



## Market Commentary

### Trump Towers

#### A glittering comeback

##### Key points:

- After all the rhetoric, Trump scored a resounding win, with a mandate stronger than in 2016.
- On the back of the Republican sweep, our sense is that the fallout from the US election can continue be the catalyst that drives markets.
- The Federal Reserve cut rates by 25bps this week, and we see one more rate cut possible in December.
- Diminished European economic prospects won't be helped by US tariff talk and may be the catalyst for further ECB rate cuts.
- Recent inflation data helped the BoE make the decision to cut rates by 25bps this week, though our concern is that inflation could be set to move higher.

**8 November 2024 (London):** So, in the end, the US election wasn't even a very close-run race. In decisively winning each of the battleground swing states, Trump not only ended up winning the popular vote, but importantly, the Republicans now have control over the Senate and also (it appears) the House, as well. In this context, Trump scored a resounding win, with a mandate effectively stronger than was the case when he won in 2016.

In many respects, it is an amazing political comeback and one which has left many Democratic supporters literally lost for words. Ultimately, it is the economy and issues that impact ordinary citizens in their day-to-day lives that helped secure this outcome. There is also a sense that Trump is, at least, authentic to himself and what he believes.

From this perspective, voters have tended to forgive some of the stupid and outrageous things that he has been inclined to say, noting that his record in office has tended to demonstrate that his actions are far more reasonable than his words.

On the back of the US vote, risk assets have rallied and fixed income yields have moved higher, as may have been expected. Nevertheless, moves on yields and the dollar have been more muted than may have seemed likely, suggesting a fair degree of the Trump trade was already in the price, ahead of the election.

That said, a Republican sweep is more of a surprise, and we do think that Trump trades may have further to run in the course of the coming days. The political outcome is expected to be fiscally stimulative, and this can keep pressure on longer dated bond yields. Moreover, moves on trade and immigration policy are also seen as potentially inflationary. This may end up limiting the room for the Federal Reserve (Fed) to lower interest rates in 2025.

On US yields, we remain happy to stick with a curve steepening bias, with a short stance on 30-year Treasuries, looking for yields to reach 4.75%-5.00% before the end of the year.

The Fed cut rates by 25bps this week and we see one more rate cut possible in December. Thereafter, we expect the Fed to go on hold, with the policy trajectory much more balanced in 2025. Of course, if the

economy does slow at some point, then the Fed still has room to cut further, but the growth trajectory remains upbeat for the time being.

Meanwhile, if moves on trade, immigration, or fiscal policy end up adding to inflation, then the Fed could end up hiking rates later next year, notwithstanding protestations from the incoming President. After all, it has been understood from this election result that workers don't want to see rising prices.

In this respect, we are more inclined to play down fears, in terms of an attack on the Fed's independence, by Trump. It is clear that Trump will want short-term rates and mortgage rates to drop, but ensuring there is not a repeat of the inflation experience of the past few years will be an overarching priority.

In terms of the incoming Trump administration, we think that immigration policy may serve as the initial focus for the incoming President. This will see deportations of overseas citizens with criminal records, who are not welcome in the USA. However, it is much more questionable whether the US will be able to quickly, or easily, send a million migrants south of the border. From this standpoint, it highlights that the US will need to work with countries such as Mexico to take individuals back and, from that point of view, the new administration will need goodwill from others.

On tariffs, we expect early action on China. However, a more wide-ranging global tariff could be used as more of a negotiating ploy with other US trading partners. There will certainly be tariffs on some goods in some sectors. Yet, the US is keen to keep Europe onside, in terms of its position relative to China, and it will also want to avert a trade war, which could add to costs and hurt consumers.

Nevertheless, we think that the bias should be for the dollar to strengthen, given the direction being taken with respect to US trade policy. With the US economy also powering ahead and ongoing evidence of US growth exceptionalism, we see scope for the dollar to rally, notably versus the euro, at a time when it may seem that the ECB is accelerating its path of monetary easing, just as the Fed moves in the other direction.

In the EU, the main news this week was the collapse of the German coalition government, which we see giving way to an election, later in Q1 next year. Growth and the political landscape remain challenged and there is some discussion that a political change, or a declaration of a state of 'crisis', could be the catalyst to securing greater fiscal support.

The catalyst of Trump in the White House may give this agenda an added push, and possible threats relating to NATO withdrawal and seeking to impose peace in Ukraine will likely force the EU to get off their hands when it comes to ramping up military spending. That said, economic prospects won't be helped by US tariff talk and, in that respect, this may be a factor that sees the ECB signal a 50bps cut in either its December or January meeting.

In addition to these macro trends impacting FX performance, this may also be a factor which sees European fixed income outperform US rates, albeit with a similar curve steepening bias, given elevated EU fiscal risks.

Across the Channel, the UK also cut rates by 25bps this week to 4.75%. Recent inflation data have helped the BoE in making this decision, though our concern is that inflation could be set to move higher in the months ahead of us. Wage growth remains inflationary in an economy with no productivity growth and is being added to by inflation-beating public sector pay deals.

The UK Budget was also seen as lifting inflation, as employers pass on increased employee costs. Labour investment spending may help to support growth but also risks some inflation if these create demand in specific sectors of the economy.

Therefore, we remain more sceptical on the path of UK rate cuts than the BoE and many market participants. Yet, we do not see this outcome helping the pound. Gilts have been underperforming moves in other markets and are now not far from the Liz Truss highs. With higher yields feeding higher borrowing costs, there is a negative feedback loop and any jump in concerns related to UK debt sustainability on higher UK yields could trigger a loss of confidence.

In that case, the UK remains in a more vulnerable position than other countries, given the experience of 2022. From this point of view, it may be viewed once again as the proverbial 'canary in the coalmine', should yields continue to rise.

Elsewhere, emerging markets managed to rally in the wake of the US election, having underperformed in the run up to it. Trump in the White House and a firmer dollar is not a great prospect for many EM countries, but following a protracted period of underperformance, we do sense that there has been a lot of bad news factored into the price.

Meanwhile, we await further details regarding Chinese fiscal support plans this coming weekend. A large headline number may act to boost sentiment, though we still remain sceptical that the direction of the economy can improve in a more material way, unless measures can be more targeted towards private consumption.

Spreads in credit markets rallied in the wake of the US election, with risk assets stronger across the board. We have previously noted that many other investors have adopted a cautious view on credit, and we have thus adopted a more constructive view ourselves, on the assumption that supply/demand technicals would be favourable.

However, with other investors now looking to put cash to work with the uncertainty of the election out of the way, we are happy to reduce our directional long credit positioning, as yields rally. The initial focus on a Trump win is less regulation and more growth, and this has boosted stocks. But as investors reflect that in terms of interest rates, that we are in a world where rates are staying much high for longer than many have appreciated, this can start to weigh on sentiment. There seems an assumption for now that the Fed will keep cutting next year, but markets have been repricing and equity investors may not have reflected on this.

Meanwhile, if long dated Treasury yields continue to rise as the volume of debt continues to spiral higher, then in the absence of overseas demand, domestic investors will need to take down supply. Some of this may well come from cash as the curve steepens and investors are paid a premium to own duration. However, there is a risk of 'crowding out', which will weigh on other asset classes too.

## **Looking ahead**

There has been much to digest in this past week and over the coming days, there will undoubtedly be more to continue to reflect on. Next week sees US CPI, though in the short term, there is a sense that the fallout from the US election can continue to dominate asset allocation shifts and be the catalyst which drives markets.

Generally speaking, we are inclined to sell major rallies, or buy into any material weakness, should this occur in many of the markets we track. Aside from this, we are staying with a view that favours some bear steepening of the curve in the US, bull steepening in the Eurozone and is short in Japan rates.

We continue to favour the dollar versus euro and sterling and remain medium-term constructive on the yen against the euro as well. In credit spreads, we are still long, but reducing exposure on strength. Elsewhere, there are opportunities within the EM space, but we need to invest with some caution.

Anyway, this will be remembered as the week when Trump has Towered above his opposition. US democracy is alive and well, and if Democrats can learn their lessons in defeat, then it will be competitive the next time the country goes to the polls. That said, you wonder how different the country and the world may look by 2028....

## **Notes to Editors**

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