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Special Coverage:

Despite political uncertainty, Fed continues monetary policy easing cycle

Key takeaways

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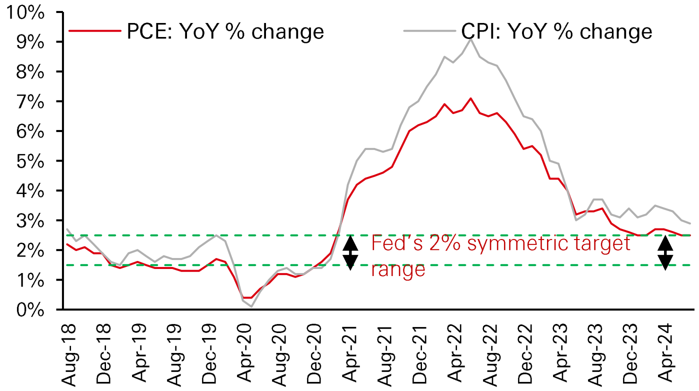
- As expected, the FOMC cut the Fed funds rate by 0.25% to the 4.5-4.75% range. We continue to expect the Fed will lower policy rates in December by 0.25% and four more times for a total of 1% to a range of 3.25-3.5% in 2025. Economic growth is slowing but still strong as real economic growth slowed from 4.4% q-o-q to 2.8% (seasonally adjusted annual rate) in 3Q24. Inflation remains under control as both the GDP deflator and the quarterly PCE deflator in 3Q24 are below the Fed's target range of 2%. Payroll growth is slowing but the unemployment rate remains near a 55-year low of 3.4%.
- Donald Trump is set to become the 47th President of the United States with 295 electoral college votes as of 7 November according to the New York Times. The Republicans have retaken control of the US Senate, after flipping seats in West Virginia, Ohio and Montana. The results guarantee the Republicans at least 52 out of 100 seats. While there's still some uncertainty around the House race, it currently appears that the House of Representatives will be controlled by the Republicans. If the Republicans win a majority in the House, that will give them a sweep of the executive and legislative branches. As a result, several initiatives like tax policy and tariffs could be passed with a simple majority in Congress.
- Although the race for the House of Representatives isn't yet settled, we believe a Trump presidency is likely to offer additional support to US stocks, principally because of the proposed tax cuts and likely deregulation. We add further to our existing US equity overweight. For the bond market, fiscal stimulus, the potential for unusually large Treasury issuance and potential tariff-related upward pressure on inflation may lead to further volatility. We downgrade USD investment grade bonds to neutral.

What happened?

- As expected, the FOMC cut the Fed funds rate by 0.25% to the 4.5-4.75% range. We expect the Fed will lower policy rates in December by 0.25% to a range of 4.25-4.5%. In 2025, we forecast the FOMC will cut policy rates four more times for a total of 1% to a range of 3.25-3.5%.
- The Fed's confidence that inflation will move sustainably to target argues for a continued gradual policy easing towards neutral. Powell reiterated Fed will support economy: "If the economy remains strong and inflation isn't sustainably moving toward 2%, we can dial back policy restraint more slowly. If the labour market were to weaken unexpectedly or inflation were to fall more quickly than anticipated, we can move more quickly."

Consumer inflation enters the Fed's symmetric target range



Source: Bloomberg, HSBC Global Private Banking and Wealth as at 7 November 2024.

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- Economic growth is slowing but still strong. Real GDP has slowed from 4.4% q-o-q to 2.8% (seasonally adjusted annual rate) in 3Q24. Consumer spending has slowed from 4.9% in 1Q23 to 3.7% in 3Q24. The GDP deflator rose 1.8% q-o-q while the quarterly PCE deflator was 1.5% q-o-q in 3Q24. Both are below the Fed's target range of 2%. Given a slowing economy and coming technology-driven deflation, potential inflation risks seem to be on the downside. Labour markets remain healthy. Payroll growth is slowing but the unemployment rate remains near a 55-year low of 3.4%.
- Donald Trump is set to become the 47th President of the United States with 295 electoral college votes as of 7 November according to the New York Times. The Republicans have retaken control of the US Senate, after flipping seats in West Virginia, Ohio and Montana. The results guarantee the Republicans at least 52 out of 100 seats. The remaining 27 House of Representatives races haven't been called. The Republicans currently have 210 seats vs. the Democrats' 198. The Republicans need 8 more House seats to secure a majority, while the Democrats need 20 (data as at the time of writing).

Investment implications

- Despite uncertainty surrounding domestic politics and a host of other issues, the Fed easing cycle continues.
- Although the race for the House of Representatives isn't yet settled at the time of writing, we believe a Trump presidency is likely to offer additional support to US stocks, principally because of the proposed tax cuts and likely deregulation. As a result, we add further to our existing US equity overweight.
- According to FactSet as of 1 November, earnings are forecast to rise 9.3% in 2024 and 15.1% in 2025. These forecasts were made prior to the election. The potential for lower household and corporate taxes should be further accretive to earnings.
- Pontential positive impacts on sectors:
  - Financials: Financial deregulation could increase lending capacity, reduce compliance costs, and potentially raise profitability for banks and financial services firms. Potential increase in M&A could lift earnings as well.
  - Consumer Staples and Consumer Discretionary: Lower household taxes may increase disposable income, potentially boosting consumer spending across both staples and discretionary sectors. However, higher tariffs could raise the vost of goods sold.
  - Technology: Reduced regulation on data privacy and tech operations could increase investment. Lower corporate taxes may also benefit tech firms with substantial domestic operations and investment in R&D.
  - Communications Services: Deregulation in data and internet privacy could create a more favorable environment for digital advertising, content creation, and communications platforms, potentially boosting growth in this sector.
- For the bond market, fiscal stimulus, the potential for unusually large Treasury issuance and potential tariff-related upward pressure on inflation may lead to further volatility. As a result, we downgrade USD investment grade bonds to neutral. We continue to see investment grade bonds as a way to generate income by locking in current yields, but think investment grade bond price appreciation becomes less likely while volatility picks up.
- We think there will be continued strong demand for gold as a hedge against tail risk, hence, we upgrade gold to an overweight position.

Potential macro and policy implications

<table>
<tr><th rowspan="2">Scenario</th><th colspan="2">Trump 2.0</th></tr>
<tr><th>Republican clean sweep</th><th>Divided government</th></tr>
<tr><td>Overview</td><td>◆ Expectations of fiscal stimulus and tax cuts—historically supportive for equities
◆ Risks of trade tensions could be an overhang—could affect the rest of the world more than the US</td><td>◆ A full extension of the 2017 tax cuts may be less likely—could result in higher focus on executive orders
◆ A policy focus on tariffs and potential escalation in trade tensions—could weigh on international markets</td></tr>
<tr><td>Fiscal policy</td><td>◆ More expansionary fiscal policy
◆ Extension of 2017 TCJA tax cuts
◆ Potential cuts to corporate and income taxes.
◆ Probable push for debt controls and deficit reduction</td><td>◆ A full extension of the 2017 tax cuts less likely without a legislative compromise like child tax credit
◆ Expiration of tax provisions deadline could create a "fiscal cliff" in 2026</td></tr>
<tr><td>Trade and tariffs</td><td colspan="2">◆ A greater focus on protectionist trade policies.</td></tr>
<tr><td>Foreign policy</td><td colspan="2">◆ Greater uncertainty around foreign relations. Funding cuts to Ukraine</td></tr>
<tr><td>Immigration policy</td><td colspan="2">◆ Higher chance of deporting unauthorised migrants
◆ Birthright citizenship could be ended
◆ Could build more of the US-Mexico border wall</td></tr>
<tr><td>Regulation</td><td colspan="2">◆ Lighter-touch regulation: fewer antitrust cases and less scrutiny on M&A</td></tr>
<tr><td>Environment</td><td colspan="2">◆ Possible slowdown in energy transition
◆ US likely to leave the Paris Climate Accord
◆ Potential investment roll backs under the Inflation Reduction Act
◆ Oil investment may increase from already record highs</td></tr>
</table>

Potential market implications

Key investment implications of a Trump 2.0
◆ **Equities** ➢ Possible tax cuts and tariffs, should support US equities and their outperformance vs other markets ➢ Risks of escalation in trade tensions could be a headwind for global trade, specifically for the European stocks and export-oriented Asian markets
◆ **Fixed Income** ➢ Under a Republican clean sweep, bond markets may see reduced Fed cut expectations and more volatility ➢ Reduced Fed rate cut expectations, and a strong USD could be headwinds for EM bond performance
◆ **USD** ➢ We believe a Republican victory would be more positive for USD vs EUR. A clean sweep offers the greatest scope for this upside to persist
◆ **EM Outlook** ➢ EM outlook could be affected via trade tensions, higher tariffs, or slower Fed cuts reducing the scope for EM central banks to cut
◆ **Sectors** ➢ Possibility for sectors such as financials and tech to outperform on expectations of looser regulatory policy

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