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Insurance Investment Management

Implications of the 2024 Election

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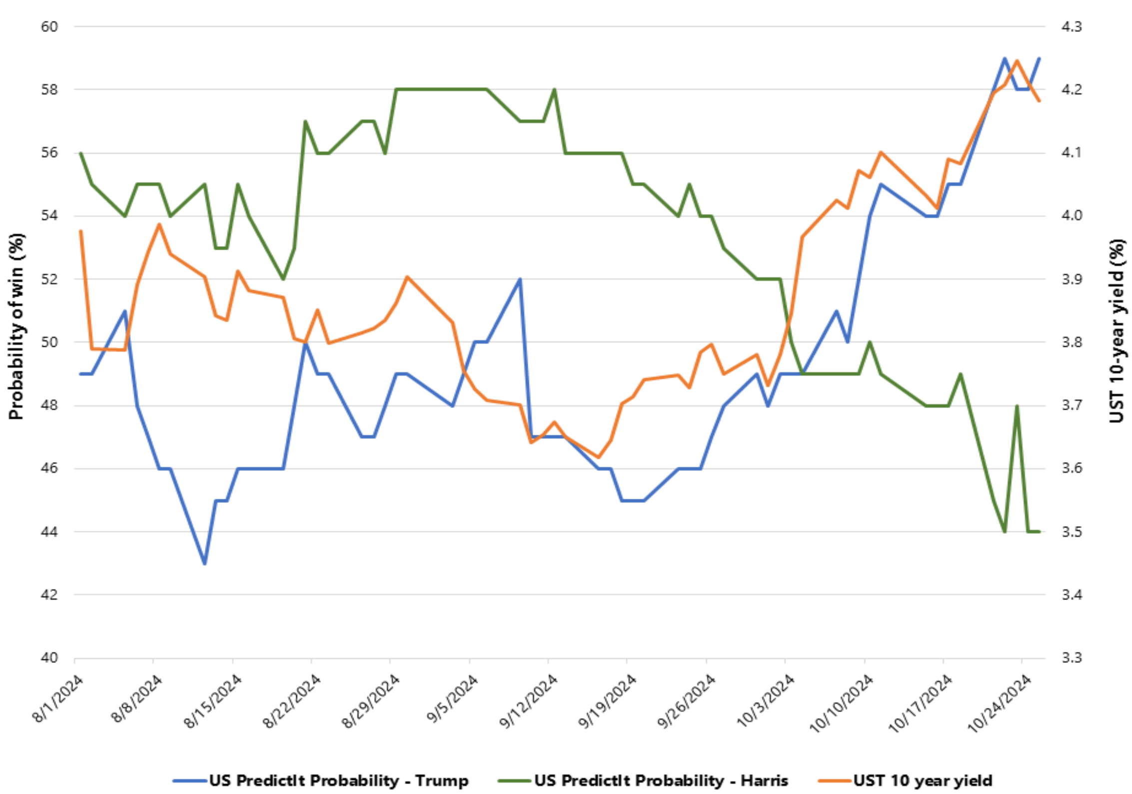
10-year Treasury yield has risen with the higher probability of a Trump win[1]



1 Source: AAM, Bloomberg (US PredictIt)

Have the Markets Decided?

Treasury yields have shifted higher this month across the curve by 40-50 basis points, as investors are pricing in a higher rate of expected inflation. In fact, the 5-year inflation breakeven rate has risen from a low of 1.9% on September 10, the day of the presidential debate, to a current high of 2.3%. As shown in the graph above, this has corresponded with an increasing probability that former President Trump wins the election per PredictIt, a prediction-related market investors use to bet on election outcomes. Statistically, this explains about 75% of the move in the 10-year yield since the beginning of September.

Why is a Trump presidency inflationary? We have outlined our thoughts regarding potential market and related economic implications in the table that follows.

AAM's View of Market and Related Implications for the U.S. of the U.S. Election

Red Wave	• Policy measures introduce upside risk to inflation resulting in rates moving higher with increased likelihood of hawkish Fed policy • Equity market volatility expected to increase with sector "winners" and "losers" related to policy and regulatory changes • While lower taxes would be supportive for domestic companies, higher interest rates would likely negatively affect those with more leverage • USD expected to strengthen • Domestic equity markets likely outperform international
Blue Wave	• Fiscal policy is prospectively positive for consumer spending, offsetting risks to growth from higher taxes and the possibility of increased regulations • Economic growth potential and corporate profit growth may be dampened • Steeper yield curve due to front-end maturities falling, although curve may also shift lower, with elevated risks to equity and credit markets due to economic growth uncertainty
Harris – split Congress	• Least inflationary with likelihood for steeper yield curve, with short-end rates tracking Fed policy lower • Levered borrowers would benefit from lower interest rates • US economic growth expected to be low single digits, which historically has been supportive for credit markets
Trump – split Congress	• Potential for unilateral policy measures with inflationary implications, bipartisan extension of TCJA • Flatter yield curve due to increased likelihood of more hawkish Fed policy in near term • Without the tailwinds of lower taxes and reduced regulation, higher inflation and rates would likely put downward pressure on the equity market

Potential Implications

What are the risks if the market is wrong?

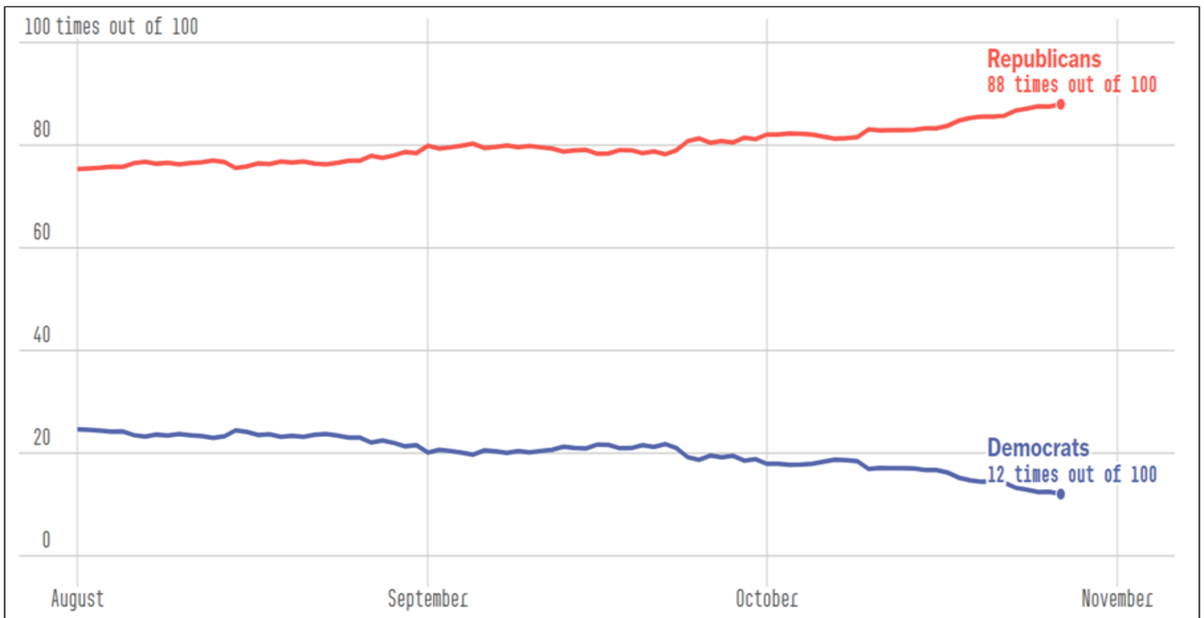
With the prediction market not only forecasting a Trump presidency but a Republican “sweep,” a split Congress or Harris presidency would likely result in falling US Treasury yields and a rally in equity markets outside the U.S. We would also expect the US dollar to weaken.

What sectors might be affected by a Trump Presidency or a “red wave?”

In terms of those expected to benefit, the expectation of reduced regulation would likely benefit industries like financials and fossil fuels. For example, the exporting of Liquified Natural Gas (LNG) is likely to increase. Additionally, geopolitical shifts such as enforcing Iran sanctions would have ramifications on various industries. Companies with a high degree of revenue generated domestically and/or domestically focused supply chains would likely benefit if tariffs were raised. While multi-layered, the auto industry could benefit.

Industries such as healthcare would likely be negatively affected if Democratic policies were repealed. The same for those industries benefiting from spending related to the Inflation Reduction Act. That said, much of this spending has been in “red” states. From a market perspective, the tax-exempt municipal sector would be affected if the SALT deduction were eliminated or made permanent, but more significantly, an elimination of the tax exemption would have material consequences. We view that as a tail-risk event.

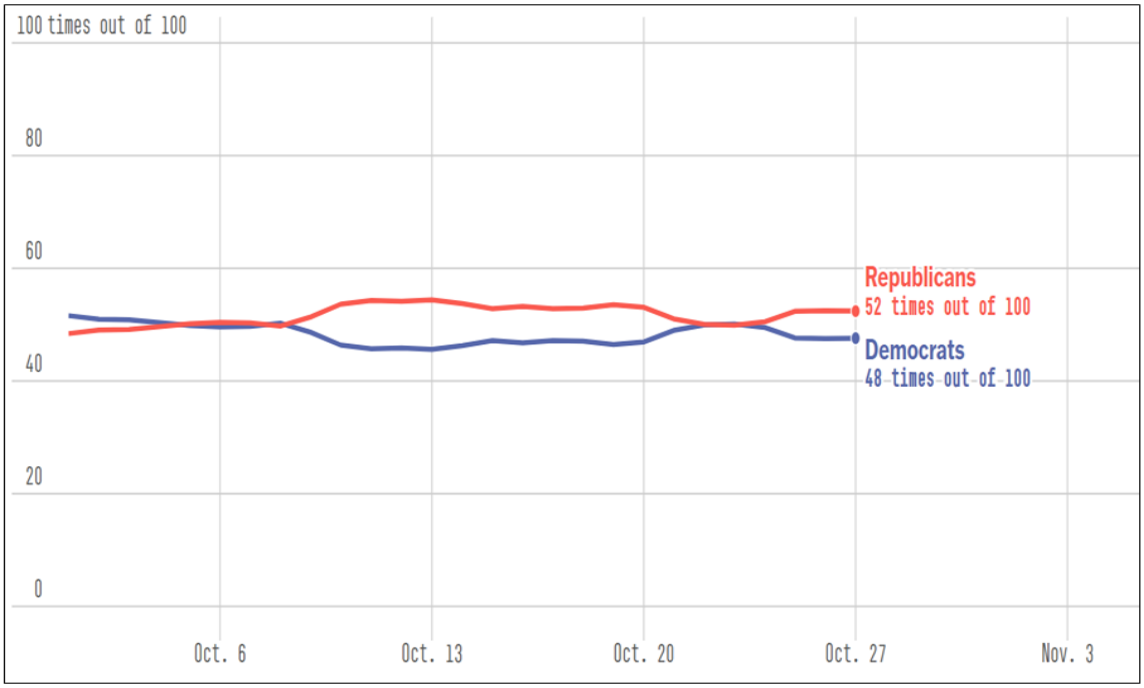
Daily forecast of Probability of Senate control[2]



Our forecast of chamber control assumes that Angus King and Bernie Sanders would caucus with Democrats and randomizes which party Dan Osborn would caucus with (one-third of the time with Democrats, one-third of the time with Republicans and one-third of the time with neither).

2 Source: FiveThirtyEight (https://projects.fivethirtyeight.com/2024-election-forecast/senate/)

Daily forecast of Probability of House control[3]



3 Source: FiveThirtyEight (https://projects.fivethirtyeight.com/2024-election-forecast/senate/)

***Elizabeth Henderson, CFA,** is a Principal, Head of Fixed Income and Director of Corporate Credit at AAM with 26 years of investment experience. She is responsible for AAM's Corporate Credit, Structured Product and Municipal Bond sectors, including the management of research analysts and traders. Elizabeth also manages portfolios for AAM clients and is a member of AAM's "Outsourced CIO" Committee. Prior to joining AAM, Elizabeth was a Director at Fitch Ratings and a Vice President at Lincoln Investment Management, analyzing public and private placement credits. She is a CFA Charterholder. Elizabeth graduated with honors and distinction from Indiana University's Kelley School of Business with a BS in Finance and earned an MBA in Finance, Analytical Consulting, and Marketing from Northwestern University's Kellogg School of Management.*