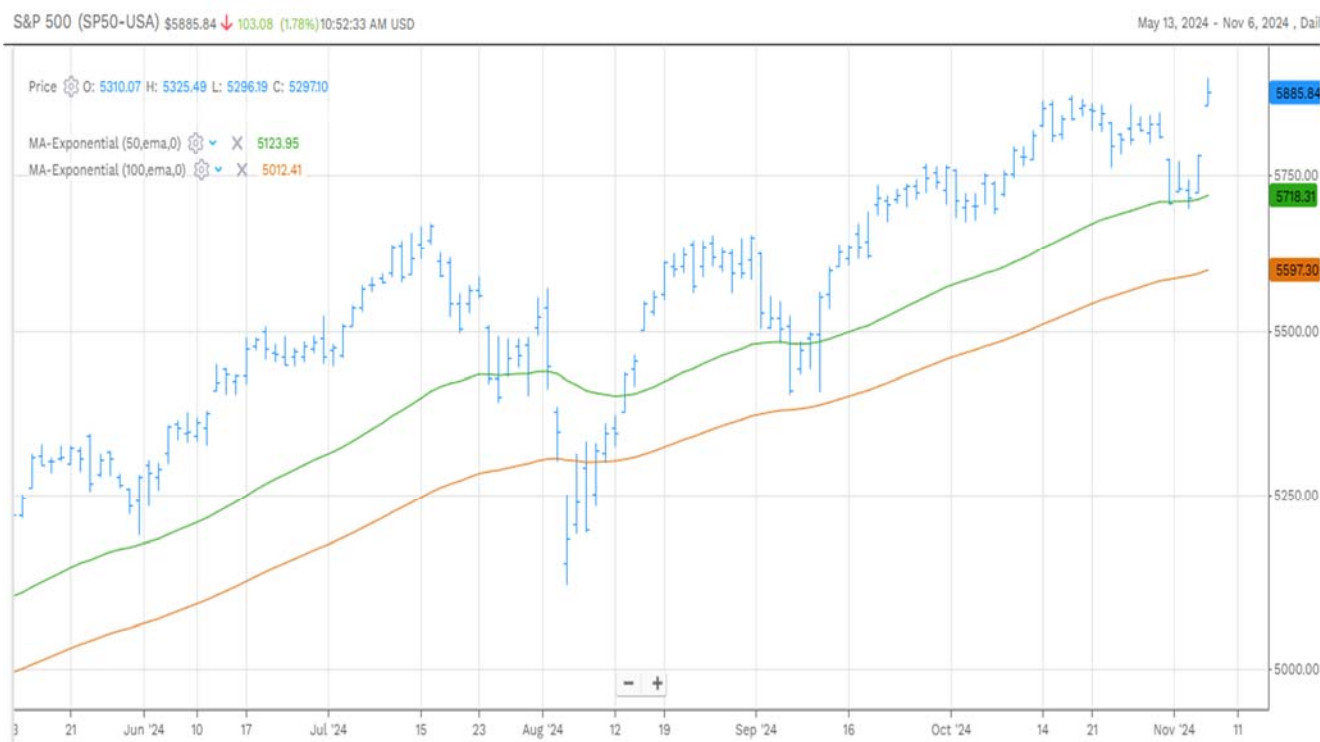


**H. Terrence Riley III, CFA**  
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**Contact: Karin Müller-Paris**  
**+1-561-208-1081 [kmm@fvcm.us](mailto:kmm@fvcm.us)**



## Equity Prices Rise on Trump Victory

The S&P 500 is up more than 2% today following the morning news that Trump has been re-elected and that the Republicans will control the Senate and possibly the U.S. House of Representatives. Politics has short legs, and we look at this election from the viewpoint of analysts and portfolio managers, not from a political perspective per se. That said, part of today's big rally may reflect simple relief among the population as a whole that the election is over. But also, there had been fears that there would be a social backlash if the race was close and partisans on either side, but particularly Trump's, were given the opportunity to claim that the election was "stolen." Because Trump's win was decisive, the election results are not likely to be challenged and—relative—social peace is likely. Aside from relief that the election is over, and over decisively, the markets are reacting to the major points in Trump's economic platform, which is positive for general business conditions and the economy:

- Provisions from Trump's original 2017 tax law were scheduled to be phased out/expire in 2025. That tax law, among other things, cut individual income taxes rates, reduced the amounts subject to estate taxes, cut the corporate tax rate from 35% to 21%, and allowed businesses to fully expense

certain investments rather than capitalize them and then depreciate over time. A Harris administration would have let these tax changes expire at the end of 2025. Now, these changes are expected to be made permanent.

- Trump's latest plan is to reduce the corporate tax rate to 15% from the current 21% for companies that manufacture products in the U.S. Lower taxes will result in higher earnings for shareholder. In contrast, Harris planned to increase the corporate tax rate to 28%.
- Tariffs—it is not clear what tariffs will actually be enacted, but proposals discussed include a 60% tariff on Chinese imports and a 10% tariff on the rest of the world. These proposals may be an opening bid by Trump for negotiations. He once offered zero tariffs for Europe if Europe would reciprocate. Europe declined. Held in isolation, Trump's tariff proposals would likely reduce imports into the U.S., cause a one-time upward shift in the price level, and have a mildly contractionary effect on growth. However, Trump's plan is to shift taxes away from U.S. income taxes and onto tariffs, which in large measure would work as a consumption tax. On a net basis, the effect of lower income taxes but higher tariffs should be positive for domestic production and income. A primary argument in favor of these tariffs on China, is that China is a Communist dictatorship and that it is necessary to eliminate supply dependence for national security purposes.
- Deregulation – A Harris administration was expected to continue the policies of the Biden administration. These policies included stringent and costly regulations on electricity production, cutting off federal lands from energy production, delays and cancellations of pipeline construction, and requirements for increased EV production. Other regulations have affected nearly every aspect of the economy from healthcare to food production. Trump is expected to reverse many of these policies to the benefit of the economy and production. During Trump's first term starting in 2016, two old regulations had to be eliminated for every new regulation. A similar policy is likely to be reinstated. Deregulation should help a range of sectors and industries, including the energy sector, manufacturers, banks and other financial companies, utilities and even technology.
- Government spending – The U.S. government spending has risen sharply in recent years, largely due to increases in social security spending as well as big discretionary spending programs such as Biden's "Inflation Reduction Act." The Wall Street Journal recently reported that the misnamed law's numerous subsidies for green projects will cost \$1.2 trillion, more than three times estimates provided by the law's supporters.

Trump has promised not to touch social security, which is a problem because it is the biggest portion of the Federal Budget. However, the Trump administration is expected to take an axe to many of these discretionary spending programs. The budget deficit should gradually decline due to greater spending discipline and faster economic growth.

- Bureaucracy – the number of Federal government employees has increased nearly 10% to 2.4 million during the Biden administration. Many if not most of these employees do not even physically show up in person to work. Trump is reportedly going to use Elon Musk as a consultant to eliminate or reduce this bureaucracy. By reducing wasteful Government spending and bureaucracy, private enterprise would benefit.

## Effects of Trump Domestic Policies

Despite proclamations published in the media, Trump's economic policies are positive for businesses and the economy. Trump will again, as he did in his first term, experience substantial resistance to his policies because there are people who earn their bread and butter from government policies that control business or that directly benefit from government spending programs. But on the whole, the Trump policies are business friendly and should help stimulate private production and profitability. Trump is also dedicated to expanding manufacturing in the U.S. with the help of friendly and low-cost energy policies. As has been said, you can't love labor and hate employers. Trump is focused on generating high wage employment through business and employer development. We see these policies as positive for capital investors. Smaller business should benefit in particular from relief provided by reductions in regulations. We remain somewhat cautious because valuations remain high, but equities should continue to offer good returns in the years ahead.

## Foreign Policy & NATO

There has been great consternation by some about Trump's "America First" foreign policy, and a brief comment is perhaps warranted in order to put Trump's outlook in a historical context. Many people outside of the U.S. think of the country as a power involved in wars and military activity throughout the globe. This is true, but the U.S. has always had a very deep isolationist streak in its DNA. During his farewell address, George Washington, the first president, warned about what seemed like endless wars between Britain and France and other European powers. Washington warned against U.S. involvement in such wars and "entangling alliances." Washington believed that the United States should consider external alliances as temporary for convenience, and should be abandoned when the national interest dictates. This anti-alliance philosophy ran deep in the U.S. for a very long time. Consider that World War I started in July 1914, but the U.S. tried to stay out and did not get involved until 1917 when Germany started submarine warfare in the North Atlantic. Or consider that World War II started in September 1939, but that the U.S. did not get involved until December 1941 when the Japanese bombed Pearl Harbor. The U.S. is surrounded by oceans and prefers to be left alone.

The American attitude toward isolationism began to change after World War II and the Soviet takeover of Eastern Europe. Many in the U.S. began to see the cataclysmic results of the second war as potentially avoidable to some degree had it not been for the appeasing policies of Neville Chamberlain and the failure of the U.S. to provide deterrence. U.S. policy during the Soviet era changed. It became common to believe that the U.S. had to proactively confront and deter the Soviets throughout the globe in order to prevent the broadening and dark reach of Communist totalitarianism. Some said it was better to fight them over there, e.g., Vietnam, rather than wait to fight them over here, as implausible as that would be. This philosophy had many adherents, notably Ronald Reagan, who took the Cold War to a new level. Reagan famously said

the Cold War would end only one way: We win, they lose. And in 1991, Reagan and the interventionist philosophy seemed to have been correct.

A shift is again underway. After more than 30 years of freedom from fear of a major nuclear power, the U.S. has perhaps become more complacent. There are now large pluralities in both the Republican and Democratic parties that want the U.S. to retreat from foreign entanglements. The Democrats have long been the “anti-war” party and offered the primary resistance to the United States’ involvement in Vietnam and more recent military conflicts. Trump has now pulled the Republican party more into this camp as well, although Trump’s motivations seem more basic. He is transactional and believes the U.S. has been carrying the weight for other industrial nations that would rather spend on their welfare programs than defense programs. Trump considers this unfair and is the reason why he has threatened to reduce the U.S.’s involvement in NATO. Trump also sees Taiwan, home to the largest semiconductor manufacturer in the world, as a free rider because of its meager military spending of 2% of GDP. There is no formal defense treaty with Taiwan, and it is a possibility that Trump would stand back and not risk American lives to defend the Taiwanese from a Chinese invasion. NATO, on the other hand, is a long standing and formal military alliance. You can hear George Washington’s farewell address ringing through Trump’s head, but it is very unlikely that the U.S. would pull out of NATO. In fact, there is likely to be additional U.S. troops sent to the Balkans and Poland if the war in Ukraine expands. A strong NATO is in the U.S. interest and Trump will not want to be the president who dismantled the most successful military alliance in history. But the talk will continue as well as pressure on other members to increase defense spending.

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