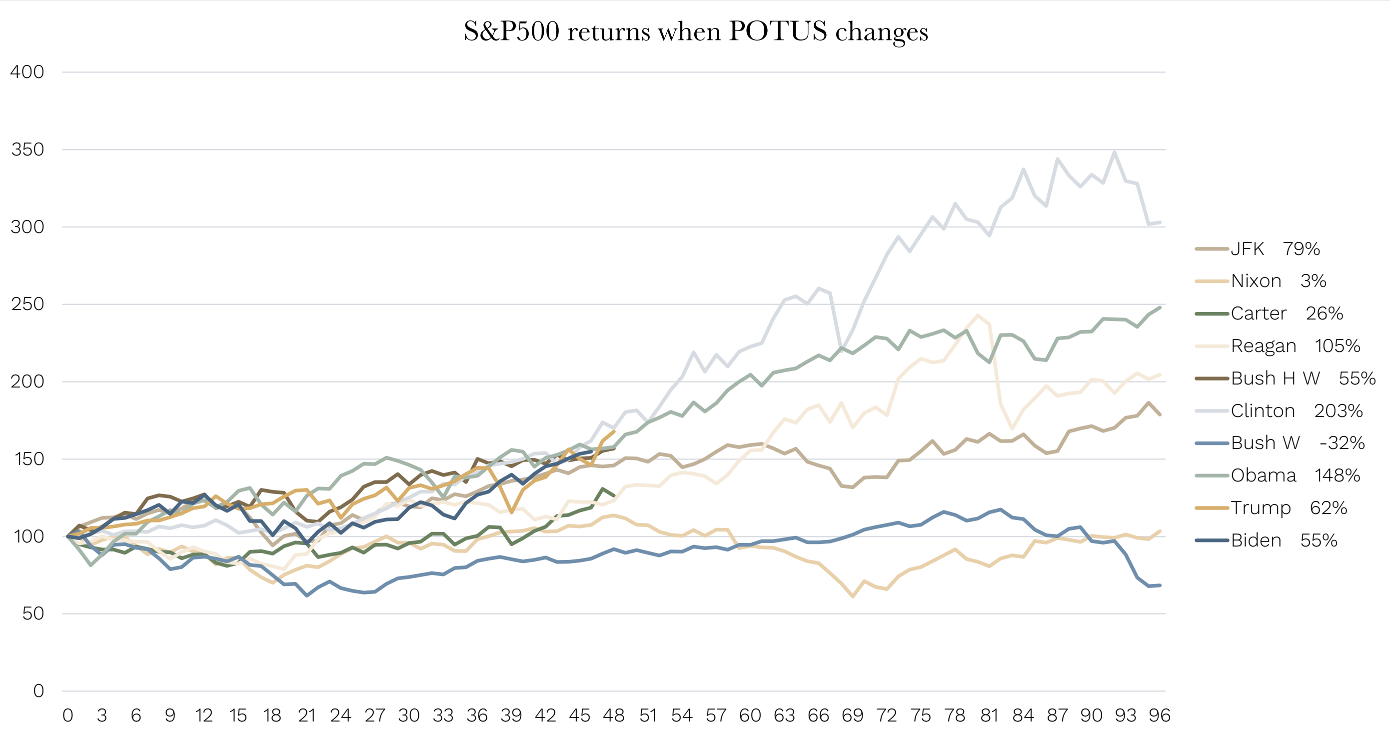




Source: Ophir, Bloomberg.

Presidential performances

Typically, a change in government is good for U.S. equities, which can be seen in the chart below.



Source: Ophir, Bloomberg.

However, individual terms and specifically the first year following an election can be heavily influenced by idiosyncratic factors that aren't necessarily linked to the governing party:

- **Bill Clinton's** two terms in office saw the fastest market rally. The S&P500 gained of 203% over eight years. The rally was fuelled by the repeal of the Glass-Steagall Act, which allowed commercial and investment banks to merge and expand financial product offerings.
- During **Barak Obama's** term the S&P gained 148% gain in a post-GFC rally. Had the financial crisis occurred during Obama's tenure (instead of just before), it would have weighed down the market returns through his term.
- Under **Ronald Reagan**, the market rose 105% with the Black Monday crash of 1987 causing the underperformance.
- The Iraq war and the September 11 attacks dragged the market down 32% under **Bush Jr**.

What policies is Trump looking to implement?

Now that Trump has won the presidency and likely both chambers of Congress, he has a platform to enact sweeping and impactful change.

Trump plans include, but are not limited to:

- Reduced Corporate tax rates
- Reduced personal taxes through reduced social security taxes, no tax on tipped income or overtime pay as well as reductions for first responders and military.
- Increased tariffs, particularly on China.
- Propping-up fossil fuel industries, particularly oil and gas.
- Potential deportation of unauthorised immigrants.
- Mixed outcomes on defence with a potential pull back from Ukraine and Europe more broadly, but a likely redirection towards China.
- Building a U.S. Strategic Bitcoin Reserve of 1 million Bitcoin over the next 5 years.

Resulting from these policies we could see:

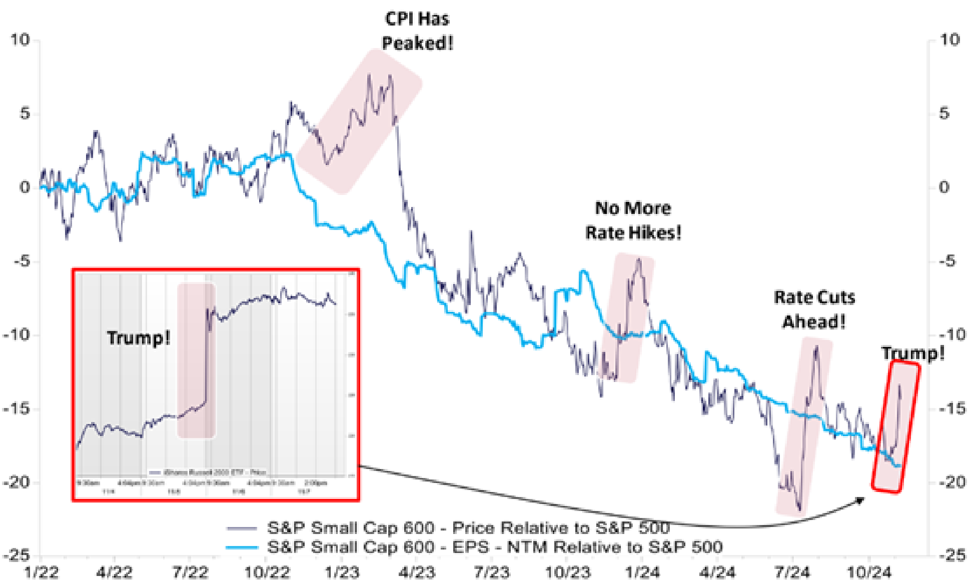
- Upward pressure on inflation, reducing the rate in which the Federal Reserve will cut rates.
- A strengthening in the U.S. Dollar as higher rates makes the U.S. relatively more attractive for investors seeking higher yields.
- Deregulation will benefit sectors including financial services, technology and fossil fuels. The Trump campaign, for example, promised to reduce environmental protection and expand U.S. energy production (oil and gas drilling).
- Ongoing support for cryptocurrency markets

How will Trump's victory impact small caps?

As highlighted above, markets reacted positively to the Trump Presidency with the S&P500 up 3.5% and the Rusell 2000 up 5.8% in the week since the election.

Michael Kantrowitz at Piper Sandler and Co points out this is the fourth time small caps have seen an outperformance spike compared to large caps more recently. This has been driven by multiple expansion, with the market pricing in a better outlook for growth and earnings.

The Election was the 4th Major Outperformance Pop for Small Caps ... Not Explained by EPS



Source: Piper Sandler & Co, November 2024.

So why do we think this time is different to the last three?

Given the protectionist nature of Trump policies, this should support U.S. companies who operate domestically. By their nature this tends to favour smaller companies that haven't yet grown enough to justify offshore expansion.

While increased inflationary pressures from Trump's policy agenda could impact the profit margins of smaller companies, this will likely coincide with an improved growth outlook. Against this backdrop, we believe strong top-line trends could drive upwards EPS revisions across the Russell 2000. Should this transpire, it could act as the catalyst for the significant valuation gap between large and small caps to begin to close.

At Ophir we focus on businesses with resilient earnings that can perform throughout market cycles. Our positioning remains a mix of cyclical and defensive names, and we have high conviction that our Funds will perform through the market cycle.