Citi Global Wealth Investments

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Discrete Repricing vs Lasting Growth

- Movements in currencies are a zero-sum game of "winner vs loser." Equity returns, in contrast, can be positive across most of the world together as the economy is able to produce *more* goods and services over time.
- Global markets shifted in favor of US assets in the aftermath of the November 5 election. The US dollar has risen 3% against liquid, tradeable currencies. Non-US equity markets have fallen while US equities have risen 3% since election day. While this has fit our tactical allocation preferences favoring US assets (please see our November 9th CIO Bulletin), we have to question how much "exceptional growth" is now priced in.
- If we look at the November 2016 election as a guide, the dollar's increase was discrete, peaking in less than two months. While trade wars and a Fed tightening cycle drove volatility in 2018, both US and non-US equities posted solid positive returns from Trump's 2016 election to the end of 2019 (60.7% for the US, 35.7% for non-US).

Potential Portfolio Implications

- US equity valuations have risen to 21.8X consensus EPS estimates for 2025 while non-US are 13.3X. As discussed last week, we are quite comfortable with our overweights in small- and mid-cap US growth stocks, but believe large caps are more fully valued for positive outcomes in the economy.
- In looking at comparisons to the first Trump administration, tariff friction didn't impact global markets until 2018. The new Trump administration may act much faster in the coming year. Even so, the drop in trade-sensitive regions suggests a good deal of concern has been priced in.
- US bank shares are most likely to benefit from de-regulation and normalization of the US yield curve. While they have gained 9.7% since November 5, the same group gained 25.6% in the first six months following the 2016 election.

Judging How the World Will Change, How it Won’t

With just eight trading days since US election results, the market value of US equities has increased $2 trillion, or 3%. The US dollar has gained 3% against an index of the most liquid, traded currencies. Measured in the now appreciated US dollar, share prices outside the United States have fallen 2.9% or about $750 billion.

In essence, the slogan “America first” played out in global markets over the past week. Even the value of gold has withered a bit against the mighty greenback (-6.5% since election day). In contrast, hopes of de-regulation and adoption in a Trump administration have sent cryptocurrencies higher.

Changes in the value of a currency vis-à-vis another is a zero-sum game of winner versus loser. The same is not true for equities. Fiat currencies generally “inflate away,” losing value in their purchasing power of goods and services over time. But over time, the economy is able to produce *more* goods and services as technology improves and contributes more, while an expanding human population works more hours. Therefore, owning the productive capital of the economy can generate sustained returns, theoretically in perpetuity.

Lessons from late 2016 – highly discrete market adjustments

When we think about the market reactions to the US political changes, we must attempt to separate the discrete repricing of certain expectations and distinguish these from the lasting factors (i.e. “zero sum” vs “enduring growth drivers”). On the discrete side, the hope for lower tax rates on US business drove a stronger view of US economic growth relative to other economies following President Trump’s election in late 2016. As tax rates don’t drop every year, this was largely priced in discretely with a “lurch” up in the real value of the US dollar, reaching a peak as 2017 began (see **FIGURE 1**). Similarly, 10-year US Treasury yields jumped 57 basis points from election day 2016 to year end. While US yields rose further through 2018, this was during a Fed tightening cycle with 200 basis points of rate hikes through the end of that year (see **FIGURE 2**)

FIGURE 1: US trade-weighted dollar index (inflation adjusted) 2010-2019

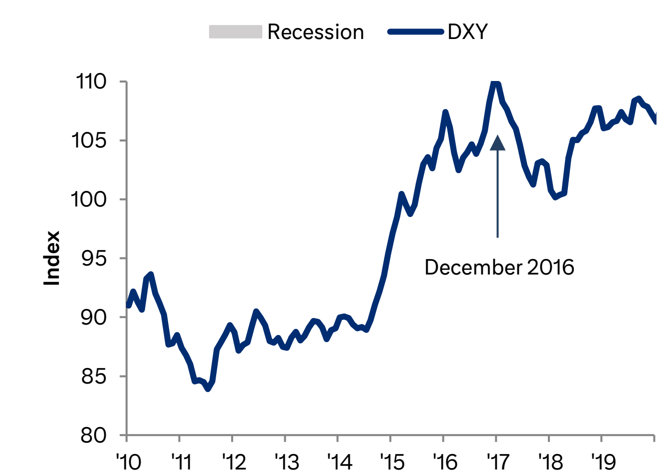
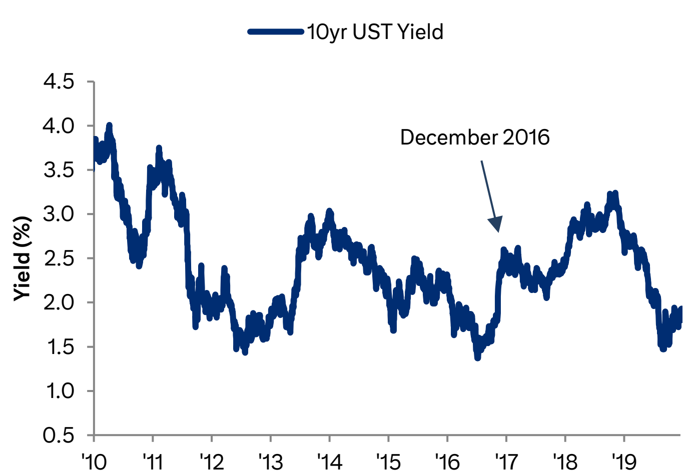


FIGURE 2: US 10yr Treasury note yield 2010-2019



Source: Haver Analytics as of November 14, 2024. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

The rise in the US dollar and yields in late 2016 was indeed highly discrete, with increases only following the 2020 pandemic events more recently. The Republican sweep in the 2016 election extracted a quick "toll" on non-US assets before positive returns resumed. However, this was likely influenced by the long delay in forming the first Trump administration. The US didn't raise tariffs on China until 2018. The new administration now promises to quickly resume where it left off.

Could the worst already be over for global shares, scared by 2018 trade war memories and campaign promises of dramatically higher tariffs? We wouldn't want to share false confidence. History, however, suggests that markets have done much of the work already (see **FIGURE 3-4**). Outside of the US, local returns have been flat or negative in all the large regional markets save Canada.

The industry composition of equity markets in the US is even clearer. Renewable energy shares have fallen by low double-digits since Trump's reelection on November 5. Traditional energy equities have gained despite a drop in the oil price and promises of easier drilling from US regulators which could sink petroleum further.

1H 2017 returns were significantly larger than those seen since Nov. 5

The share price gains from the 2016 election through 1H 2017 suggests promise. For example, in that six-month period, banks gained far more than they have in the past few weeks. As discussed in last week's CIO Bulletin, to the extent that Fed rate cuts steepen the US yield curve, it generates improved economics for lenders. Expectations of deregulation have already boosted large bank share prices, but the gains have come on low valuations and severe underperformance for nearly two decades.

FIGURE 3: Regional equity market performance since 2024 US election and six months after 2016 election

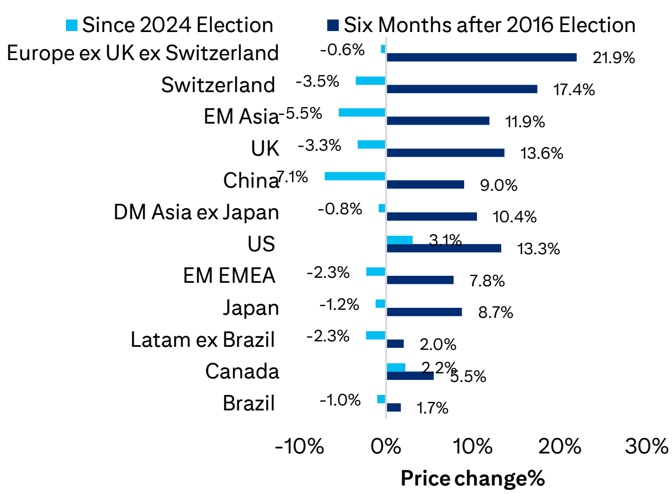
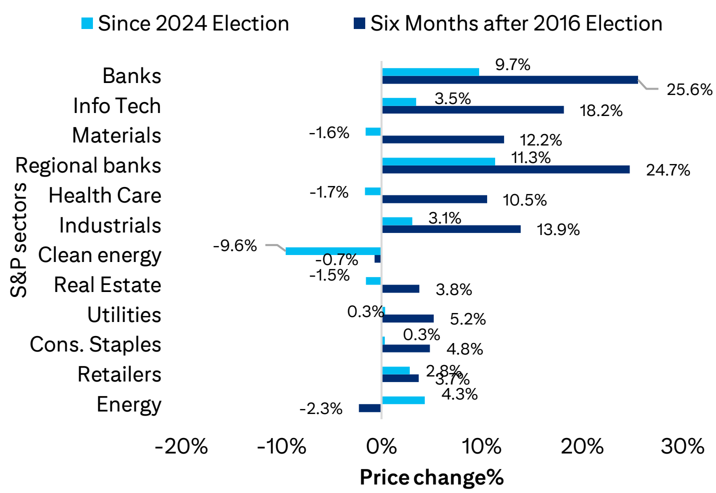


FIGURE 4: US Sector equity market performance since 2024 US election and six months after 2016 election



Source: Bloomberg as of November 14, 2024. Regional markets are using MSCI indices as proxy and sectors are using S&P indices as proxy. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

Ongoing growth and recovery – lest we forget

We should not forget that EPS gains were broadening across sectors and regions before attention turned to the US election (see **FIGURE 5**). As we've highlighted many times, EPS declined for many firms in 2022-2023 while labor markets were strengthening. Excluding the Magnificent 7[1] large cap US tech related firms, EPS was down roughly 7% for other S&P 500 firms and for non-US firms in 2023 (see **FIGURE 6**). This makes 2024 only the mere starting point for a profit rebound.

A return to "trade wars" can introduce new volatility in markets in 2025, but when looking at the full period to the end of 2018, global markets still came out with solid gains. This was far broader than the US even with the trade friction period of 2018 and the Fed tightening cycle that preceded the pandemic (see **FIGURE 7**).

FIGURE 5: EPS gains/declines by region and consensus for 2024

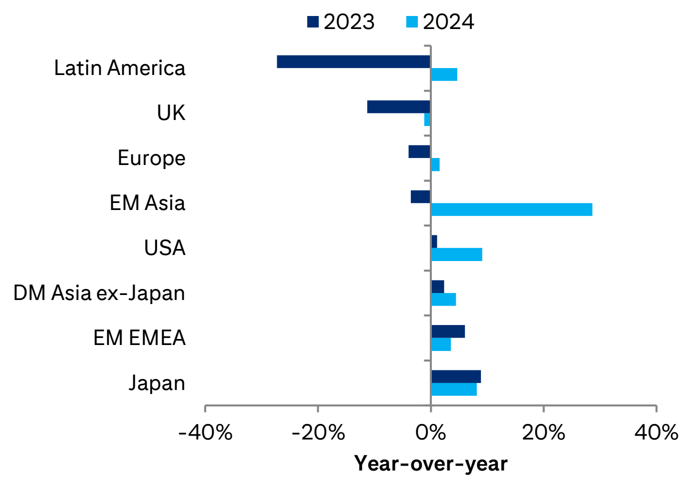
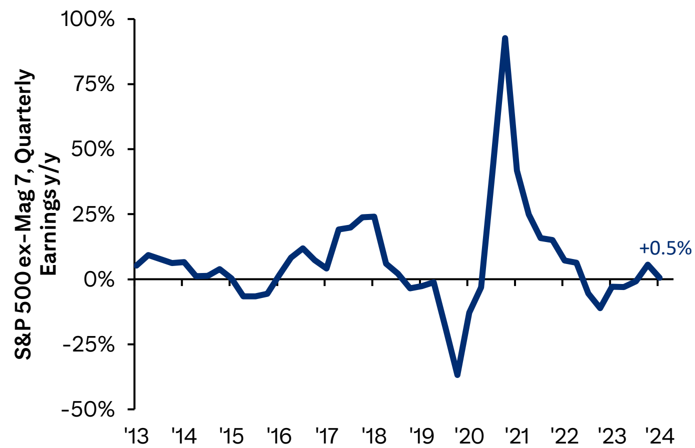


FIGURE 6: S&P 500 EPS Y/Y% ex-Magnificent 7



Source: Bloomberg as of November 14, 2024. Regional markets are using MSCI indices as proxy. The Magnificent 7 stocks include Amazon.com (AMZN), Apple (AAPL), Google parent Alphabet (GOOGL), Meta Platforms (META), Microsoft (MSFT), Nvidia (NVDA) and Tesla (TSLA). The securities or company names included herein are for illustrative purposes only and do not constitute a recommendation of or solicitation to purchase or sell any security. Indices are unmanaged. An investor cannot invest directly in an index. They are shown for illustrative purposes only and do not represent the performance of any specific investment. Index returns do not include any expenses, fees or sales charges, which would lower performance. Past performance is no guarantee of future results. Real results may vary.

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FIGURE 7: Regional share prices in USD since Nov 5, 2024 election and from 2016 election to end 2019

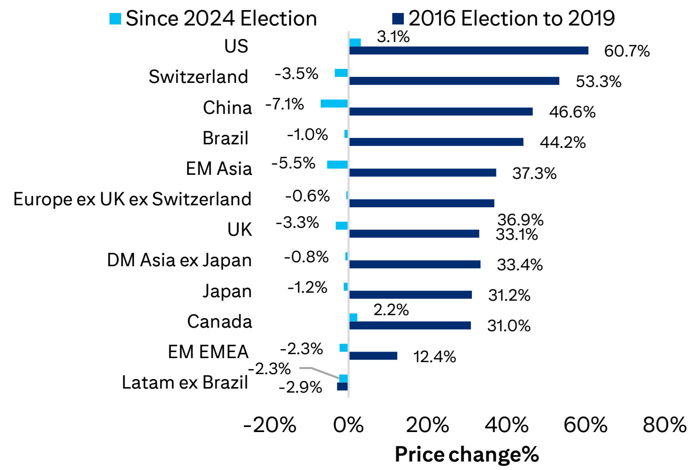
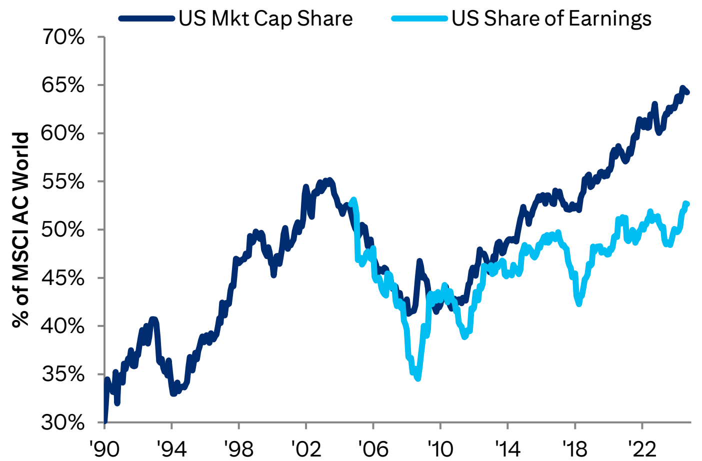


FIGURE 8: US share of global equity market capitalization and share of global corporate profits



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As our Global Investment Committee meets in the coming week, we have to ponder the large rise in US shares and slump elsewhere in the world. As we noted last month in the CIO Bulletin, the divergence in valuation between US and non-US shares (22.9X vs 13.3X next year's estimated EPS) is at an extreme. It reflects different growth rates of corporate profits, with the US growing faster, gaining share relative to the rest of the world. Yet as **FIGURE 8** shows, US market cap has been gaining even faster.

If not for the prospect of a quick resumption of trade friction and a somewhat firmer rate outlook, the case for increases in non-US equity allocations would be clear. But then again, if not for US election-driven factors, many non-US markets would likely already be higher.


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Medium grade	Baa	BBB	BBB
Not Investment Grade			
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Low grade (speculative)	B	B	B
Poor quality (may default)	Caa	CCC	CCC
Most speculative	Ca	CC	CC
No interest being paid or bankruptcy petition filed	C	D	C
In default	C	D	D

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