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Insight

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Trump's Win Could Accelerate Macro Trends Already in Motion

Thoughts on the market implications after Donald Trump's decisive victory.

Key Points

- Former President Donald Trump prevailed as the victor in a highly polarized US presidential election while Republicans regained control of the Senate. The balance of the House of Representatives is still in play.
- Trump's victory could accelerate macroeconomic trends already in motion: labor supply (weaker), the supply of tradable goods (contracting), and a deteriorating fiscal backdrop. These are likely to lead to higher near-term inflation and higher inflation volatility.
- Bond yields have already increased, and prices have dropped in anticipation of rising inflation pressures. Supply-side cuts with fiscal easing are a perfect recipe for a structurally higher level of yields and term premium.[1]
- The Federal Reserve's (Fed) comfort level with the current inflation backdrop prompted a recent reduction in rates and signals of possible further cuts. If this confidence wanes in the wake of deteriorating fiscal health and increasing inflationary pressures, the Fed may need to shift again.
- Polarization is still building. Income inequality remains both the main driver and a key driver of structural policy decisions from both parties. Resolving inequality is a major challenge that the new administration will have to tackle.

Insight from sub-adviser Wellington Management

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Trump emerged as the clear victor in a highly polarized US presidential election. While the exact level of majority is still unclear, Republicans also gained control of the Senate while the outcome for the House of Representatives is, at the time of writing, too close to call. This is a remarkable result for Trump, regaining the presidency for a second time in an extremely tight race.

Much will become clearer over the coming days as all the results are tallied and Trump starts the process of putting in place his administration and laying out priorities. Beyond the immediate market reaction, here are some bigger themes that I'm watching which could have significant implications for investors over time.

A Deeper Dive on Macro Trends and Implications

Trump's victory could accelerate underlying trends around labor supply (weaker), the supply of tradable goods (contracting), and a deteriorating fiscal backdrop. In turn, this dramatically increases the probability of higher near-term inflation, but also higher inflation volatility over the short and medium term, which is critical for the level of yields and term premium. Bond yields, which had already moved up significantly in the run-up to the election, continued to do so the morning after the election and may continue to do so, bringing them more in line with my medium-term structural analysis, which posits that yields on the 10-year Treasury will settle in the 5.5%–6.0% range over time.

Supply-side cuts with fiscal easing are a perfect recipe for a structurally higher level of yields and term premium. Even if Republicans don't hold the House, I think there's still a strong chance of fiscal easing next year and into 2026 since a Democratic House could potentially trade tax cuts for spending increases.

Here's some additional color on these trends:

- **Labor supply** — The US, like much of the world, faces demographic headwinds with most future growth in the labor force relying on immigration. All else being equal, the demographic headwinds could lead to more persistent labor shortages, a higher non-accelerating inflation rate of unemployment (NAIRU)[2]—the level of employment rate that doesn't lead to higher inflation—and a worse trade-off between inflation and growth. Over the past 12 months, the surge in immigration has represented a massive increase in labor supply, but that has likely peaked, meaning that labor-supply headwinds could reemerge over the next 12–24 months. While both candidates were advocating more restrictive immigration policies, Trump's proposals are even more restrictive, particularly if he pursues his deportation plans.
- **Tradable goods supply** — Total trade volumes in the US have been on a structural decline since 2009. Trump's first term elevated these developments through his use of tariffs, but trade restrictions had already been growing beforehand. Now, his proposed trade policies are even stricter. My research suggests that across-the-board tariffs could represent a GDP growth hit next year of 0.5%–1.0% and an inflation boost of 1%–2%. All else being equal, a contraction in the supply of tradable goods makes goods prices more sensitive to demand and increases the probability of sustained inflation volatility.
- **Fiscal policy** — While I projected the US's fiscal position to deteriorate under both candidates, it's now likely to occur at a quicker pace with a significant rise in debt-to-GDP levels likely over the next 10 years under current law, potentially going up to 140%. At this stage, I see limited evidence of concern from policymakers about these debt levels, despite interest costs now being higher than defense spending for the first time in history.
- **Fed reaction function** — The Fed has recently reduced rates because it feels more comfortable about the inflation backdrop, and looking at spot inflation, I think that confidence is justified for now. If that confidence wanes (which I think may be more likely over time), the Fed may be likely to shift again—first by pausing the cutting cycle, and possibly by hiking again later in 2025 if necessary. However, these decisions will now take place in the context of a new administration that would like to see the White House play a larger role in setting monetary policy.
- **Polarization** — This has been a risk I've become increasingly concerned with over the last decade, and it's still building. By some measures, the US is more polarized now than at any point in history—including the Civil War. And I think income inequality continues to be both the main driver of polarization and a key driver of structural policy decisions from both parties. Resolving inequality will take years and will be a major challenge for the new administration to tackle.

Overall, I think all these trends will continue, but Trump's victory translates into a significant quickening of the pace. The next milestones to look out for in this election cycle are who Trump nominates in key positions and the sequence he uses to pursue his policies.

If Fed confidence wanes, it may be likely to shift its strategy—first by pausing the cutting cycle, and possibly by hiking again later in 2025 if necessary.

Talk to your financial professional to help make sure your portfolio is prepared for whatever happens in Washington D.C.

[1] The term premium is the amount by which the yield on a long-term bond is greater than the yield on shorter-term bonds. This premium reflects the amount investors expect to be compensated for lending for longer periods.

[2] The non-accelerating inflation rate of unemployment (NAIRU) is the lowest unemployment rate that can be sustained without causing inflation to increase.

Important Risks: Investing involves risk, including the possible loss of principal. • Different investment styles may go in and out of favor, which may cause underperformance relative to the broader stock market.

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