PCM
Peak Capital Management

Trumponomics 2.0

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By now, we are all used the rhetoric; "This is the most important election of our lifetimes", "Democracy is at risk in this election", "All of our freedoms are at risk if (insert name of political opponent) wins". The winning candidate, in virtually every election over the last 20 years, has claimed they have a mandate based on winning the election. The reality is, none of it is true regardless of how hard the media, on both sides, might insist.

Trump won by what could be considered a landslide victory, surprising everyone by winning both the Electoral College and popular vote with almost 77,000,000 votes. His vote total was 2,500,000 higher than in 2020 and 14,000,000 more than he received when he beat Hillary Clinton in 2016. Republicans barely held onto a majority in the House and, as universally expected (by everyone except the DNC), handily won a majority in the Senate as a result of the states being contested. I still do not think a mandate for a massive shift is present.

What cannot be overstated is the difference on the economy and markets the Trump victory will produce compared to a Harris win. Trump was elected a second time to be the caretaker of the economy and to secure the border, that much is certain. Investors will do well to prepare their portfolios for changes that are likely to take place, namely tariffs.

Contrary to media coverage, tariffs are not new or even all that controversial. If mainstream/network media is your primary source of information, you will probably be surprised to hear that the Biden Administration implemented multiple new tariff's during his term in office. For example, Biden slapped a 100% tariff on imported Chinese EV's, effectively eliminating Chinese EV manufacturers from competing in the US market. There was also a 50% tariff on Chinese-made semiconductors among other tariff's Biden initiated without any fanfare or media attention.

Trump will raise the ante on tariffs and utilize them to achieve policy objectives as much as revenue generation. Using tariffs to accomplish policy goals has pros and cons and no one can state with any certainty what the ultimate impact will be. Trump floated the idea of 10% across the board tariffs on imports and 60% on Chinese imports. In 2023, the latest year data is available, the US imported $3.1 trillion in goods that would have brought in $228 billion in revenue compared to the $50 billion currently collected. This assumes no retaliatory moves by other countries that negatively impact economic growth (highly unlikely).

The biggest risks with tariff's are the impact on inflation, interest rates, the USD, and labor markets. Global economies are very interconnected and do not operate in a vacuum, trade wars matter both domestically and, in particular, for US export companies. I ignore the "Free-Trade" argument as that has never existed outside of an academic discussion. All US competitors take actions to manipulate trade to the benefit of their country whether direct or indirect.

"Using tariffs to accomplish policy goals has pros and cons and no one can state with any certainty what the ultimate impact will be."

Tariffs are not the only economic policy investors should be expecting to impact their portfolios. It is widely expected Trump will forcefully pursue a corporate tax rate, publicly stating his desire for a 15% corporate tax. If passed, this would dramatically increase corporate profits and likely make markets appear undervalued. Jay Hatfield, CEO of Infrastructure Capital Advisors, has stated lowering corporate tax rates has the greatest impact on economic growth. His research shows a 60% correlation between corporate tax rates and economic growth rates and forecasted the S&P 500 would hit 7,000 if rates fall to 18% and 7,500 and if rates go to Trump's target of 15%.

Trump also wants to bring back aspects of the 2017 TCJA bill that allowed companies to fully expense R&D expenditures and accelerate depreciation on capital expenditures. If implemented, industrial, technology, consumer staples, materials and healthcare equipment would benefit the most. R&D-heavy companies like IBM, Pfizer, and Medtronic should see profits rise substantially and lift stock prices. Cap ex companies like AT&T, Verizon, Amazon, and Tesla would benefit from accelerated deductions.

Extending the 2017 tax cuts could cost as much $4 trillion over 10 years according to the CBO so Musk and Ramaswamy will need to work miracles to not balloon deficits. Left unchecked, deficits and the national debt will continue to structurally reduce growth potential of the US economy and require an ever-growing share of government revenues to service. That will also likely result in higher interest rates that may negatively impact growth.

There will be unintended consequences with tariffs and rate cuts that can only be speculated at now, but investors would be wise to contemplate the potential impact and ensure their portfolios are sufficiently hedged.

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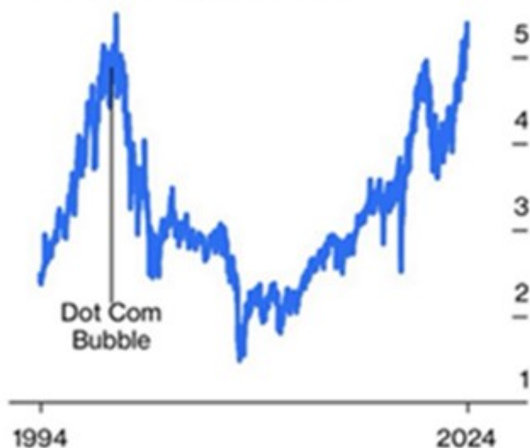
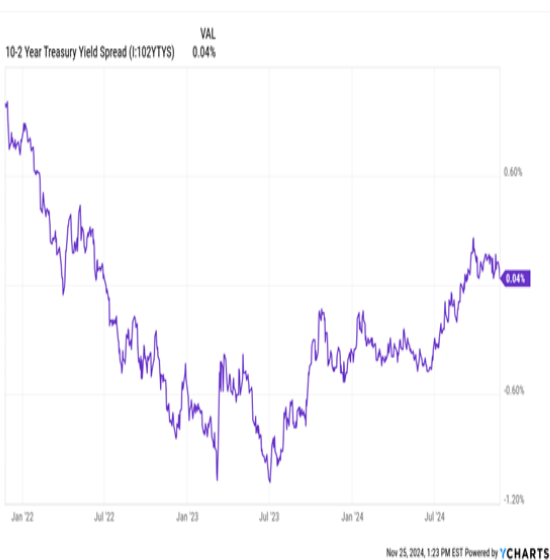
Valuations: Up, Up and Away



The Dot Com Bubble burst 25 years ago but is still a primary reference point for investors considering the valuation of the markets. When the Nasdaq lost more than 80% of its value over a three-year period, many investors thought the markets could never return to a period of overvaluation compared to what occurred in the late 1990's. They were wrong. The Price to Book ratio on the S&P 500 recently exceeded the level of 1999 and many other metrics appear just as overvalued. Another widely followed metric, Price to Sales, is above 3.0 today versus 2.2 at the Dot Com bubble. Price to Sales is higher today than the peak of the COVID shutdowns when much of the economy was forced to close.

- The Shiller Cyclically-Adjusted PE ratio (CAPE) is at the 3rd highest level in history, the only prior periods exceeding today's level were 1929 and 1999, just before historic bear markets.
- Ominous for retail investors has been the historically high level of underperformance compared to the broad indices. Small investors are clearly more concerned about valuations and have hedged risks.

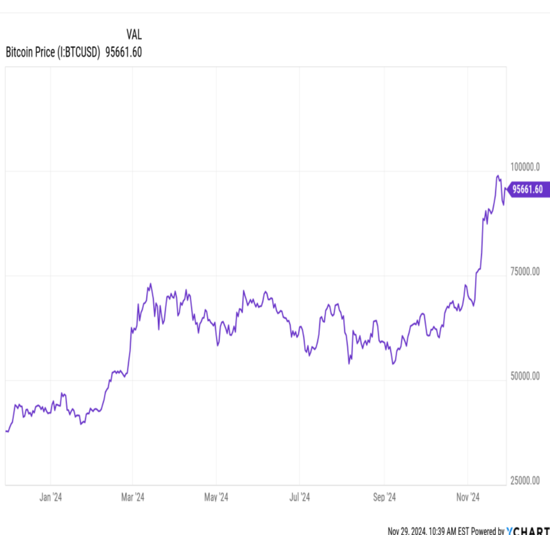
Yield Curve Signal



Investors will recall 2022 when the Federal Reserve aggressively hiked interest rates from essentially zero during the onset of COVID to over 5% with the subsequent onset of inflation. Consequently, shorter-dated Treasury yields rose well above the yield on longer -dated (ten-year) Treasury bonds. At the time, the market was pricing in a recession as the yield curve between two- and ten-year maturities became inverted and remained inverted for some time. The chart to the left illustrates the ratio between two- and ten-year maturities, which reached as low as -1.0% (a bearish signal).

- As the chart illustrates, the yield curve has been "normalizing" since early July 2023 and remained so throughout the Trump election in November. The bond market is signaling that a recession, at least for now, is not in the forecast. Perhaps the Fed, through its monetary tightening, did achieve its soft landing.
- Now, the yield curve is suggesting a more optimistic view where strong economic growth necessitates higher long-term interest rates (relative to shorter-term rates). While still well below the historical two- and 10-year average spread (roughly 1%), a normalized curve is an encouraging sign.

Bitcoin Approaches $100,000



Bitcoin is approaching the $100,000 milestone, driven by its unique monetary qualities, limited supply of 21 million coins, and growing adoption worldwide. Its scarcity and resistance to inflation enhance its value, especially amid fiat currency devaluation. While its long-term potential remains speculative, some envision Bitcoin reaching millions per coin as economic and technological advancements reshape wealth. Rising 162% in the past year, Bitcoin continues to be a transformative asset for safeguarding private property rights. As it nears $100,000, the key question is how high it can go. Although future prices are unpredictable, Bitcoin's fixed supply and fiat money's unlimited nature suggest no theoretical ceiling for its value.

Three factors fueling the current surge:

- Monetary Strength: Bitcoin's predictable, scarce, and state-resistant nature attracts users seeking sound money, boosting its perceived value.
- Increased Accessibility: New platforms and Bitcoin-focused ETFs enable wider adoption among institutional and retail investors.
- Regulatory Shifts: Favorable U.S. policies, including SEC leadership changes and state-level initiatives like Pennsylvania's Bitcoin Rights Bill, foster financial innovation.

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Quinn VandeKoppel

Macro View – Fed Signals Cautious Rate Cuts

The Federal Reserve's November meeting minutes reflect cautious optimism about inflation and the labor market. Though inflation remains above the 2% target, officials believe it is declining, supporting gradual interest rate cuts. In response, the Fed reduced the benchmark rate by a quarter-point to 4.5%-4.75%, with the potential for additional cuts if economic stability continues. Despite this positive outlook, uncertainties remain, particularly regarding the inflationary risks tied to President-elect Trump's proposed tariffs. This has led the Fed to be cautious in identifying a "neutral" interest rate that neither stimulates nor restricts growth. Key factors, such as a slowdown in shelter costs and limited business pricing power, are expected to help lower inflation. The labor market is viewed as stable, despite modest October job gains influenced by weather and strikes. Overall, the Fed's stance is data-driven, aiming for measured rate adjustments to maintain economic stability.

Taking Stock – Scott Bessent for Treasury Secretary

The U.S. stock market reacted positively to President-elect Donald Trump's choice of Scott Bessent as Treasury Secretary. Bessent, a respected Wall Street figure, is seen as a strong pick due to his market expertise and alignment with Trump's growth-oriented, low-inflation economic strategy. Following the announcement, stock futures rose, and Treasury yields fell, signaling market approval. Bessent supports a plan to grow the economy at 3%, reduce the budget deficit to 3% of GDP, and boost oil production. Wall Street commentators welcomed the nomination, viewing it as reinforcing a favorable environment for equities. Though some Democrats, like Senator Elizabeth Warren, voiced concerns about his ties to Wall Street, Bessent is expected to secure bipartisan support in the Senate. His presence is anticipated to balance more aggressive members of Trump's Cabinet as the administration pushes for economic growth.

Fixed Income – Yields Decline Amid Stable Inflation Data

Treasury yields decreased last Wednesday as inflation data aligned with expectations, signaling continued market stability. The 10-year Treasury yield fell over 3 basis points to 4.27%, while the 2-year yield declined 2 basis points to 4.23%. The personal consumption expenditures (PCE) price index, the Federal Reserve's preferred inflation gauge, rose 0.2% month-over-month and 2.3% annually, slightly exceeding September's 2.1% rate. Analysts noted the data supports the Fed's measured approach to future rate cuts. Labor market data also remained strong, with weekly jobless claims falling by 2,000 to 213,000, below expectations of 215,000. Minutes from the Fed's November meeting emphasized confidence in inflation trends and a cautious trajectory toward rate cuts, conditional on stable inflation and employment. Currently, markets are estimating a 70% likelihood of a December rate cut, according to the CME Group's FedWatch Tool.

Technical – SmallCap All-Time-High

Since the election, small-cap stocks, represented by the iShares Russell 2000 ETF, have surged over 8.2%, outpacing the 5.2% gain of their large-cap counterpart, the S&P 500 Index. Despite this recent rally, small caps remain nearly 7% behind the S&P 500 year-to-date. However, the tides may be shifting. The chart below shows the small-cap ETF oscillating between two trendlines throughout the year, unable to break out significantly. With a business-friendly administration set to take office and anticipated Federal Reserve rate cuts, small caps could gain momentum, potentially narrowing the performance gap and accelerating higher in the months ahead.

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Performance Review

Clint Pekrul, CFA

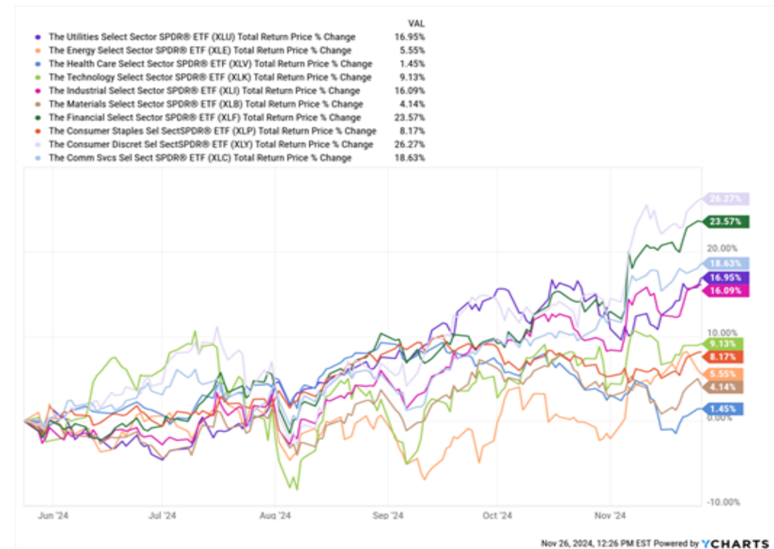
This year has been fraught with uncertainty - a new regime in the White House, fiscal policy that seems unsustainable, heightened inflation expectations and lofty asset valuations compared to historical measures.

Yet, the S&P 500 Index, on a total return basis, has advanced roughly 27% year-to-date. By comparison, the average annual return for stocks since 1950, as measured by the S&P 500, is roughly 10%.

Meanwhile, the NASDAQ 100, which is dominated by technology stocks, has advanced roughly 30% despite an estimated 33x price-to-earnings multiple. The allure of AI development and infrastructure buildout has commanded a lofty valuation for stocks such as Nivida and Microsoft.

The ten-year Treasury bond yield has risen from a six-month low of roughly 3.6% in mid-September to approximately 4.4% today. The Bloomberg Aggregate Index, which measures the performance of investment-grade corporate bonds and U.S. Treasury securities, is only modestly higher by roughly 2.5% year-to-date.

The chart below illustrates the six-month performance of select sectors of the broader S&P 500 Index:



The leadership from the financial sector is not surprising. The ratio of near-term risk-free yields of less than two years to longer-dated risk-free yields has steepened. Banks and lending institutions can collect interest on long-dated loans that exceeds the interest they pay on shorter-dated deposits.

Meanwhile, the consumer discretionary sector has surged higher by approximately 27% over the past six months. Perhaps this sector performance reflects increased consumer confidence.

According to the University of Michigan Consumer Confidence Index, sentiment has improved over the past six months. Meanwhile, industrial stocks have delivered compelling results over the same period. Industrial sector returns reflect the broader market rally beyond the mega-cap tech stocks that have dominated performance for the past two years.

Fixed income returns were generally higher over the past six months. Despite the Federal Reserve's tightening policy, longer-dated yields edged higher, which in turn sent bond prices lower.

The chart below illustrates various segments of the fixed income market over the past six months:

On a relative basis, high-yield corporate bonds outpaced both investment-grade and mortgage-backed bonds over the past six months. Performance peaked in mid-September when yields fell but returns subsided over the past two months when interest rates spiked.

The yield on investment-grade bonds is approximately 3.6%, based on the Bloomberg Aggregate Bond Index. By comparison, the S&P 500 yield is roughly 1.5%.

Market leadership has changed over the past month. Sectors, such as financial and energy stocks, have led the way in stark contrast to performance over the last several years.

Market breath, in terms of sector performance participation across the board, reflects confidence that the economy is on solid ground. While the valuations (based on price-to-earnings multiples and yields) remain lofty compared to historical measures, the outlook remains positive.

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Q: Why did Bitcoin surge after Trump elected President?

The surge in cryptocurrencies across the board has been impressive since the November 5th election. Bitcoin, at all-time highs nearing $100,000, has risen 30% in the last week and brought all digital currencies with it. The slightly bizarre Dogecoin, closely followed by Elon Musk skyrocketed 152% since the election. Trump gained the trust, and respect, of crypto investors by venturing into the space personally. He and his three sons launched their own decentralized finance platform, World Liberty Financial, and launched their own cryptocurrency ($WLFI). At campaign events, he highlighted thought leadership in cryptocurrency and proclaimed that he would make the US the world leader in digital currency utilization. Not surprisingly, he accepted bitcoin for political donations and went on shows like Joe Rogan to proclaim his belief in digital currencies.

Bitcoin investors see Trump's victory as assurance that heavy-handed regulation of crypto would not occur on his watch paving the way for Bitcoin and others to become more mainstream in finance. It is anticipated that Musk and Ramaswamy will use publicly viewable blockchain to track and highlight their work on government efficiency. It was not long ago that Trump criticized Bitcoin and cryptocurrency, calling it dangerous to the US and global economy as a facilitator of illicit and illegal activity. Needless to say, his opinion has changed and clearly the global cryptocurrency investment community believe the Trump presidency will shine a positive light on Bitcoin and drive crypto higher.

As of this writing the spot price for Bitcoin is roughly $98,000, which represents a year-to-date return of roughly 133%. By comparison, the S&P 500 is higher by approximately 26% over the same period. So, the move in cryptocurrency has been substantial. Pinpointing what precisely is driving the rally is difficult, but I think there are likely three primary forces at play – fear of missing out by retail investors (FOMO), concern over reckless fiscal spending in Washington and the uncertainty over the new Trump administration.

FOMO is a powerful phenomenon, particularly among retail investors, that can push an asset price exponentially higher over a short period of time. As the hype around bitcoin spreads, investors throw more money at it and inflate the price. Our deficits and fiscal policy are a source of concern in terms of inflation expectations and the long-term stability of the U.S. dollar as the global reserve currency. Likewise, the impact of potential Trump tariffs on inflation has investors considering hedges beyond traditional gold. In summary it is not surprising that bitcoin has rallied considering the confluence of many factors around the election. What bitcoin is worth, however, is a subject of considerable debate. A pullback after this rally would not be surprising.

Q: Who do you forecast will be the winners and losers in Trump's first year?

The GOP won the trifecta in the 2024 elections, White House, House of Representatives, and Senate, will give them tremendous power in setting the economic and social agendas for the next 2 years. I believe Trump and his advisors will focus on the economy out of the gate and push for extending the soon expiring 2017 tax cuts and lowering corporate income taxes. The path to achieve this will be tricky as the GOP does not have a veto-proof majority of 60 votes.

The biggest bang for the buck would be re-instituting immediate tax deductions for capital spending and R&D spending, currently required to be spread out over a 5-year period. I expect companies with high levels of R&D and cap ex spending will be the biggest beneficiaries as they will see an immediate increase in earnings with the lower tax burden. Some of these companies are highlighted in the Introduction of this report.

There will be losers as a result of Trump's victory over Harris. At the top of the list will be green or renewable energy companies that rely heavily on tax credits to be viable. Those on the political Left are scrambling to try and allocate funds for green initiatives funded in the mis-named Inflation Reduction Act that will likely go away when Trump takes office. Other losers include retailers and companies that rely on exports for profits. Tariffs are likely to negatively impact these businesses for the foreseeable future.

Given that this will be Trump's second term as president, we can look back to 2017 to get some idea as to what market sectors might outperform the broader market. Afterall, Trump ran and won on a similar platform from eight years ago of lower taxes, deregulation and tariffs. One market segment that could do well is financials. Since late September the ten-year Treasury yield has risen from roughly 3.7% to approximately 4.4% perhaps on the expectation that future deficit spending and new tariffs could stoke inflation. Meanwhile, the Federal Reserve is cutting interest rates, which implies a steepening yield curve heading into 2025. A normalized yield curve combined with deregulation could be a tremendous tailwind for the financial sector.

Another market segment that could benefit under Trump is small cap stocks via lower corporate tax rates and protectionist policies that don't favor multinational corporations. Likewise, energy companies, particularly fossil fuel stocks, could benefit from deregulation (drill baby drill). Segments that might come under pressure in 2025 are longer-duration bonds if inflation begins to creep higher through the implementation of tariffs. Likewise, ESG friendly businesses, such as green energy, might underperform the broader market given they are not particularly favored by the Trump administration.

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