Ostrum ASSET MANAGEMENT

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Market views and strategy

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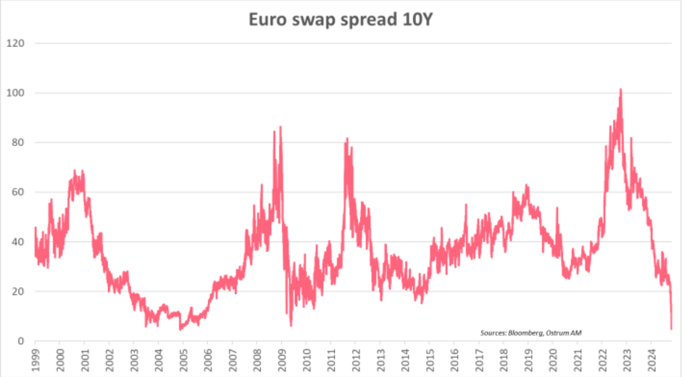
Topic of the week: US elections: the key policy differences between Kamala Harris and Donald Trump
by Axel Botte

- The Presidential election appears extremely tight at the time of writing. Key states look like coin tosses as polls are within the margin of error;
- There are significant differences in policy views between Donald Trum and Kamala Harris. Corporate taxes could fall under Trump and rise if Harris gets into the oval office. Taxes on richer households (both inheritance and capital income) may also increase if Democrats win the election;
- Whatever the election outcome, deficits will stay elevated with higher risk of outsized fiscal slippage under Trump;
- Trump signaled its intention to raise trade tariffs by 60% on China and 10-20% elsewhere, making baseless claims that customs revenue would reduce deficits. This could be both inflationary and disruptive for global trade;
- Harris wants to strengthen NATO and keep supporting Ukraine against the Russian aggression whilst Trump has threatened to pull the U.S. support to NATO.

Market review: “Higher for longer”: the come back!
by Zouhoure Bousbih

- High volatility in sovereign bond markets, reflecting fears of a resurgence in inflation.
- Decline in equity indices driven by the repricing of rate cuts by central banks.
- Widening of the BTP-Bund spread to 129 basis points due to zero GDP growth in Italy in Q3.
- Underperformance of Gilts following the presentation of the 2025 budget.

Chart of the week



The 10-year European swap spread has reached a low since 2000 at 4.75 bp, indicating a paradigm shift for financial markets: sovereign risk is now the focus, more than credit risk.

The tightening has accelerated following the presentation of the UK budget for 2025, indicating higher-than-expected funding needs.

Beyond the U.S. election, fiscal risk will continue to dominate financial markets in 2025, putting pressure on sovereign bond markets that will need to absorb significant issuances to finance high deficits.

Figure of the week

21.9 %

It is the percentage of Americans who plan to take vacations abroad according to the latest Conference Board survey, marking a high since 2005. This is also a sign that American consumption remains robust.
Source: Bloomberg

Topic of the week

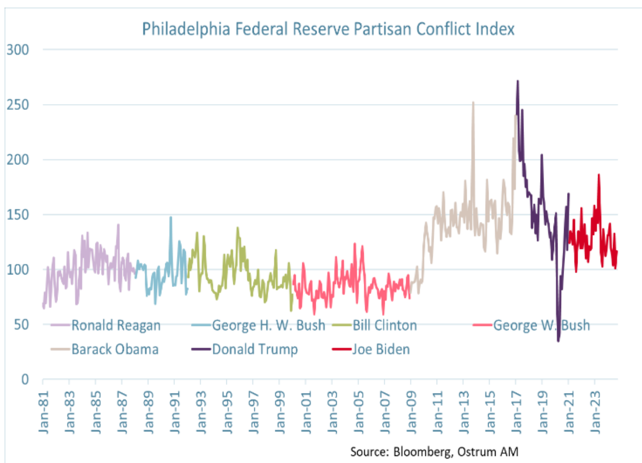
US elections: the key policy differences between Kamala Harris and Donald Trump

The latest polls are within the margin of error in the seven key battlegrounds of the US Presidential elections. Likewise, chances are that Congress will be split, with a Republican majority in the Senate and a Democratic House. We investigate the candidates' differing views and intentions on the key economic and financial issues and the consequences of policy choices for the equity market.

The Disunited States of America

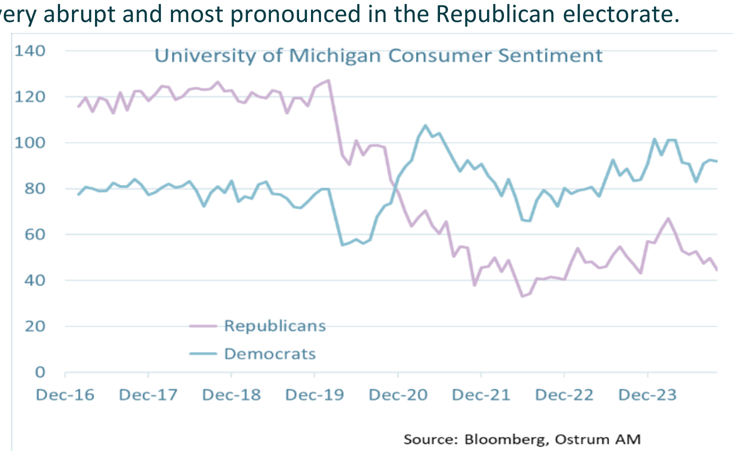
A highly fragmented US electorate

The US electorate is particularly divided at present. The Philadelphia Fed has constructed an index of partisan conflict, that took off shortly before the 2010 mid-term elections and culminated in March 2017, effectively two months into the Trump Presidency. The index never fell back to the pre-GFC era.



Source: Bloomberg, Ostrum AM

The University of Michigan consumer sentiment survey indicates that Americans who identify themselves as Republicans have a much bleaker perception of the US economy than respondents affiliated with the Democratic party. Sentiment shifts are very abrupt and most pronounced in the Republican electorate.



Source: Bloomberg, Ostrum AM

In addition, though national polls suggest Kamala Harris is likely to attract more voters, the battleground states are still undecided and, as it stands, the momentum heading into the November 5th election may be favorable to Donald Trump in the key swing states.

Differient views on taxes

Harris endorses higher tax rates on capital and inheritance.

Donald Trump aims to extend the tax cuts from 2017 due to expire next year, which would keep lower tax rates and other benefits (including child tax credit), potentially saving taxpayers about $4 trillion over a decade. However, he has not clarified how he would manage budget deficits. He has suggested additional tax breaks, such as exemptions for tips, deductions of car loan interest expenses and expenses related to newborns, while also criticizing increased IRS enforcement under Biden.

Kamala Harris, on the other hand, supports maintaining Biden's promise not to raise taxes on households earning under $400,000, which would preserve tax cuts for 97% of Americans. She advocates for a refundable child tax credit and supports some of Biden's proposed tax increases, which could raise top tax rates significantly. Harris would allow some Trump tax cuts to expire and endorses taxing unrealized gains. Capital gains above $1 million would be taxed at ordinary income rates and those worth at least $100 million would face a 25% minimum tax, including annual taxes on unrealized gains.

Corporate taxes would rise under Harris, whilst Trump will try to cut them

Trump wants to cut corporate tax rates while Harris wants to implement the global minimum tax agreement.

Donald Trump wants to lower the corporate tax rate further from the current 21%, potentially to 20% or even 15%. Unlike other provisions from the 2017 tax law, this rate cut does not expire after 2025. Extending his tax cuts could also reinstate previous corporate tax benefits, such as immediate write-offs for capital investments and relaxed limits on interest deductions.

Kamala Harris plans to raise the corporate tax rate from 21% to 28%, which would generate over $1.3 trillion in revenue over ten years. She aims to tax foreign income of U.S. companies as part of a global minimum tax agreement and increase the corporate alternative minimum tax from 15% to 21%. Additionally, she intends to quadruple the tax on stock buybacks and impose restrictions on the deductibility of executive compensation.

Be careful what you wish for with tariffs

Trade policy – Trump waging all-out war again

Donald Trump diverged from traditional bipartisan support for free trade during his first term by implementing significant tariffs on China, as well as tariffs on steel, aluminum, and products from various countries, including allies. He intends to increase tariffs further, suggesting a 60% tariff on China and 10% to 20% on other countries. The specifics of these increases are uncertain, and he has called for tariffs to match those imposed by other countries on U.S. goods. The President of the US can unilaterally raise tariffs using existing executive powers.

Kamala Harris, in contrast, would largely continue the trade policies of President Biden. She supports maintaining most of Trump's tariffs on China while also increasing some tariffs, such as those on electric vehicles. Harris opposed the U.S.-Mexico-Canada Agreement (USMCA) due to its insufficient measures on climate change, indicating a preference for more progressive trade policies than Biden. She would likely prioritize American workers and employ targeted tariffs to support them, focusing on strategic cooperation in trade without reducing tariffs through agreements like Biden's Indo-Pacific

Economic Framework.

Healthcare policy

Donald Trump claims he would reduce overall healthcare costs. Details of the plan are scarce. He failed to repeal the Affordable Care Act (ACA) in his first term but now indicates he would welcome improvements to Obamacare.

Kamala Harris played a key role in passing the Inflation Reduction Act, which allows the U.S. government to negotiate prescription drug prices for Medicare patients. She aims to expedite these negotiations, cap out-of-pocket drug expenses at $2,000 annually and $35 monthly for insulin and address noncompetitive practices by pharmaceutical companies. Previously, she supported a Medicare for All proposal. Harris also advocates for helping states eliminate patients' medical debts.

Energy and climate

Donald Trump has dismissed climate change as a "hoax" and plans to eliminate the $7,500 tax credit for electric vehicles. He aims to repeal the Inflation Reduction Act and its subsidies for green technologies. Trump's campaign platform includes lifting restrictions on energy production and reversing Biden administration regulations on coal plants, vehicle emissions, and methane leaks. Although Project 2025, created by former Trump advisers, proposes significant changes to federal climate agencies and research, Trump has distanced himself from its recommendations.

Kamala Harris played a crucial role in the passage of the Inflation Reduction Act, which allocates hundreds of billions for renewable energy, fossil fuel reduction, and climate change preparedness. Although she initially advocated for a ban on fracking, she later reversed that stance, emphasizing the need to invest in diverse energy sources to decrease reliance on foreign oil. Harris has highlighted the importance of clean air and water as fundamental freedoms at stake in the upcoming elections.

NATO and the Russia-Ukraine conflict

Donald Trump has shown a strong inclination to withdraw the U.S. from NATO. Trump frequently criticizes allies for not meeting the defense spending target of 2% of GDP. He has suggested a reduced American commitment to European security, implying that European allies should take on more responsibility. This has direct consequences for the ongoing conflict between Russia and Ukraine. Donald Trump has claimed he could broker a peace deal for Ukraine within 24 hours by threatening both Kyiv and Moscow. When asked if it is in the U.S. interest for Ukraine to win the war, Trump avoided a direct answer, expressing a desire for the war to end.

Kamala Harris, in contrast, aims to strengthen NATO and maintain unity among allies, particularly in support of Ukraine. Given growing congressional resistance to large funding packages, she emphasizes the importance of NATO as a vital military alliance and that member countries must increase their defense spending. However, Harris is unlikely to sever ties with any allies based on their military budgets, focusing instead on collective defense and deterrence against Russian aggression.

Dem Presidents are better for bonds, Reps favor stocks

Implications for the world economy and financial markets.

We have looked back at financial market returns around past elections dating back to Jimmy Carter's win in 1976: that is 7 wins for the Democratic Party, 6 for the GOP. We compare median returns or basis-point variations for stocks (DJIA), the dollar (DXY index), gold prices and T-note yields and 2s10s and 10s30s spreads.

For what it is worth, there are a few takeaways. In equity markets, stocks have negative returns in the 4 weeks to the elections and bounce over the 4 weeks after a Republican win by 2.4 % vs. a slight median loss of 0.1 % after Democratic wins. The dollar is weaker by 1.6% before Republican wins by a bit stronger afterwards. The median return on the DXY index is positive before and after Democratic wins. Gold falls after either Party's win but tends to grind higher ahead of Republican wins. It could mean that markets perceive Republican policies as being more inflationary. Yields tend to fall sharply after Democratic wins (median change of -18 bps) and rise after Republican wins (+15 bps). The 2008 financial meltdown when Barack Obama got elected does distort the picture though, but without the outlier it would still be a fall in yields. Accordingly, the curve flattens after Democratic wins and is roughly unchanged after Republican wins.

Bottom line, stocks fare better immediately after the election of a Republican President. Bonds perform well after a Democratic win. Gold is higher in the run-up to a GOP President win.

Looking forward to 2024, a Trump administration would likely mean fiscal largesse. Donald Trump's claims that customs receipts from higher tariffs would generate enough revenue to close the fiscal gap are baseless. The current CBO forecasts of annual budget shortfalls worth 6% of GDP over the next decade could turn out to be an understatement. In this context, the term premium on long-term US Treasury securities will continue to increase. The spread to SOFR OIS on 30-year bonds now exceeds 80 bps compared with 40-50 bps less than two years ago. The US would attract ever larger amounts of savings from the rest of the world at a premium, which could prove disruptive in many economies and force the Fed's hand to lower interest rates and resume quantitative easing. This could mean a weaker dollar, initially.

Higher tariffs are a tax on consumption. President Biden's $ 800 billion checks to households from 2020-2021 sparked a consumption boom that never abated since. The rising cost of living is central to this election. The number of households who consider it is a bad time to buy high-ticket items is now higher than in 2008 and still near 2022 highs. Current inflation is one thing, price is another (the Fed is also missing that point). A sharp slowdown in US private consumption could tip the U.S. and the rest of the world into a recession. Furthermore, chaotic communication from Donald Trump around tariff announcements would be conducive of higher volatility in financial markets.

Conclusion

The US Presidential race appears very tight. As regards tax policy, Donald Trump wants to lower the corporate tax whilst Harris wishes to comply with the global corporate tax agreement. Harris has made proposals to reduce healthcare costs whilst Trump's plans lack details. On climate change and energy policy, the

divide is even clearer. The most disruptive policy could be trade. Tariffs will be weaponized by Donald Trump but Kamala Harris will press on with Biden's targeted pressure on Chinese high-end technologies. On NATO and Ukraine, Donald Trump has been inconsistent. Kamala Harris will side with Ukraine and preserve relationships with allies.

Axel Botte

Market review

"Higher for longer": the comeback!

Fears of a resurgence in inflation have revived the specter of the "higher for longer" thematic.

The week was marked by high volatility in sovereign bond markets, as evidenced by the MOVE index of U.S. sovereign bond volatility, which reached a high since October 2023. Short-term interest rates soared between +10 and +13 basis points on both sides of the Atlantic, driven by rising inflation and growth expectations in financial markets. Equity indices ended the week in the red in the wake of rising nominal rates. The S&P 500 dropped by 1.35%, weighed down by technology stocks, particularly in the semiconductor sector. The Euro Stoxx 600 finished the week down 1.52%, amid fears of escalating tensions in the Middle East and moderated expectations for rate cuts from the ECB among financial markets.

Economic data released this week indicates resilience in overall activity. In the Eurozone, Q3 GDP growth surprised on the upside at 0.4% quarter-on-quarter, compared to 0.2% in Q2, driven by France, Spain, and Germany, which is avoiding recession. However, it is worth noting that half of France's growth (0.4% quarter-on-quarter) is linked to the Olympic Games, making Q4 uncertain. Italy recorded zero growth in Q3, likely due to a contraction in its exports, leading to a widening of the BTP spread to 128 basis points (+6 basis points). In the United States, economic momentum remains robust. The first estimate of Q3 GDP growth was 2.8% on an annualized quarterly basis, driven by strong consumer spending. U.S. growth is likely to exceed the Fed's forecast. The employment report for the month of October was muddled by hurricanes and Boeing strikes, but wage growth remains strong at 0.4%.
In China, both the official and Caixin surveys indicate a rebound in activity in October, which bodes well for Q4 GDP. Authorities are expected to announce details of stimulus measures after the U.S. election.

Eurozone inflation rates are rising again in October. The preliminary European inflation rate for October was 2%, up from 1.7% in September, due to the end of favorable base effects. However, core inflation remained unchanged at 2.7%, with service inflation at 3.9%, the ECB's preferred measure. The "prices paid" component in the ISM manufacturing survey significantly rebounded in October.

The presentation of the UK 2025 budget reminded that fiscal maneuvering space is limited. Governments will need to borrow more than expected to finance their deficits. Financial markets will have to absorb governments' funding needs, advocating for high interest rates. Gilts outperformed over the week, with the 10-year British yield rebounding by over 20 basis points to 4.45%. The focus has shifted to sovereign risk, as evidenced by the 10-year European swap spread, which has reached a low since 2000.

Zouhoure Bousbih

Main market indicators

G4 Government Bonds	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Bunds 2y	2.27%	+18	+7	-13
EUR Bunds 10y	2.41%	+13	+20	+39
EUR Bunds 2s10s	13.7bp	-5	+13	+52
USD Treasuries 2y	4.16%	+2	+23	-9
USD Treasuries 10y	4.28%	+0	+32	+40
USD Treasuries 2s10s	12.3bp	-2	+8	+50
GBP Gilt 10y	4.47%	+21	+34	+93
JPY JGB 10y	0.95%	-3	-9	-44
€ Sovereign Spreads (10y)	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
France	74bp	+2	+1	+21
Italy	127bp	+6	+0	-41
Spain	70bp	+1	0	-27
Inflation Break-evens (10y)	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
EUR 10y Inflation Swap	2.02%	+8	+1	-11
USD 10y Inflation Swap	2.53%	+5	+10	+12
GBP 10y Inflation Swap	3.68%	+14	+7	+14
EUR Credit Indices	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
EUR Corporate Credit OAS	104bp	+0	-14	-34
EUR Agencies OAS	61bp	+0	-7	-9
EUR Securitized - Covered OAS	49bp	-5	-14	-30
EUR Pan-European High Yield OAS	321bp	-22	-42	-78
EUR/USD CDS Indices 5y	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
iTraxx IG	58bp	+2	0	0
iTraxx Crossover	312bp	+7	+0	-1
CDX IG	53bp	+1	+0	-4
CDX High Yield	332bp	+5	+2	-24
Emerging Markets	04-Nov-24	1wk (bp)	1m (bp)	2024 (bp)
JPM EMBI Global Div. Spread	334bp	-4	-28	-50
Currencies	04-Nov-24	1wk (%)	1m (%)	2024 (%)
EUR/USD	$1.090	0.814	-0.656	-1.2
GBP/USD	$1.296	-0.100	-1.219	1.8
USD/JPY	JPY 152	1.055	-1.965	-7.0
Commodity Futures	04-Nov-24	-1wk ($)	-1m ($)	2024 (%)
Crude Brent	$75.1	$4.1	-$2.3	0.6
Gold	$2 737.8	-$5.6	$84.2	32.7
Equity Market Indices	04-Nov-24	-1wk (%)	-1m (%)	2024 (%)
S&P 500	5 729	-1.37	-0.39	20.1
EuroStoxx 50	4 889	-1.63	-1.34	8.1
CAC 40	7 433	-1.64	-1.44	-1.5
Nikkei 225	38 054	0.37	-1.51	13.7
Shanghai Composite	3 310	-0.36	-0.79	11.3
VIX - Implied Volatility Index	22.41	13.18	16.66	80.0

Source: Bloomberg, Ostrum AM

Additional notes

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