Guess Who's Back, Back Again?

Donald Trump is back in the Whitehouse amidst the U.S. stock market posting back-to-back price gains of over 20%. For 2024, the S&P 500 increased 23.3%, following closely behind its strong 2023 rebound of 24.2%. This was one of its best years in almost the last 100 and marked the 12th time in the last 15 years it outperformed the rest of the world.

During the fourth quarter, the S&P 500 gained 2.1%, losing leadership to its tech-heavy sibling, the NASDAQ index, which gained 6.2% on the quarter. This reversal of leadership closely mirrors a broader theme to end 2024, things changed quite meaningfully as a Trump victory was priced into global financial markets. From our perspective, this change in global pricing began in late August and into September.

The primary losers of Trump's sweeping victory across the White House, Congress, Senate and even the popular vote were mostly not tied to a U.S. centric outlook. Developed stock markets (excluding the U.S.) which includes major U.S. trade partners like Europe, fell 8.4% during Q4, leaving them barely positive on the year with a modest 1.1% price gain. Ditto for emerging markets which includes China, which Trump had threatened 60% tariffs against during the campaign trail. The emerging market stock index fell 8.1% in the fourth quarter to post an annual gain of 5.1%. Canada on the other hand fared relatively well given strong resource sector performance on the year and an oil price rally in Q4, with the S&P/TSX Composite index up 3.0% in Q4 and 18.0% for 2024. This was of course prior to Trump signaling a 25% tariff in January.

Bond markets were poised to post a second winning year in a row after dreadful performance in the years immediately prior. However, price direction for global bond markets abruptly changed as Trump got more likely to win. For the global bond market, prices declined 5.1% during the quarter to end the year down 1.7%. Elsewhere, U.S. and Canadian bond markets also fell to end 2024, down 3% and 1% in Q4, respectively. This left both markets modestly higher in 2024 before accounting for returns from interest.

The standout performer for 2024 was a repeat of 2023, with the AI and tech-heavy NASDAQ posting a close to 30% gain in 2024. Those watching President Trump's inauguration may have noticed the heads of many of these companies in attendance including representation from Google, Meta and maybe todays most famous tech billionaire, Elon Musk of Tesla and SpaceX.

Trump 2.0: The Golden Age of America?

The President kicked off his first day with a bang, giving a speech covering:

- A focus on defeating inflation;
- Reviving U.S. manufacturing;
- Opening the taps on domestic energy production to export to the world;
- Curtailing green initiatives;
- Ending illegal immigration and materially changing Mexican border security;
- Taking back the Panama Canal from China?;
- Planting an American flag on Mars; and even
- Having a future "proudest legacy [of being] a peacemaker and unifier".

This is not an exhaustive list...

While the degree and pace of American protectionism are unknowable, Trump is expected to be aggressive and to live up to his reputation of being a "deal" guy (look no further than his latest social media posts). At this moment there is certainly high political and social will for change within America. Given all the moving parts between both allies and adversaries and the rate at which Trump announces different or additional future actions (China now to receive 10% tariffs as a recent example), we won't be the least bit surprised to see a period of heightened volatility across global financial markets as they digest his outbursts and then calculate probabilities to their likelihood, magnitude and timing.

With that said, the President is not mincing words in his intended outcomes: American exceptionalism. We can readily envision Mr. Trump sitting in bed each evening reviewing the U.S. stock market action of the day, akin to a daily report card. The historically great investor Stanley Drunkenmiller even commented "I've been doing this for 49 years, and we're probably going from the most anti-business administration to the opposite." Trump knows the number one concern for the American public is inflation (the top 20% of U.S. consumers by income now represent nearly 40% of spending as inflation has ravaged lower income earners) and the economy, and he is likely to support the latter in hopes of propelling domestic equities higher. And while our anticipated prospects of corporate tax cuts have rescinded over the past several weeks, we do believe the probability of tariffs has increased across the board. We expect the unintended consequence of his pro-growth and tariff agenda to be that of increasing inflation. Fortunately, the second derivative consequence of that outcome being a potential reduction to tariff severity or application as we move through time to appease citizens.

If America Gains, WHO (World Health Organization for one) Loses?

No matter one's view of Donald Trump, he is already having a material impact on the global geopolitical and economic outlook. Front and center include plans to tariff China ~~60%~~ 10%, Canada and Mexico each 25% and the rest of the world (even Putin!) maybe 10%. This could lead to the most aggressive tariff policies in almost 100 years. But the outlook is changing rapidly (we suspect this commentary could look stale in the shortest window ever based on the current pace of information out of the White House). So, while he entered office suggesting no tariffs would be immediately implemented, by the end of his first day he had announced a loose plan to implement border tariffs to the north and south around February 1. Needless to say, the market is dealing with uncertainty.

There are varying theories in his practical implementation plans for growth slowing tariffs. On the one hand, he could be quite simply stating that the headline tariffs will be implemented in full on a date in the not-too-distant future. Conversely, there is some precedent in his prior administration to use the waving of his severe tariffs stick to ultimately implement targeted tariffs against specific sectors or industries in specific countries as opposed to blanket tariffs. Many of our most connected investment partners whose headquarters reside in the U.S. believe it is more likely than not that a staged approach to tariffs will be implemented. This could mean that if a country is looking at a 10% end tariff target, that 2% per month be gradually introduced until the nation decides to ultimately give Trump his intended list of demands.

As a team of primarily Canadians living in the energy producing province of Alberta, we certainly hope we are not about to be taxed 25% on all barrels of oil that head south of the border. There is quite limited or no modern precedent for this scale of action against an ally and neighbor. Depending on the reaction by the Government of Canada, or whoever fills the negotiating void during the current parliamentary prorogation, the economic and foreign exchange consequences could be dire and generally unprecedented. We continue to believe it is not in the U.S.'s best interest to create unnecessary inflation through the taxation of Canadian energy exports to Gulf of ~~Mexico~~ America refiners. If fully implemented, there is risk of the Canadian dollar needing to fall far enough to make a U.S. consumer indifferent in their purchase of Canadian goods and services. This same risk is being borne by other nations susceptible to Trump tariffs. In roughly ranking those countries with the most to lose, if we compare domestic country exports to the U.S. as a percentage of their GDP we see Mexico, Vietnam, Canada rank first through third followed by other South Asian countries like Thailand and Malaysia. And while China ranks fairly low on this list it does not mean they will avert pain as they have the largest bilateral trade deficit with the U.S. at nearly US$300 billion. There are not many nations not in the crosshairs of the Trump administration in his early days in office.

Beyond corporate and political fall-out, there has been a substantial change in the outlook for inflation and as a result, bond prices and yields. From our perspective this is an area that represents some of the largest wild cards in potential outcomes. Trump's policies are pro-growth for the U.S. economy. With current low levels of unemployment, and combined with the inflationary impact of tariff policy, there is an increasing risk of a resumption of inflationary forces as we move through 2025.

The U.S. Federal budget deficit is already at unsustainable levels and could get worse depending on the degree of change in a few key variables. For one, government revenues would fall is there is a corporate tax cut implemented (we see this as less likely than a few months ago). On the opposing side, tariffs are a revenue enhancer and create better government deficit sustainability. Now to the cost side of the ledger: the newly created Department of Government Efficiency (or DOGE), headed by none other than Elon Musk. We see several commonalities between this new department and cost cutting measures undertaken by Senator Truman during President Franklin Roosevelt's time in office post World War II. Truman's objective was to cut wasteful spending and improve transparency on government inefficiencies. Ultimately the Truman Committee uncovered gross misuse of government funds and also helped build back public trust in Congress. This would be the blue-sky positive scenario for Musk and his DOGE team. If DOGE can slash significant wastefulness, we could even see a budget surplus before the end of Trump's time in office, which would mark the first U.S. Federal government budget surplus since 2001. On the flip side of this coin is whether the department cuts too much, too fast and leads to economic weakness and unemployment itself. We have yet to come across thoughtful analysis in this regard and therefore anticipate at a minimum there will be hiccups along the road.

Many Futures Are Possible While Only One Will Come to Pass

The global chess board is being set, geopolitically and economically. There is much uncertainty but directionally we believe there is merit in some of the investor and economist community arguments that Trump may represent the "most pro-stock market president in history". On the other side of the table, America's gains may come at the expense of other countries' industries, or he may inadvertently materially slow global growth including in America. Either way, we see elevated valuation levels, particularly for those companies, industries and countries perceived to be winners in the new Trump 2.0 era.

Meanwhile bond markets that have seen falling yields from falling inflation may reverse course in the quarters and years ahead if inflation resurfaces. At a minimum, the risk-reward trade-offs of fixed income markets are murkier than they were not long ago.

The combination of the above fundamental and valuation factors has led to BWM being cautiously optimistic but also guarded in positioning. The Federal Reserve and Trump administration may once again represent a dual "put option" on the economy and market, whereby any weakness in the months ahead will see a resulting stimulative response by either group. We see clear improvements in the very near-term for average corporate America and have been positioning through the use of lower volatility alternative asset classes tied to this outcome without bearing the valuation risk we see in public equity markets.

While we have no crystal ball for the future, we do measure risk within all our client portfolios and believe we have been reducing downside risk in the past year so that no matter the outcome of Trump's victory, our clients can rest well at night knowing they are shying away from uncompensated risks while leaning into asset classes and securities that will participate should Trump recognize his vision of producing "the Golden Age of America".

Bessette Wealth Management
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