Understanding the Investment Risks Associated with the US Elections

Independent Securities expresses no opinion about the suitability or desirability of either US presidential candidate. It seeks merely to identify potential investment opportunities or risks associated with either of the two parties contesting the US election.

The geopolitical landscape in the United States has implications for global markets, and understanding the divergent policies of the Democratic and Republican parties is essential to understanding investment risks associated with the upcoming US elections. More so for investors are the US budget deficit and fiscal policy, which are critical concerns when weighing up the US market for investment.

The Economic Impact of Democratic and Republican Policies:

The economic policies of the Democrats and the Republicans differ significantly, presenting unique risks or opportunities in the US equity market.

The Democratic Party, with its progressive stance, often emphasises increased government spending on social programs, infrastructure, healthcare, and clean energy initiatives. Critical policy stances include:

- Higher Corporate Taxes
- Increased Regulation
- Clean Energy Projects and Incentives
- Social Spending

The Biden administration has long been vocal about raising corporate taxes to fund expansive social programs. Higher taxes won’t go down well on Wall Street; a squeeze on margins from higher corporate tax rates will cause equity valuations to de-rate and equity prices to decline in the short to medium term.

Democrats have traditionally favoured stricter healthcare, technology, and finance regulatory frameworks. Additional regulatory hurdles will result in less flexibility and higher costs for corporations, potentially dampening corporate profits in the short term but aiming for long-term stability and consumer protection.

Investments in renewable energy and sustainability are cornerstone policies for the Democrats. Companies in the clean energy sector could see substantial growth, while traditional energy sectors might face stricter environmental regulations and reduced subsidies.

Enhanced government spending on healthcare, education, and social welfare could stimulate domestic consumption, benefiting sectors like consumer goods, technology, and services.

In contrast, the Republican Party generally champions lower taxes, deregulation, and policies favouring American industries. Fundamental policy stances include:

- Spending Cuts
- Private Sector Solutions
- Energy Independence
- Defence and Infrastructure Spending

Republicans often push for tax cuts for both corporations and individuals.

A Republican-led government will likely reduce regulatory burdens, particularly in the finance, healthcare, and energy sectors. Deregulation can lower operational costs and foster business growth, albeit with potential long-term risks to stability and oversight.

Republicans typically support the oil and gas industries, advocating for fewer environmental regulations and increased drilling and pipeline construction. This can lead to growth in the energy sector.

Republicans often advocate for increased defence spending and infrastructure development, benefiting sectors such as defence contractors, construction, and related industries. However, this may be different under the Trump administration.

The Legal Battles of Donald Trump:

Former President Donald Trump's ongoing legal challenges are critical and unpredictable in the upcoming elections and may not be resolved during the US elections. Trump faces multiple legal battles, including allegations of financial misconduct, interference in the 2020 election, and various other charges.

The uncertainty surrounding the leadership of the Republicans has a significant impact on the broader market sentiment, including:

- Uncertainty surrounding Trump's legal status can lead to heightened market volatility. Investors tend to react sharply to political uncertainty, which can lead to fluctuations in stock prices, especially in sectors closely associated with Trump's policies.
- Trump's legal woes could influence investor sentiment. Some investors may perceive his legal troubles as destabilising, prompting a flight to safer assets or other geographies. Conversely, a definitive resolution to his legal challenges could stabilise markets.

For the decerning investor considering investing in the US market, the US debt and fiscal policy should be of more concern when considering your core US stock holdings.

The US Budget Deficit:

The current gross federal U.S. debt of $34 trillion and the ever-growing US budget deficit of $8.8 trillion are crucial issues for investors to consider during the upcoming elections.

The ramifications of high national debt and a sustained budget deficit are not taken lightly. They can result in increased borrowing costs, higher taxes, and reduced government spending on essential services, significantly impacting economic growth. The potential for a prolonged expansion in consumption in 2024 is a stark reminder of these consequences.

The personal consumption expenditures index published on 21 June is forecast to have risen at an annual rate of 2.6 per cent, down from 2.7 per cent in April, according to economists surveyed by Bloomberg.

As investors, we are responsible for carefully considering the country's fiscal policies in managing its debt and deficits after the elections. These decisions will impact the nation's economic growth and long-term financial prospects and have a ripple effect on bond and equity markets. Our actions can make a difference.

Strategic Considerations:

As a South African investor in US equities, I know the upcoming US elections present challenges and opportunities. The contrasting policies of the Democratic and Republican parties and the legal uncertainties surrounding Donald Trump add layers of complexity to your investment strategy.

The pendulum could swing either way, and whether it is a Republican or Democratic victory, our investment strategy is to remain invested in high-quality businesses that will prosper in either political environment to preserve capital and maximise tactical investment opportunities.

Given the complexities of the US political environment and the US debt, there are strategic considerations for refining an offshore investment strategy:

- Diversification remains a cornerstone of risk management. Ensure your portfolio spans various sectors and asset classes to buffer against political and economic shocks. Diversification across geographies can also mitigate country-specific risks.
- Currency risk remains among the most considerable risks to consider when investing in foreign markets. Political events can cause significant currency fluctuations, affecting the value of your offshore investments.
- Maintain a long-term perspective on your investments. While elections can cause short-term volatility, a long-term investment horizon often smooths out these fluctuations, allowing you to benefit from the overall growth trajectory of the market.
- Engage with your portfolio manager and financial adviser with expertise in international markets. They can provide personalised insights and strategies to optimise your offshore investments.

Our Core Holdings for the US Elections are:

- **Brookfield Corporation** – A well-diversified alternative asset manager, able to deploy capital as and when needed. Brookfield will benefit from infrastructure spending and green energy projects in a Democratic-led America through its exposure to Brookfield Renewable Partners, which invests in green energy solutions such as solar and hydroelectricity. Similarly, Brookfield will prosper under Republican tax breaks and their exposure to oil and gas projects through partnerships and subsidiaries like Oaktree, which holds meaningful stakes in the sector.
- **Mastercard** – The provider of the proverbial rails for money transfers and payments globally. A stricter regulatory environment might put more eyes on Mastercard, but the company is undeniably a crucial cog in the global financial system. A more stringent regulatory environment will only enhance Mastercard’s already wide moat by hindering the entry of new participants in the sector.
- **Amazon** – The e-commerce and cloud infrastructure provider has easily navigated many foreign jurisdictions and regulatory requirements. Amazon will not only be able to adapt but also thrive in any regulatory environment, be it stricter or looser.

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