Roundtable on the US election: A new chapter? Or the same ol' story?

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Expert Access roundtable featuring:

- **Craig Jerusalim,** Senior Portfolio Manager, Equities
- **Michael Sager,** MD & Head of Multi-Asset & Currency Management
- **Aaron Young,** VP, Client Portfolio Manager, Fixed Income

The 2024 US presidential election will likely go down in history as one of the most contentious and unpredictable. While it's impossible to forecast who will win and how markets will react, in this roundtable we explore how candidate policies might affect equities, fixed income and currencies. We also discuss how investors can best position themselves to ride through the uncertainty.

(Host) Mark Obrai: Thank you for joining. To call the 2024 election campaign "extraordinary" would be an understatement. The political twists and turns have generated significant interest—and uncertainty—about the future. And we still have weeks to go.

History shows markets tend to perform similarly under Democratic or Republican presidencies. Does this election introduce a new chapter for investors or does the tried and true strategy of ignoring the noise still hold? Even if the story remains the same, it's important to understand how the policy landscape could shift, influencing the long-term prospects for various assets.

To discuss, today I am joined by Craig Jerusalim, Michael Sager and Aaron Young from the CIBC Asset Management investment management team.

Michael, let's start with you. While presidents often get too much credit for the health of the US economy and financial markets, how might differing candidate policies—for example, on energy and trade—influence economic output and inflation?

Michael Sager: At this time, the presidential race is essentially a toss-up, and a divided government is the most likely outcome. That makes wide-ranging policy initiatives difficult to enact, which may give investors comfort, to the extent they like the look of the status quo. It also likely means that the impact of the election on the performance of investor portfolios is likely to be fairly limited. That's consistent with history—US Presidential election years, in terms of equity returns, have not been much different for the S&P 500 than any other year. This talks to another important observation—elections don't take place in a vacuum. They are just one of many variables that are constantly interacting to influence markets. In the long term, the broader environment for economic growth and inflation, as well as central bank policy making and technological innovation, are a much more important driver of long-term earnings, interest rates, and thus equity and fixed income performance.

All that said, if the election outcome shifts to a Republican or Democrat sweep, then more leeway for substantive policy change can lead to different outcomes for markets, at least in the short term. This is why it is important to identify any significant policy differences between the two candidates. From a macro perspective, we can focus on two: trade and fiscal policy.

Most of the discussion around trade policy has focused on China. But that's not a point of differentiation: regardless of who wins the election, the US is expected to continue its efforts to curtail the growth of Chinese technological capabilities, and to seek to reduce US economic exposure to China– this is a high conviction priority for both US political parties. That said, trade tariffs levied on China could be much higher and more encompassing under Trump than Harris (although the Biden/Harris administration has by no means avoided the use of tariffs in its dealings with China). A Trump administration may also levy additional tariffs on all friendly trade partners, perhaps including Canada; or at least threaten to levy them as a bargaining ploy to achieve other objectives. To the extent tariffs increase, this could have important negative implications for global growth—including perhaps as a result of a tit-for-tat tariff war—as well as implying higher inflation than might otherwise prevail, and therefore higher interest rates.

In terms of fiscal policy, the Trump January 2018 tax cuts that are scheduled to expire in 2025 will likely be renewed whoever wins, but there will be differences in strategy. Trump is expected to renew all personal tax cuts, and potentially add another corporate tax cut; Harris will likely renew personal tax cuts only for those individuals with income below $400k, and could partly fund these with tax increases on wealthier individuals and corporations. This implies a more obvious fiscal stimulus to growth under a Trump administration, at a time when it is not clear this is what the resilient US economy needs. Perhaps more importantly, whichever candidate wins there appears to be no desire to correct the rising (and ultimately unsustainable) debt path the US federal government is on. This also implies a higher level of interest rates than would otherwise have been the case.

How do you see this affecting the Canadian dollar?

Michael Sager: The Canadian dollar (CAD) has traded sideways for many years now against USD (US dollar) around 0.73-0.74. We would classify the Loonie as weak relative to our estimate of its long-term Fair Value, which we think is about 10-11% higher than the current exchange rate, at 0.83. So definitely room for CAD to strengthen. That said, we don't think this is likely to happen in the next few quarters and instead expect it to remain in its recent weak range for the foreseeable future.

There a few factors to consider, including the potential impact of election-related trade policies. This would be most relevant under a second Trump administration. Even so, the extent of the risk posed by a generalized trade tariff that encompasses Canada is relatively low, such that this factor is less important than three other risks unrelated to the US election. First, the relative central bank interest rate policy outlook. Here, I think market expectations of cumulative US Federal Reserve (Fed) interest rate cuts over the next year currently look too aggressive; by contrast, they seem more reasonable for the Bank of Canada. At the margin, as market Fed expectations adjust towards our view, this seems likely to favour the US dollar and hinder CAD. Second, we are not particularly constructive on the price of key commodities such as oil, which are an important driver of CAD versus the US dollar. And third, the other really important theme for CAD versus the US dollar is productivity trends between Canada and the US. Higher productivity is often expected to attract inward capital investment, which in turn can support the currency of the receiving country. For several years, Canadian productivity has been poor—and has actually fallen in level terms. Reasons include relatively weak investment spending. By contrast, the last couple of years has seen strong US productivity growth. To the extent this dynamic continues—and we think it will for a while—better productivity growth in the US than Canada is helpful to the US dollar, and unhelpful to CAD.

Putting all these elements together, it seems likely that we will see some support for USD vs CAD into year end. Put another way, we think CAD will likely stay relatively weak for the foreseeable future.

If we extend the analysis to a multi-year horizon, there is more room for optimism that CAD can ultimately strengthen against the US dollar from current levels. But this is not an actionable view at present.

Craig, from a Canadian equity perspective which sectors are potentially more sensitive to the outcome of the election?

Craig Jerusalim: It is still unclear if the protectionist angle under President Trump will envelope Canada or North America in its entirety given his thumbprint on the modernized version of NAFTA (North American Free Trade Agreement), the USMCA (United States-Mexico-Canada Agreement) as well as America's need for many of the raw materials coming from Canada. While the US may claim to be energy independent, that claim is really a North American claim considering the vast amount of heavy oil imported from Canada to the Gulf Coast refineries.

That being said, increased tariffs of goods going into the US could have a dampening effect on certain manufacturers and importers as a result of inflationary pressures. We would also be wary of green policies for renewables and electric vehicles under the Republicans, however many of these green power projects are now being advanced by corporations who have made commitments to their own stakeholders and are less reliant on Government subsidies. The reverse would be true under Democrats. Additionally, many of our engineering and construction (E&C) firms with large environmental practices would likely benefit slightly more under the Democrats. One final advantage for Canadian equities under Republicans would be lower taxes and less burdensome regulatory requirements benefiting anyone with operations south of the border.

Given political uncertainty, are Canadian companies shifting attention to overseas markets? Are they doing anything differently?

Craig Jerusalim: We haven't witnessed any companies specifically shifting attention away from the US as a result of political risks. We have seen a trend over the past few years of companies shifting their attention globally, outside of our home market, but that more often than not begins in the US. We would expect these globalization trends to continue.

How does the election factor into how corporate and high yield bonds are evaluated in Canada and the US?

Aaron Young: Our key focus is on how each candidate's economic policy will impact relative strength/weakness in US versus Canada and the opportunities and risks that arise. The interplay between USD and CAD currencies, rate differentials will be a key driver of relative value in Canada versus US corporate allocations. Higher yields in the US and lower yields in Canada could make US corporates look more attractive in Canadian dollar terms. While corporates in general are showing strong fundamentals, higher rates for longer could pose some stresses for issuers refinancing their debt into a higher rate backdrop. We would also argue that Canadian corporate valuations are relatively tight given headwinds facing the Canadian economy. Any further policies which weaken Canada's stance relative to the US could put pressure on Canadian spreads.

There are signs of slowing consumer spending across North America, implying both the Federal Reserve and Bank of Canada will maintain a dovish stance. How does the timing of the election factor into the Fed's calculus in the fall? And looking further out, how do differing candidate policies affect the long-term view for the Treasury curve?

Aaron Young: In the short term we don't view the Fed as playing politics and should guide monetary policy independent on the upcoming election.

Longer-term, continued Canadian and US economic divergence would further amplify relative value to be found in US treasuries over Government of Canada bonds, especially in the long-end. Increased overall volatility across government bond curves which would come with divergent economic and monetary policies should provide a plethora of opportunities to find alpha in the otherwise sleepy sovereign bond markets.

The election is well-underway and despite the uncertainty, markets are near all-time highs. What course of action has historically worked well for investors during elections and other periods of ambiguity?

Michael Sager: The best course of action—when confronted by a specific event that drives market volatility and uncertainty higher—has always been to stay invested and focused on long-term goals. Uncertainty over possible policy changes might encourage investors to try and time market participation. This has historically proven to be a bad decision—staying invested in a well-diversified portfolio through short-term volatility (whatever the source) has paid off.

To this point, it's important again to emphasize that factors other than elections typically have greater long-term impacts on portfolio performance. This includes fundamentals such as economic growth and inflation trends that impact interest rates and corporate profitability, as well as technological innovation across various sectors. So my advice would be to stay focused on long-term goals, stay appropriately diversified, and stay invested.

Are you doing anything significantly different within your portfolios with respect to the election or general economic climate?

Craig Jerusalim: If you were handed a crystal ball that could have predicted the outcome of the last two US elections, with 100% certainty, I am still not sure that would have helped predict the reaction of equities broadly. As such, we are not doing anything differently across our portfolios. We instead will continue to focus on investing in the highest quality companies with strong financial positions, defensible competitive advantages and growing earnings that are positioned to thrive regardless of the political or economic backdrop.

Michael Sager: It is undeniable that political risk is more prominent at present than usual—not just in the US, but also in Europe, the Middle East, the South China Sea, and between China and Western economies. In addition, recent economic activity data have raised concerns, particularly in Europe and China, that the global growth recovery is not unfolding quite as strongly as expected. As a result, we are positioning currency and global bond portfolios relatively cautiously at present—with less exposure to global growth and some exposure to diversifying hedges that can offer protection against temporary volatility spikes. At the same time, we are also cognizant that temporary market corrections provide opportunities to add risk and value consistent with our longer-term fundamental views. So near-term caution, but longer-term opportunity.

Aaron Young: Short-term volatility around changing election odds is noise for our medium-term strategy. However, we always look for dislocations within which we can utilize relative value across Canadian and US markets to find opportunities to add value relative to purely Canadian holdings.

Thank you Craig, Michael and Aaron for participating in today's session.

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