GLOBAL Insight WEEKLY

Perspectives from the Global Portfolio Advisory Committee September 12, 2024

In brief: Harris and Trump on the issues

Kelly Bogdanova – San Francisco

A gulf exists between Vice President Kamala Harris and former President Donald Trump on policy issues. Following is an executive summary of the third article in our U.S. election series in which we address key policy differences that matter most to the economy and stock market.

We have long held that the stock market doesn't march to the president's drum—or Washington, D.C.'s for that matter. Quite often other factors supersede developments inside the Beltway. And let's face it, many campaign proposals don't see the light of day because of the checks and balances built into the system. Yet it's still useful to consider candidates' economic proposals given that some presidential decisions can impact the market overall or select industries, even if just for a short time.

Tax plan takeaways

The large tax cuts on individuals, investments, and estates that were implemented in 2018 during Trump's presidency, known as the Tax Cuts and Jobs Act (TCJA), will expire at the end of 2025. If nothing is done, they will automatically revert to higher levels previously in place.

- Trump proposes to extend all of the low tax provisions in the TCJA beyond the year-end 2025 sunset date, regardless of household income, and he wants to cut taxes on Social Security retirement benefits.
- Harris seeks to extend the low tax rates for most taxpayers but is in favor of raising taxes on households with incomes above $400,000 per year, and increasing the long-term capital gains tax for those earning $1 million or more. She would boost the TCJA child and small business tax credits and would introduce a new tax credit for certain first-time homebuyers.
- The corporate tax rate, which the TCJA cut to 21 percent from 35 percent, does not sunset at the end of 2025—it will stay in place until it is proactively raised or lowered.
- Harris advocates raising the corporate tax rate to 28 percent from 21 percent. While Trump had previously called for lowering the corporate rate to at least 20 percent, more recently he proposed reducing it to 15 percent for companies that manufacture goods in the U.S., with some restrictions.

Decoding the impact of tax code changes

Regardless of who is elected president in 2024, the congressional election results will play an important role in determining tax and other fiscal policies.

- We don't think major tax code changes on individuals or corporations are factored into stock market sentiment as of this writing.
- We also don't think a corporate tax rate change is factored into S&P 500 consensus profit margin forecasts, which are currently near the upper end of the range since 1990.

For perspectives on the week from our regional analysts, please see pages 4–5.

For important disclosures, required non-U.S. analyst disclosures, and authors' contact information, see page 6.

Priced (in USD) as of 9/11/24 market close (unless otherwise stated). Produced: 9/12/24, 13:42 ET; Disseminated: 9/12/24, 13:55 ET;

- Even so, it's notable that a Bloomberg study found, "Over the long run there has been essentially zero correlation between the effective corporate tax rate and the performance of the S&P 500…"
- But investors should keep in mind that before we get to the "long run," the policy debate between the next president and Congress (and lobbyists) about tax rates and other fiscal issues could have a short-term impact on U.S. stock market volatility following the election, including at times during 2025.

The tax cuts worked

The median tax rate of S&P 500 firms significantly declined after TCJA

Source - Bloomberg News, "What the data says about actual corporate tax rates: Macro Man" 8/20/24; data represents the median 12-month effective tax rate through 4/30/24

Price plans and populism

Despite the significant decline in the year-over-year consumer inflation rate, the presidential candidates and most voters are still focused on the fact that overall prices remain very elevated.

- Harris proposes to tackle high prices by targeting "price gouging."
- We believe any new, comprehensive price gouging legislation would go nowhere in the next session of the Senate and would also struggle to gain support in the House of Representatives, no matter which party wins control of these two congressional chambers.
- Nevertheless, we would expect a Harris administration to more aggressively investigate and prosecute federal antitrust and consumer protection cases compared to the Biden administration and previous Trump administration.
- Trump's strategy to bring prices down focuses on incentivizing more domestic oil and natural gas production and energy exports, with the aim of substantially lowering energy and power prices overall, which are key cost inputs of many goods and some services.
- Even if this were to dampen global oil and goods prices, we believe some of Trump's other policies, namely tariff increases, could partly or fully wipe out the benefits that lower energy and power prices would bring.

Talking tariffs

Many of Trump's tariff policies are more sweeping than those he implemented during his previous term, and they differ greatly from those of Harris.

- Trump supports across-the-board tariffs on all imports of 10 percent or more, and high tariffs on Chinese imports of 50 percent or more. He would levy tariffs on goods of U.S.-based companies that are produced overseas and imported into the country, and would use tariffs against domestic companies that outsource American jobs. He has also threatened to use tariffs against countries that trade outside of the U.S. dollar system.
- Harris does not support across-the-board tariff increases and views such tariffs as "in effect a national sales tax." She also does not support significantly raising tariffs on Chinese imports but would likely keep in place the China tariffs and sanctions that Trump and President Joe Biden implemented.
- RBC Global Asset Management Inc. Chief Economist Eric Lascelles contends that tariffs "undeniably hurt the country that has tariffs levied against it…" However, he cautions, "Less intuitively, tariffs usually also hurt the country levying them."

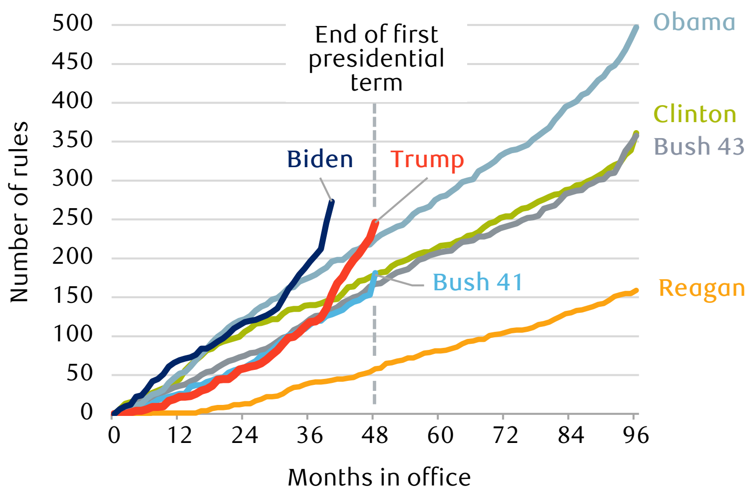
Regulations and red tape

The widespread perception among market participants that Trump is likely to have a more business-friendly regulatory regime than Harris rings true to us, except there are nuances.

- While the Biden-Harris administration added 11 percent more "economically significant regulations" in almost 3.5 years than Trump did in his full four-year term, Trump's administration ended up implementing more regulations than President Barack Obama did in his first term.
- We think a Harris administration would implement more proactive and stringent environmental regulations. She would look for opportunities to advance the ball on climate-related issues, whereas Trump stated he would roll back existing climate regulations and targets.
- Despite multiple presidential candidates' pledges to "cut the red tape" in campaign after campaign, a heavy regulatory load on businesses has been the norm for decades. Only a concerted, laser-focused effort on reducing regulations would change this, in our view. For deregulation to work for both the business sector *and* society, we think a scalpel would be needed rather than a sledgehammer.

Regulation has increased under every president since Reagan, and accelerated during the last three administrations

Cumulative number of economically significant final rules by administration



Note: "Economically significant final rules," as defined by the 1996 Congressional Review Act, are rules that result in an annual effect on the economy of $100 million or more, or a major increase in costs and prices, or a significant adverse effect on competition and various economic indicators.

Source - Regulatory Studies Center at The George Washington University; data through 8/5/24

Influence on industries

The candidates have different approaches when it comes to certain industries, but more similar approaches for other industries than is commonly understood.

- **Banks and financial services:** Trump's regulatory policy proposals and his administration's approach to mergers and acquisitions within the industry and in general would likely be more favorable than those of Harris. Among other regulations, Harris seeks to limit customer fees.

- **Oil, natural gas, coal, power, and rare earth minerals:** Trump is willing to declare a national emergency to significantly increase domestic energy supplies and exports, and to build out power infrastructure, including to support the growing power needs of artificial intelligence (AI). While Harris no longer supports a fracking ban, we think she would likely impose more stringent regulations on oil, gas, coal, power producers, and mining than Trump.

- **Clean energy and cleantech:** Harris seeks to keep in place and build on the Inflation Reduction Act's (IRA) unprecedented industry subsidies and incentives. Trump seeks to "rescind all unspent" IRA funds through legislation.

- **Pharmaceuticals and health care insurers:** Harris proposes to add more pharmaceuticals to the Medicare price cap list, building on Biden's policies. She also wants to extend the price cap list to all Americans, not just retirees in Medicare, and she seeks to permanently cap out-of-pocket drug spending at $2,000 per year for everyone. Trump has previously supported granting Medicare the ability to negotiate prescription drug prices and to level-out prices between the U.S. and other countries. More pharmaceutical pricing restrictions could benefit some health care insurers.

- **Technology:** We believe each candidate would be supportive of the technology industry overall, including AI development, as they understand tech firms are key drivers of innovation and GDP growth. However, both candidates will likely maintain and add more restrictions on tech exports to China, citing national security concerns, which could negatively impact select U.S.-based companies.

- **Military weapons contractors:** Both candidates support significant weapons spending and exporting U.S. weapons to allies and friendly countries. Historically, Republicans have advocated for higher spending levels, but over the years weapons spending has become more of a bipartisan issue as both parties are now dominated by foreign policy hawks.

While candidates' industry leanings are useful to consider, individual investors should be careful not to jump to conclusions on how stocks of particular industries or sectors might fare depending on who wins the presidential election.

Presidents don't govern the stock market

Whether Harris or Trump wins in November, we remain convinced that the formal and informal checks and balances built into the government's structure will constrain the next president from fulfilling her or his full slate of policy goals. Furthermore, other factors will likely play greater roles in shaping the market's direction such as the natural ebb and flow of the business cycle, the Fed's monetary policies, and industry innovation.

For individual investors, we think the best investment strategy vis-à-vis elections is to give deference to the long-term investment strategy that is already in place, and to avoid the temptation of making drastic asset class or sector changes based on various election outcome scenarios.

For more on this topic, see the complete report, "Harris and Trump on the issues."

UNITED STATES

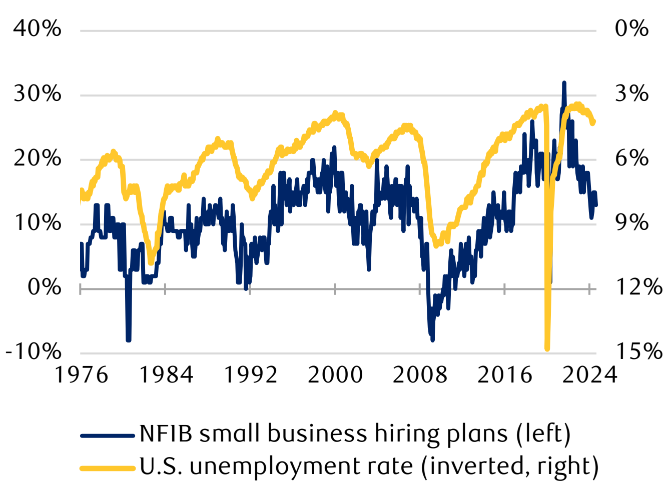
Tyler Frawley, CFA – Minneapolis

- **U.S. equities are on track for weekly gains on the week as investors look ahead to next week's highly anticipated Federal Open Market Committee (FOMC) meeting.** All major indexes are higher, with the tech-heavy Nasdaq Composite being the best relative performer, returning 4.74%. The S&P 500 has outperformed the Dow Jones Industrial Average, but both are higher, rising 2.94% and 1.17%, respectively.

- **Small businesses in the U.S. dialed back their hiring expectations in August,** with only 13% of net respondents stating they plan to create new jobs over the next three months, down from 15% in July, and just off the lowest levels seen since mid-2020. Understanding that small businesses are significant contributors to U.S. job growth, we view the recent weakness in hiring expectations as a worrying sign that unemployment may continue to move higher in the coming months. In fact, when we look at the correlation between small business hiring expectations and the U.S. unemployment rate, on a three-month lag, going back to the mid-1970s, we see that the two metrics have a negative correlation of 0.72, indicating a strong inverse relationship. This means that as small businesses begin to temper their hiring expectations, unemployment tends to rise in the ensuing months. As economic concerns continue to shift away from elevated inflation toward concerns of a potential slowdown in the labor market, we think it will be important for investors to monitor the health of small businesses to get clues about where the unemployment rate may be heading as we move into the end of the year.

- **Inflation continued to move lower in August, falling to its lowest levels since January 2021.** Headline inflation fell to just 2.5% y/y, down from 2.9% in July, inching closer to the Federal Reserve's 2% target. However, month-over-month core inflation, which excludes volatile measures such as food and energy prices, came in at 0.3%, above the 0.2% consensus expectation driven by greater-than-expected increases in housing and transportation services costs. This higher-than-expected month-over-month reading caused market participants to recalibrate their rate-cut expectations for the FOMC meeting, with the market now expecting the probability of a 50 basis point cut to be just 13%—down from 34% prior to the report, according to the CME's FedWatch Tool.

U.S. small businesses dialed back their hiring plans in August



Source - Bloomberg; data as of 9/11/24

CANADA

Zachariah Muhn – Toronto

- **The Canadian labour market has softened further.** The economy added a weaker-than-expected 22,100 jobs in August, according to Statistics Canada's monthly Labour Force Survey. Despite returning to positive job gains after edging lower in the previous two months, the unemployment rate increased to 6.6% from 6.4% in July. This marks the highest level of unemployment since 2017 (outside of the pandemic-related distortions) and brings the rate up more than a full percentage point year over year. According to RBC Economics, roughly 75% of the increase in unemployment can be attributed to young workers under the age of 35—indicating a more challenging labour market for students and new graduates entering the labour force trying to secure work. Layoffs have also remained elevated, climbing over 20% year over year. Moreover, the survey details revealed a less-than-favourable employment mix: **the modest net employment gain in August represented a decline of 43,600 full-time jobs offset by the addition of 65,700 part-time positions.** In our view, rising unemployment and continued declines in per-capita GDP will likely motivate the Bank of Canada to retain its "dovish" stance and move forward with a fourth consecutive interest rate cut at its October meeting.

- **The value of a post-secondary education remains compelling.** According to RBC Economics, university graduates remain amongst the highest earners in Canada across their respective fields. A recent report noted that "Respondents with a bachelor's degree or higher had the highest median income in 2021 at C$61,600—44% higher than the overall median income in the sample." However, RBC Economics noted that the return on an investment in post-secondary education has been shrinking recently as the cost of tuition has outpaced income growth. On an inflation-adjusted basis, the cost of tuition for an undergraduate education rose 12% between 2012 and 2017, while the median income for graduates increased by just 4% between 2017 and 2022. On an industry-specific level, graduate income growth in the engineering and architecture fields has notably lagged tuition hikes. Regardless, incomes are still positively correlated to higher education, with median salaries from undergraduate degrees (C$61,600) comparing favourably to university diploma/certificate holders (C$45,600) and workers with a high school education (C$30,200).

EUROPE

Frédérique Carrier & Thomas McGarrity, CFA – London

- **The shares of Germany's second-largest lender, Commerzbank, jumped over 20% in the two trading days following the news on Wednesday that Italy's second-largest bank, UniCredit, acquired a 9% stake in the former.** UniCredit announced that 4.49% of this was acquired in an accelerated book building offering on behalf of the German federal government, in line with its intention to reduce its stake in Commerzbank, while the rest of the stake was built in the market. UniCredit's CEO said in a Bloomberg interview that "all options are on the table" with respect to exploring value creation opportunities. His comments raised the prospect of UniCredit seeking to take over Commerzbank.

- RBC Capital Markets views the probability of a deal as at least 50%. Clearly, many questions remain, including whether the German government, which is Commerzbank's largest shareholder with a 12% stake, would allow it. But if such a cross-border tie-up comes to fruition, it **could pave the way for what we believe is an arguably much-needed wave of consolidation across the fragmented European banking sector.**

- **The European Central Bank (ECB) cut interest rates by 25 basis points to 3.5%,** as expected by markets. Headline eurozone inflation dropped markedly in August to 2.2% y/y, the lowest level since July 2021, thanks to lower energy prices.

- Core inflation, which excludes volatile food and energy prices, was far less obliging, barely improving and posting an annual increase of 2.8% in the same period. With this and domestic-driven services inflation continuing to grow, **RBC Capital Markets expects the ECB will stand pat in November and proceed with an additional cut in December.** RBC Capital Markets has penciled in one more cut next year, though it acknowledges additional adjustments could be required should the economy stall.

ASIA PACIFIC

Nicholas Gwee, CFA – Singapore

- **Asia Pacific equity markets traded broadly lower during the first half of the week** as the sluggish September seasonality continues to weigh on sentiment. Singapore was a standout to the upside and was helped by the local banks (benchmark heavyweights) where the relatively high-dividend yields are driving investor interest.

- **Equities from members of The Association of Southeast Asian Nations (ASEAN)** continue to see strong investor interest that started in early August. According to a Bloomberg report, foreign inflows are on track for a fifth consecutive week while the MSCI ASEAN Index is now trading near its highest level since April 2022 and is up about 10% since late July. We believe local currency appreciation would benefit importers, USD borrowers, and banks in current account deficit countries, while negatively impacting exporters (tech, glove manufacturers) and tourism. The U.S. election and seasonality remain near-term headwinds, in our opinion. Emerging Market funds remain Underweight ASEAN, except for Indonesia, while we think the valuation of the MSCI ASEAN Index remains attractive (forward P/E of 13.6x vs. 14.7x five-year average).

- **The following are some other notable points about select ASEAN members. Singapore:** We think all eyes are on the Real Estate Investment Trusts sector given prospects of rate cuts. **Indonesia:** Fiscal discipline was maintained in the 2025 budget (which we believe was positive for inflows) with a potential U.S. Federal Reserve rate cut a near-term catalyst. **Malaysia:** We believe the focus is on the data centre pipeline and semiconductor Foreign Direct Investments, and the country strives to be a regional renewable energy hub. **Thailand:** Weak domestic demand was offset by solid Q2 earnings, a stronger currency, and the removal of a political overhang; however, a fading fiscal boost suggests to us a more challenging H2 for the economy.

- **The race to be the next prime minister of Japan kicked off this week.** Nine lawmakers have declared an intention to enter the September 27 Liberal Democratic Party (LDP) leadership election. We think the winner will almost certainly be voted in as prime minister because of the LDP's majority in Parliament. While the public does not get to vote, the most popular candidates in opinion polls are Shigeru Ishiba, a former defence minister, and Shinjiro Koizumi, the youngest candidate and son of a former prime minister.

Growing interest in Southeast Asian equities

MSCI AC ASEAN Index (USD)

Source - RBC Wealth Management, Bloomberg; price data through 9/11/24

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