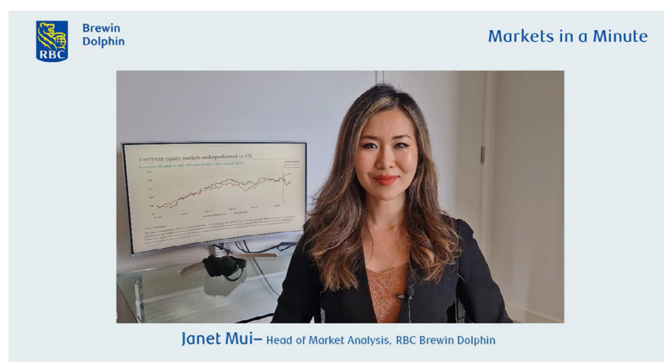
17 September 2024

Markets in a Minute

After the recent market swings, Head of Market Analysis, Janet Mui, and Chief Strategist, Guy Foster, examine the implications of the Trump-Harris debate on prediction markets, and what surprising U.S. inflation data could mean for interest rates.



Janet Mui– Head of Market Analysis, RBC Brewin Dolphin

To view the latest Markets in a Minute video click here.

Markets generally staged a bit of a recovery last week. Most major markets were positive for the week but were still off their highs for the year.

Trump and Harris face off

The most anticipated news last week was the debate between presidential hopefuls Kamala Harris and Donald Trump. The debate was typically feisty but showed the Democrats have learnt some lessons in how to debate Trump. They largely dispensed with Hilary Clinton's approach of trying to be policy-focussed. Instead, Harris managed to needle Trump on the size of his rallies.

It was hardly a magisterial performance from the vice president, but the consensus seems to be that even if she didn't win the debate, former President Trump seemed to lose it. This debate's enduring soundbite? Trump's rant about unsubstantiated stories of immigrants eating pets.

Prediction markets have given Harris a slight edge since the debate, arresting a slide in her odds after the initial burst of momentum she enjoyed in the weeks surrounding the launch of her candidacy.

Over the last two weeks, markets have tended to follow the movements in the most likely winner of the election. They fell as Trump's chances rose ahead of the debate, and they have rallied as Trump's chances have ebbed in the aftermath. Does this mean the market is anxious about the prospect of a second Trump term?

That's probably not the right conclusion to draw. Not least because in the preceding weeks, markets seemed more positively correlated with Trump's chances. More importantly, it's unclear exactly which candidate the market would be happier with.

Over the weekend, there was a second assassination attempt on Trump. While he declared he is safe and well, it adds to a sense of chaos and raises questions about his security protection. The market impact is unclear, though this time the assassination attempt has not immediately boosted his probability of winning the election according to betting odds, unlike the first attempt. Investors will continue to focus on policy proposals and economic developments in the run up to the election.

Who are investors backing?

From an investor's perspective, the key dividing line between either a Trump or Harris presidency is corporation tax rates. Trump would like to cut the corporate income tax rate from 21% to 15%, whereas Harris would like to increase it to 28%.

Taken on its own, therefore, this clearly makes Trump seem the preferred candidate from an investment perspective. However, there are caveats.

The first caveat is Trump's use of broad global tariffs and particularly harsh Chinese tariffs. These will be inflationary and, when they are inevitably met with retaliatory measures, they will also impede growth.

Furthermore, we shouldn't just assume that because a victorious candidate has made a tax pledge it will inevitably become law. According to the U.S. Constitution, all finance bills must be proposed in the House of Representatives. They pass through several steps within the House of Representatives and the Senate before a finalised bill is sent to the president's desk where they will either sign it into law or veto it. So, the president's role (in theory), is actually pretty modest in shaping policy.

Trump campaigned on the basis he'd reduce corporate income tax to 15% during his first campaign in 2016, but the subsequent Tax Cuts and Jobs Act of 2017, which reduced the tax to 21%, was essentially authored by Kevin Brady (the Chairman of the House Ways & Means Committee).

The question is, then, if the 2017 House of Representatives wasn't prepared to cut tax rates as much as Trump wanted, will the 2025 one be prepared to?

It's only likely if the Republicans win the House of Representatives, which is touch and go. Then it would also need to be approved by the Senate, which Republicans are likely to win from the Democrats. Only a clean sweep of the presidency, House of Representatives and the Senate will enable the Republicans to pursue a tax cutting agenda. It's also unclear how aggressively they would do so given the U.S. is already running a 6% budget deficit and government debt to GDP is on course to exceed 10% during the coming Congress.

What is clear, is that there are several hurdles which need to be cleared to reap the anticipated benefits of a Trump presidency; the market-unfriendly tariffs and the general unpredictability he brings are more of a foregone conclusion.

The most obvious downside of Harris winning the presidency, the risk of an increase in corporate income tax, seems a vague risk given it's very unlikely the Democrats would control both the House of Representatives and Congress.

Beyond these measures, Trump is likely to be a less stringent enforcer of regulation than Harris, which shareholders would certainly appreciate.

U.S. inflation data surprises

The main economic news from last week centred on U.S. inflation data coming in a little stronger than had been anticipated. Generally, investors saw this as tilting the Federal Reserve's (the "Fed") bias in favour of a more modest 0.25% cut when they announce their policy this week, rather than the more extreme 0.5%.

The main reason for the surprise was shelter inflation, but it does seem like rents will contribute less in future periods, so the Fed need not be too concerned.

There was also a slightly higher measure of core services inflation (excluding housing). This measure, known as supercore, would be more concerning for the Fed as it's the kind of inflation that central banks aim to control by retraining and stimulating the economy. The context here though, is that supercore had been very weak for the last three months, perhaps sustainably so, and therefore a little rebound shouldn't be troubling.

Moreover, the general employment and consumption data has tilted weak in recent months, so there doesn't appear to be a problem with excessive demand. Another validation of this comes from some of the alternative measures of the consumer price index (CPI) – trimmed mean and median, for example – which generally eased during August.

It's all in the data...

Overall, the market seemed settled on a quarter point interest rate cut as the Fed entered the pre-meeting blackout period. It will have retail sales numbers to digest this week, and I still wouldn't discount the chances of a 0.5% cut. Policy is currently tight, and on balance, data being released over the last few weeks has suggested that high interest rates are at last starting to bite.

Indeed, the European Central Bank did cut interest rates last Thursday and in the accompanying commentary, President Christine Lagarde was keen to emphasise the bank is data dependent. As we've previously discussed in the weekly round-up, it's very difficult for central bankers to take steps which don't seem justified by current economic data.

So this week we'll have monetary policy being set by the Fed, the Bank of England and the Bank of Japan, of which the Fed is considered the only bank likely to change policy.

The value of investments, and any income from them, can fall and you may get back less than you invested. Neither simulated nor actual past performance are reliable indicators of future performance. Investment values may increase or decrease as a result of currency fluctuations. Information is provided only as an example and is not a recommendation to pursue a particular strategy. Information contained in this document is believed to be reliable and accurate, but without further investigation cannot be warranted as to accuracy or completeness. Forecasts are not a reliable indicator of future performance. We or a connected person may have positions in or options on the securities mentioned herein or may buy, sell or offer to make a purchase or sale of such securities from time to time. For further information, please refer to our conflicts policy which is available on request or can be accessed via our website at www.brewin.co.uk

RBC Brewin Dolphin is a trading name of Brewin Dolphin Limited. Brewin Dolphin Limited is authorised and regulated by the Financial Conduct Authority (Financial Services Register reference number 124444) and regulated in Jersey by the Financial Services Commission. Registered Office; 12 Smithfield Street, London, EC1A 9BD. Registered in England and Wales company number: 2135876.

® / ™ Trademark(s) of Royal Bank of Canada. Used under licence.

RBCBDM1809_2409