

November 22, 2024

BILBoard December 2024 – Red Sweep

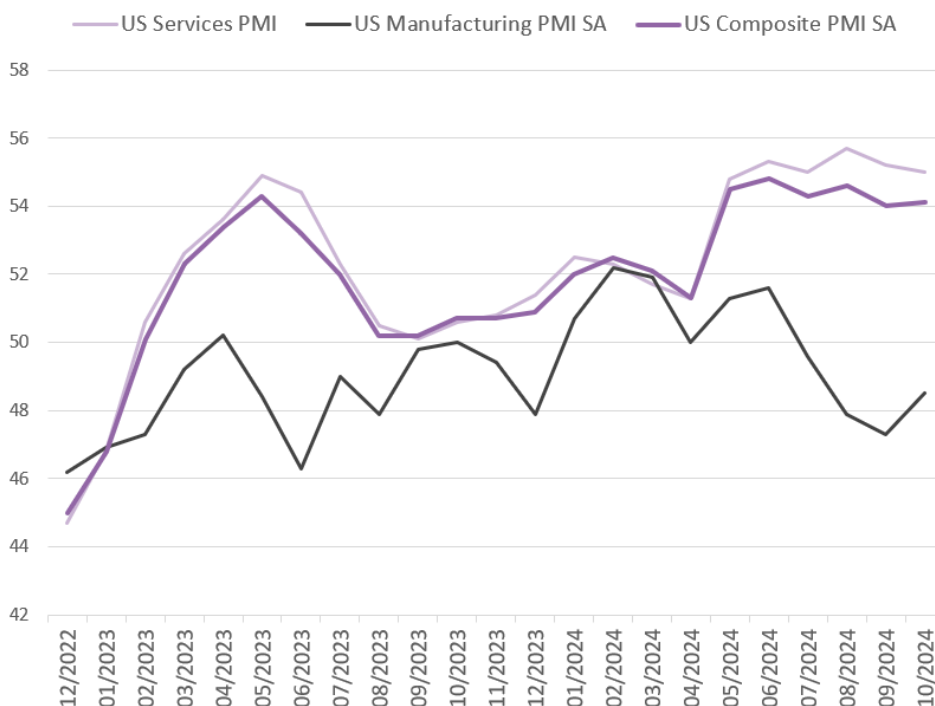


*At BIL, we are long-term investors guided by **stable**, strategic asset allocation guidelines. However, our investment strategy itself is a living, breathing thing, proactively **adapted over time**, as we strive to deliver long-run **performance** for our clients. Certain times call for more adjustments than others. The election of Donald Trump and the subsequent red sweep across the US Congress significantly alters the landscape, promising to create ripples around the world. As such, the month of November saw more changes than usual to our investment strategy as we gear up for an entirely new environment.*

US exceptionalism continues when it comes to both the macroeconomic situation and corporate earnings. Growth has proven remarkably resilient, with consumption holding up despite headwinds. Indeed, Q3 earnings releases show that while shoppers are being more

selective, they have not stopped spending, and retailers are optimistic about the holiday season. Note that consumer confidence ticked up as Trump's chances of winning the election improved, and the same can be said for sentiment among small businesses. When it comes to larger firms, the Services PMI is firmly above 50 and the manufacturing downturn is easing. Some analysts expect a post-election surge in investment given executives should now have a better idea of how the land lies. We are cautiously optimistic on that front; many of Trump's plans still lack detail and it is difficult to differentiate between bluster and true policy intentions.

US private sector activity is robust



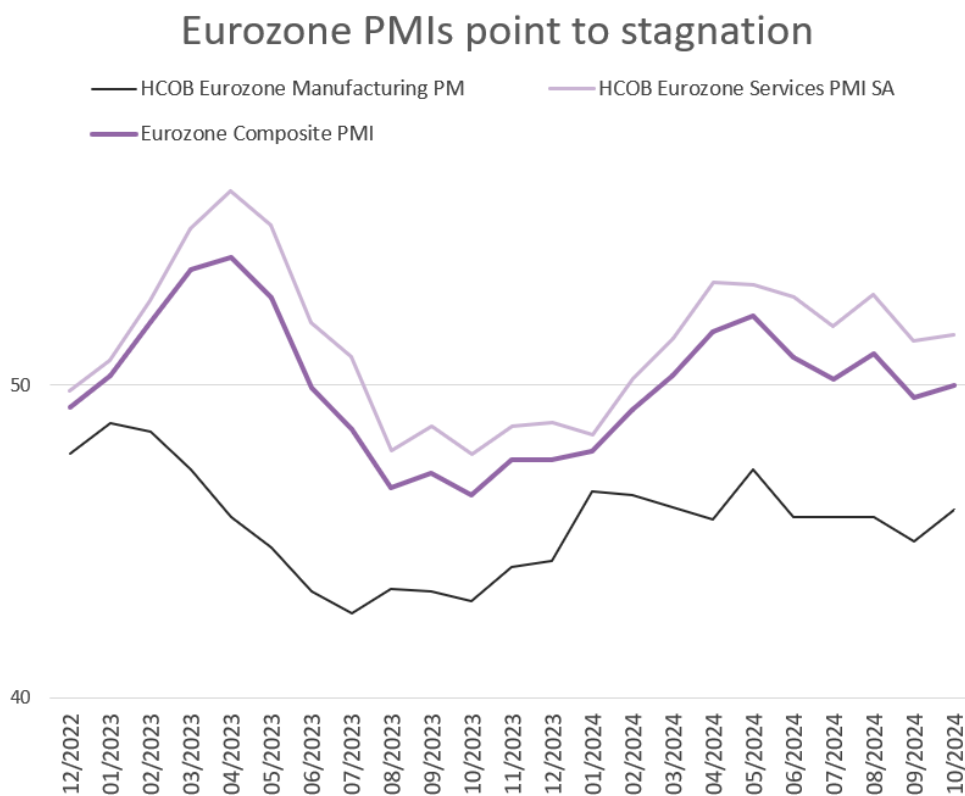
Source: Bloomberg, BIL

Inflation worries are taking the gilt off the gingerbread in the robust US economy. Headline CPI ticked up to 2.6% in October and Trump's policies (particularly on trade and immigration) could further rekindle pricing pressure. Alas, the US now faces a renaissance of the "higher for longer" scenario. Investors have pared back expectations for Fed rate cuts and see only a 50/50 chance of another quarter-point reduction in December. The policy rate is currently in the 4.50%-4.75% range: as Logan of the Dallas Fed recently pointed out, that is "right at the top" of the estimated range of the **neutral rate**, where policy acts neither as a headwind nor a tailwind for growth.

The fact that the Republicans have taken full control of both the Senate and the House, leaves

Trump relatively unbridled when it comes to pushing a radical agenda through the legislature. The US already carries a \$35tn debt burden and this will only get heavier amid tax cuts and big spending plans. Higher Treasury yields are a real risk and bond market vigilantes may be the biggest (or only) check on Trump's power over the next year.

Trump's election to a second term as President raises the bar for friends and foes alike, with the US poised to pursue "America First" policies and lower taxes while pushing tariffs and more defence spending onto other nations. For **Europe**, the timing is hardly optimal – both France and Germany are embroiled in political uncertainty, the war on its doorstep has reached its 1000th day, and the economy faces stagnation, with risks tilting to the downside. While weak growth and easing inflation should force quicker monetary easing, **negotiated wage growth** surged to 5.42% in Q3 2024, the highest increase since Q1 1993, warranting caution.



Source: Bloomberg, BIL

Trump 2.0 also complicates matters for **China**, which is already struggling to meet its 5% growth

target this year. Beijing has unveiled a broad package of monetary and fiscal stimulus measures in an attempt to revive economic activity, but for now, the housing market is still under immense pressure and consumer confidence is in the doldrums. The President-elect imposed hefty tariffs on China during his first term and the Biden administration has maintained \$360 billion dollars' worth of those, while imposing additional ones of its own. Economists polled by Reuters expect that the US could impose tariffs of almost 40% on imports from China early next year, potentially slashing growth in the world's second-biggest economy by up to 1 percentage point.

The Trump administration should be positive for the US dollar. Indeed, the greenback notched its biggest one-day gain against peers the day after Trump was re-elected. The future trajectory of the currency partly hinges on whether (or how fully) Trump will enact the tax cuts and tariffs that are key elements of his economic platform. Those policies risk ramping up inflation and could keep US interest rates above those of other countries, thus enhancing the dollar's allure to investors. In the event of continued dollar strengthening, **emerging markets** with dollar-denominated debt will come under mounting pressure.

ASSET ALLOCATION CHANGES

Equities

Mid-November, we **increased our overweight to US equities**, believing that robust earnings growth should continue to drive the market into next year. That trade was funded using cash reserves and by **increasing our underweight to Europe**.

Simultaneously, we also added **downside protection on 50% of our overall US equity exposure until late March**. Several reasons underpin this decision. Firstly, we perceived animal spirits were in play, with the market perhaps too optimistic about the prospects of Trump's win (indeed the Trump rally has since begun to fizzle out). Even with a red sweep, Trump isn't the man in the red suit and January 20th won't be like Christmas day, with all of his agenda magically delivered overnight. Policy changes will be incremental, and market sentiment could oscillate based on what his administration chooses to prioritise. In addition, there may also be a few lumps of coal for markets in Trump's sack of proposed policies. Analysis shows that if his agenda (including tariffs and an immigration crackdown) is implemented **in full**, it won't be all merry and bright. In

fact, it could have a negative impact on the economy and business activity. For example, who will bear the burden of tariffs? Largely domestic companies and consumers, not foreign manufacturers. How will international trading partners retaliate?

One market segment, however, does seem poised to benefit from a new inward-looking administration: **US small caps**, since they tend to engage in less cross-border trade than larger multinationals. After switching 10% of our US equity exposure into small caps in October, at the latest meeting, we switched an additional 2%, 3% and 5% in Low, Medium, and High profiles, respectively.

All remaining **euro-hedged US equity exposure was also switched into unhedged equivalents** given that the Trump administration should be positive for the US dollar, as previously mentioned.

Within our reduced **European equity exposure**, we prefer to **use actively managed products**, covering the full capitalization spectrum. This offers greater flexibility to seek shelter from Trump's tariffs.

Equity Sectors

Beneath the surface, the Presidential election has substantially changed the outlook for some sectors. To reflect this, we have:

Upgraded US domestic industrials to positive. Returning US President Trump has promised protectionist trade measures, relaxed regulation and cheaper energy for consumers. Global manufacturers are firmly in Trump's sights. He has threatened 10% tariffs on all goods imports, and up to 60% and 100% for China and Mexico, respectively, for certain products. If enacted, the costs would be passed on to US buyers, raising prices and depressing import volumes. This will help US domestic industrials. More international manufacturers may try to get inside the protectionist wall by building US factories. "I want German car companies to become American car companies", Trump said at a rally last month. The construction of those new factories will provide additional tailwinds for the sector.

Upgraded US financials to positive. While it could take some time for Trump to enact his intended agenda, there is ultimately scope for a more relaxed approach to antitrust regulation. Continued economic expansion and an increase in confidence among CEOs may also underpin a rise in corporate consolidation and act as a catalyst for IPO activity. All of the above would

help financial companies involved in trading and corporate finance activities. At the same time, banks may also benefit from the rate environment: Trump policies could be inflationary which means rates and yields may stay higher for longer, boosting interest rate income.

Downgraded US real estate to negative. The higher for longer rate and yield environment is detrimental to the sector. Lately, we have seen a sharp increase in 10-year and 30-year Treasury yields which, in turn, will increase borrowing costs. Real estate companies may lag the overall market in the coming weeks and months.

Downgraded US utilities to neutral. Within utilities, there are several companies that have exposure to renewable energy which is not a priority for the President-elect. Higher for longer rates would also be negative for the sector. Nonetheless, we maintain a neutral stance because there are still positives: higher electricity demand from new and yet-to-be-installed data centres, and from the rise of electric vehicles. Electricity demand is on a structural growth trend. Selective stock-picking will be key moving forward.

Negative	Neutral	Positive
EUR Consumer Discretionary	EUR Financials	IT
US Real Estate	US Healthcare	EUR Utilities
	Consumer Staples	EUR Healthcare
	EUR Industrials	EUR Real Estate
	Energy	US Communication Services
	Materials	US Industrials
	US Utilities	US Financials
	US Consumer Discretionary	

Fixed Income

US Treasury yields have moved sharply higher in recent weeks, pulling international peers along in sympathy. There are two key drivers underpinning this trend: expectations of more expansive fiscal policies under Trump, and less easing by the Federal Reserve in response to sticky inflation.

In light of this, we also have also adjusted our fixed income strategy.

Firstly, **we have switched US high-yield (HY) exposure** into loans. US HY spreads recently reached the tightest levels since the GFC and as such, we took the opportunity to crystallise gains (largely on “fallen angels”) and move into loans. These floating rate instruments offer high carry with no duration, while ongoing economic strength tempers default risk.

In defensive profiles, we switched 3% of sovereign exposure into investment grade (IG). IG bonds have a limited duration and give a thicker cushion to protect against rising yields, while the carry on offer remains attractive.

In Low and Medium profiles, we moved 1% of our IG exposure into HY, again to reduce exposure to duration, as well as to boost the potential for income generation.

CONCLUSION

While the Wall Street valuation soufflé continues to rise, equities have yet to fully bake in the Trump uncertainty discount. For this reason, we have added downside protection, in case the market starts to be nervous about political noise or valuations. The lesson from Trump’s previous term in the Oval Office is that investors should remain humble and cautious in their interpretation of his messages. What might seem market positive at first glance could have unintended side effects and consequences further down the line.

13/11/2024	DEFENSIVE			LOW			MEDIUM			HIGH						
	Bonds: 100%			Equities: 15% - 45%			Equities: 25% - 75%			Equities: 40% - 100%						
	Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation		Strategic Weight	Tactical Allocation					
Previous		New	Change		Previous	New		Change	Previous		New	Change	Previous	New	Change	
Equities				30,0%	28,0%	29,0%	↑ 1,0%	50,0%	47,0%	49,0%	↑ 2,0%	90,0%	87,0%	89,5%	↑ 2,5%	
Fixed Income	100,0%	97,0%	97,0%	⇒ 0,0%	65,0%	64,0%	64,0%	⇒ 0,0%	42,0%	44,0%	44,0%	⇒ 0,0%	10,0%	5,0%	5,0%	⇒ 0,0%
Cash & cash equivalents	0,0%	0,5%	0,5%	⇒ 0,0%	0,0%	3,0%	2,0%	↓ -1,0%	0,0%	4,0%	2,0%	↓ -2,0%	0,0%	3,0%	0,5%	↓ -2,5%
Other	0,0%	2,5%	2,5%	⇒ 0,0%	5,0%	5,0%	5,0%	⇒ 0,0%	8,0%	5,0%	5,0%	⇒ 0,0%	0,0%	5,0%	5,0%	⇒ 0,0%
Equities																
USA				12,0%	12,7%	15,2%	↑ 2,5%	20,0%	22,5%	26,0%	↑ 3,5%	36,0%	42,6%	46,6%	↑ 4,0%	
Europe				12,0%	10,5%	9,0%	↓ -1,5%	20,0%	17,5%	16,0%	↓ -1,5%	36,0%	33,5%	32,0%	↓ -1,5%	
Japan				3,0%	1,8%	1,8%	⇒ 0,0%	5,0%	3,0%	3,0%	⇒ 0,0%	9,0%	5,4%	5,4%	⇒ 0,0%	
China				1,0%	0,8%	0,8%	⇒ 0,0%	2,0%	1,0%	1,0%	⇒ 0,0%	4,0%	1,4%	1,4%	⇒ 0,0%	
Emerging Markets Ex-China				2,0%	2,2%	2,2%	⇒ 0,0%	3,0%	3,0%	3,0%	⇒ 0,0%	5,0%	4,1%	4,1%	⇒ 0,0%	
Fixed Income																
Government Bonds - Developed	50,0%	39,0%	36,0%	↓ -3,0%	30,0%	26,0%	26,0%	⇒ 0,0%	20,0%	19,5%	19,5%	⇒ 0,0%	5,0%	5,0%	5,0%	⇒ 0,0%
Emerging Market Debt	7,0%	4,0%	4,0%	⇒ 0,0%	5,0%	3,0%	3,0%	⇒ 0,0%	3,0%	2,0%	2,0%	⇒ 0,0%	0,5%	0,0%	0,0%	⇒ 0,0%
Corporate - Investment Grade	33,0%	44,0%	45,5%	↑ 1,5%	23,0%	28,0%	27,0%	↓ -1,0%	14,0%	17,5%	16,5%	↓ -1,0%	3,5%	0,0%	0,0%	⇒ 0,0%
Corporate - High Yield	10,0%	10,0%	11,5%	↑ 1,5%	7,0%	7,0%	8,0%	↑ 1,0%	5,0%	5,0%	6,0%	↑ 1,0%	1,0%	0,0%	0,0%	⇒ 0,0%
Other																
Oil				0,0%	0,0%	0,0%	⇒ 0,0%	0,0%	0,0%	0,0%	⇒ 0,0%	0,0%	0,0%	0,0%	⇒ 0,0%	
Gold				5,0%	2,5%	2,5%	⇒ 0,0%	8,0%	2,5%	2,5%	⇒ 0,0%	0,0%	2,5%	2,5%	⇒ 0,0%	
Total Return	0,0%	2,5%	2,5%	⇒ 0,0%	0,0%	2,5%	2,5%	⇒ 0,0%	0,0%	2,5%	2,5%	⇒ 0,0%	0,0%	2,5%	2,5%	⇒ 0,0%
USD	0,0%	2,0%	5,0%	↑ 3,0%	12,0%	12,7%	18,2%	↑ 5,5%	20,0%	21,5%	28,0%	↑ 6,5%	36,0%	40,6%	46,6%	↑ 6,0%



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