

**JULY 2024**

**QUARTERLY COMMENTARY**

Investors want to know how this November’s election results can impact their investments. In addition to altering the course of the economy, political outcomes can influence financial asset class performance for stocks, bonds, real estate, commodities, and even traditional and virtual currencies. Make no mistake, sectors such as health care (under Obama), energy (under Trump), and transportation (under Biden) have experienced transformative shifts because of changes in political power. The automotive industry recently experienced a rebirth as a result of President Biden’s tax and other financial incentives for electric vehicle (EV) purchases. EV manufacturers, Tesla, Rivian, Lucid Motors, Polestar, and others have contributed to the growth in the U.S. workforce. Before then, Facebook (now Meta) was attacked by former President Trump for imposing a two-year communication ban in the aftermath of the January 6, 2021, Capitol Riot. Trump remarked, “I consider Facebook to be an enemy of the people,” prompting immediate investor reactions. The stock dropped by over $60 billion due to the President’s aggression. At that time, investors felt that a Trump victory would make it harder for Facebook to consummate further acquisitions necessary for future growth. Similarly, recent elections in India, Mexico, and France also illustrate how election results influence financial market volatility, especially in the short-run. Fortunately, market stability is typically restored before long as more clarity is known and uncertainty reduced.

After the recent Biden-Trump debate, an increasing number of investors are anticipating that Trump will win not just the presidency but also Congress. Given such an outcome, Trump would have few restrictions on his agenda which markets now interpret to mean even larger deficits and higher interest rates. Conversely, a Democratic victory would undoubtedly result in a similar outcome. Nevertheless, investor consensus suggests a Trump victory would be more favorable for the U.S. stock market. Why? For 30 years economies have migrated toward increased globalization resulting in more competition, lowering prices and inflation for consumers. Under Trump’s “America First” deglobalization policy, bringing back manufacturing to the U.S. along with expected tariffs on foreign made goods infers America’s companies may have an advantage over foreign companies. Globalization is already starting to contract. This changes international trade relations and manufacturing supply chains, natural resource procurement and energy security, NATO and other defense alliances, technology sharing as demonstrated by European countries’ desire to reduce dependency on Elon Musk’s SpaceX satellites and spacecrafts, redistribution of labor to other countries, and more. Increasing U.S. jobs at higher wages than workers receive overseas also may mean moving from a two percent to three percent inflation environment. Re-industrialization of America may be a great investment theme benefiting many companies in the U.S. If there is a clear winner this election, financial markets are expected to rally, reflecting relief and avoidance of chaos and civil unrest.

It is common knowledge that President Biden’s popularity has suffered due to the higher cost of living for all consumers. Less publicized is that most companies are deeply challenged, too. Without sufficient ability to pass on all cost increases in labor, goods, technology advances, and government regulation to consumers, company profit margins have been negatively impacted. Only shareholders of the Magnificent 7 (Alphabet/Google, Amazon, Apple, Meta Platforms, Microsoft, NVIDIA, and Tesla) and few other companies have prospered the last few years due to their ability to grow profits well above inflation. Consequently, the average large U.S. company gained 6% in the first half of this year. But many investors feel dissatisfied with those results if their portfolio didn’t have at least a third of their equity holdings in Mag 7 stocks because the investors that did earned 15% during this period. Not to be misled, two thirds of this rate of return dispersion was due to the contribution of one stock, NVIDIA, and little contribution from most of the other six. Investors haven’t experienced a market with so few stocks advancing since the 1930s, an economic environment also extremely difficult for companies to grow earnings. With interest rates expected to fall later this year, investors increasingly believe that more companies, especially small and cyclical companies, will participate and possibly lead in further market gains. Some Wall Street analysts are even forecasting earnings growth for smaller U.S. companies to be superior to the Mag 7 next year which helps the case for a broadening in stock performance. Furthermore, all 11 Standard & Poor’s sectors are expected to post positive earnings growth in 2025. A minority of investors think that the stocks that benefited the most from artificial intelligence (AI), especially the Mag 7, may be vulnerable to increased risk from elevated valuations and the risk of an AI overbuild. If this outlook materializes, there is a compelling case for maintaining a more prudent and time-tested diversified equity portfolio strategy instead of paying a premium to concentrate holdings in a few companies believed to better endure a slower economy.

Bond inflows are now the largest since 2021. Investors who flocked to money market funds and CDs offering slightly above 5% are transitioning to bonds in order to lock-up higher interest rates for longer before both short- and long-term yields drop further. Unlike money market instruments, when interest rates fall, bonds historically appreciate substantially. Although Chairman Powell has articulated that he does not want to send signals on any date regarding Fed policy, Wharton Finance Professor Jeremy Siegel strongly suggests that Chairman Powell notice the public at the next meeting in July of the Federal Reserve’s intent to lower interest rates during the Fed’s September meeting, if not sooner. Due to unemployment increasing by more than 0.5%, Siegel advocates this is sufficient warning that lowering rates sooner than later is in our economy’s best interest to avoid a recession. Another dominant factor influencing bond prices is the amount of debt issued by the U.S. Treasury. Professor Siegel is not concerned about debt trends for the next few years until mid-2030s when our sizable debt starts to ramp up faster. He says the U.S. is in the mid-range of all countries on a debt to gross domestic product (GDP) basis. The U.S. national debt is almost $35 trillion, translating to debt per person of $103,503 and debt per taxpayer of $266,953. Japan, France and many other advanced economies owe much more on a GDP basis than the U.S. To see how fast our debt is growing by the minute, it is worthwhile to visit the website, <https://usdebtclock.org./> With a mature economy headed for a soft landing, bonds appear to be a timely investment.

Investors are already closely anticipating and reacting to both the September 18th Federal Reserve meeting when the first interest rate cut is expected and November 5th, the day of U.S. general elections, to better understand America’s future direction. Ultimately, the economy and corporate earnings have shown to matter more than election results. Higher energy prices or other unforeseen events could delay rate cuts but not deter the Fed from further pursuing its dual mandate. Two tailwinds will help investors, rising earnings and expanding profit margins. More companies are expected to benefit from these trends, meaning positive implications for patient investors. Artificial intelligence has far-reaching long-term economic implications, but history has shown that every economic story doesn’t necessarily mean an equal and obvious investment opportunity. In the short-run, many factors can influence market volatility in either direction as global equity markets continue to reach new all-time highs. The Investment Counsel Company team looks forward to meeting these and other challenges and opportunities on behalf of our valued clients.

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