Equity Trump Trades 2.0

The Republican sweep of D.C. has unleashed a frenetic recalibration for equity markets with investors extrapolating potential policy prescriptions in hopes of positioning appropriately. Some emerging trends are logically consistent, however broader price movement reflects a lack of overall conviction, at a minimum, and a misapplication in certain pockets.

In our view, Trump Trade 2.0 is just getting started with plenty more room for winners to run and new opportunities to uncover. In the following passages we detail the framework through which we evaluate the impact policy action could have and reconcile the market reaction with what we expect to be more lasting effects.

Framework

1. Taxes	2. Trade	3. Regulation	4. Security

As written in our August report[1], we view a Trump victory as supportive for broader equities and the industrial complex, more specifically, while major risks loom with regards to trade frictions and immigration shocks. These positions are emboldened given the magnitude of victory and sweep of control in Congress.

Our framework for evaluating the potential equity implications of President-Elect Trump and Republican control of Congress operates within the context of four policy verticals which we consider to be of paramount economic importance: 1) taxes, 2) trade, 3) regulation, and 4) security.

1 Alpine Macro *Equity Strategy* "Making $ense Of U.S. Election Outcomes For Equities" (August 28th, 2024)

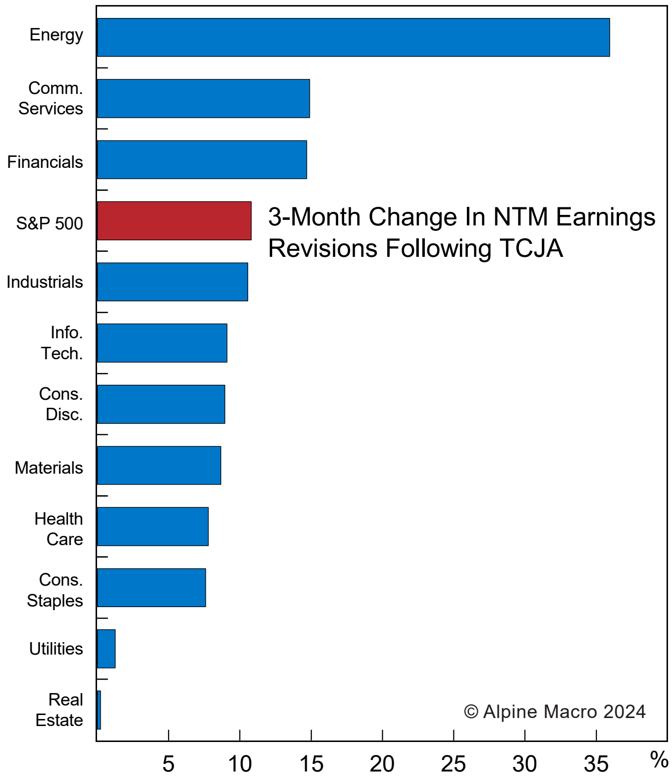
1. Taxes: Asymmetrical Upside

Tax policy is the most immediately tangible election boost for equities given the calendar catalyst that looms next year as major elements of Trump's signature Tax Cuts and Jobs Act (TCJA) are set to sunset. Provisions set to roll off focus on individuals and represent a fiscal cliff as taxpayers of all income brackets would face higher average tax rates.

It's in the tax realm where Republican control of Congress will prove most enabling as a major concern was that business favored provisions of the TCJA— including the domestic corporate rate of 21%— would be on the chopping block for negotiation. Republican-swept government, and its ability to effect change through the legislative process of reconciliation, removes any downside risk of higher rates while keeping the door ajar for potential tax sweeteners.

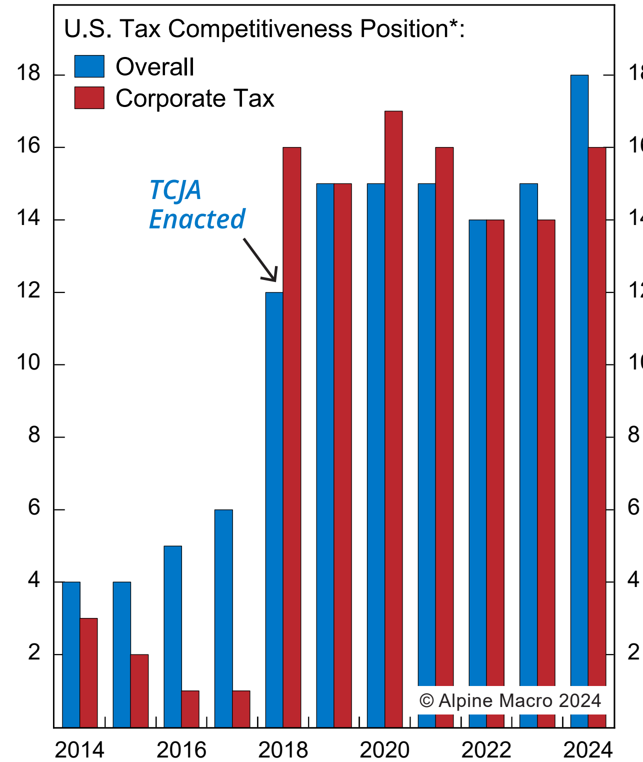
We view the likelihood of the domestic U.S. tax rate moving significantly lower as minimal given the fiscal backdrop, but there could be movement with regards to international taxation, the depreciation schedule for capital investment and R&D, and the

Chart 1 TCJA Induced Step Up For Earnings



Note: Data from Nov. 2017 to Feb. 2018; source: Bloomberg Finance L.P.

Chart 2 TCJA Brought U.S. Competiveness To Par



*Rank out of 35 countries, higher = better; source: The Tax Foundation

tax treatment of certain work performed or income (tips, family care, etc).

The bottom line is that the possibility of tax hikes are off the table with risks skewed to the upside. This is a boost to the outlook for cash flows to equity investors and is a strong advantage to U.S. companies. Chart 1 shows that the original TCJA corresponded with a step-up in earnings estimates by 10-12% while U.S. corporate tax competitiveness increased substantially (Chart 2).

Chart 3 shows the effective tax rate for each sector within the S&P 500 alongside the potential tax shield benefit given the full expensing of CapEx along with research and development. Sectors with higher tax intensity could have more upside upon new legislation.

2. Trade: Prisoners Dilemma

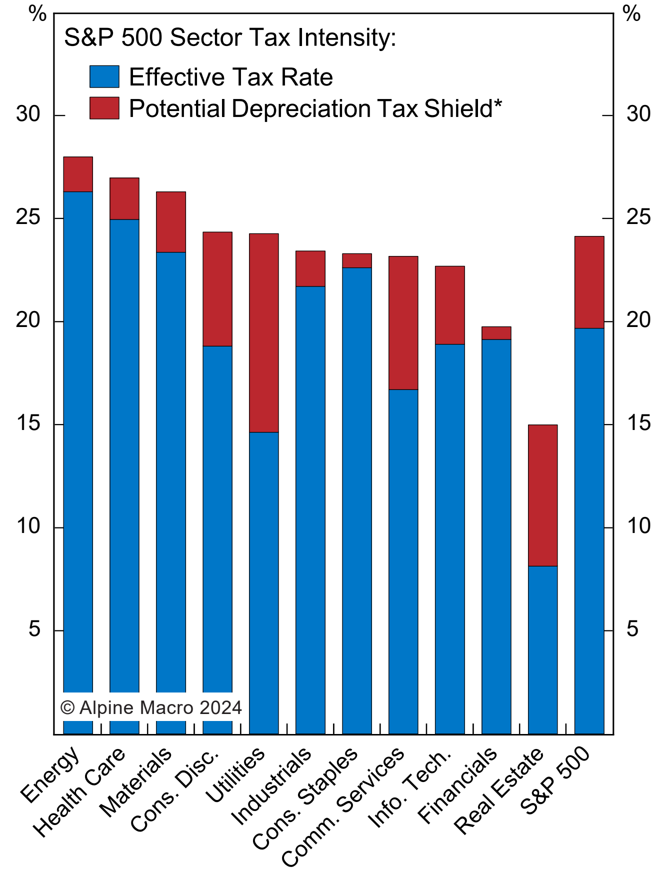
A Trump 2.0 presidency will lead again with trade as a defining issue. President Elect Trump proposed: A) 10% tariffs on all goods imported to the U.S., B) 60% tariffs on all imports from China, and C) removing China's favored nation status. According to the Tax Foundation, 10% tariffs and the retaliatory effects would sink the U.S. economy by 1.1%, while raising tariffs on China would boost revenue but increase prices and slow growth.

It's important to understand that tariff proponents generally view the measures as a stick to wield in

Trump/China Trade War of 2018-2020

In 2018 the Trump administration invoked Section 301 to target Chinese imports for tariff. China responded with a list of products to retaliate. Trump countered by broadening target lists and raising rates further. Ultimately, China ran out of U.S. imports to tariff while Trump promised to tariff all remaining imports at higher rates. Before reaching that point a deal was struck with leaders on both sides signing off on a "Phase One" framework which includes some protections for intellectual property, technology transfer, foreign investment, dispute resolution, and currency float in addition to substantial commitments made to purchase U.S. agriculture, energy, manufactured goods, and services. China missed their targeted commitment for goods and services by approximately 57%.

Chart 3 Greater Tax Intensity, Greater Tax Upside



*Estimated as tax rate (21%) multiplied by capital expenditures and R&D as % of revenues. Actual tax shield may vary

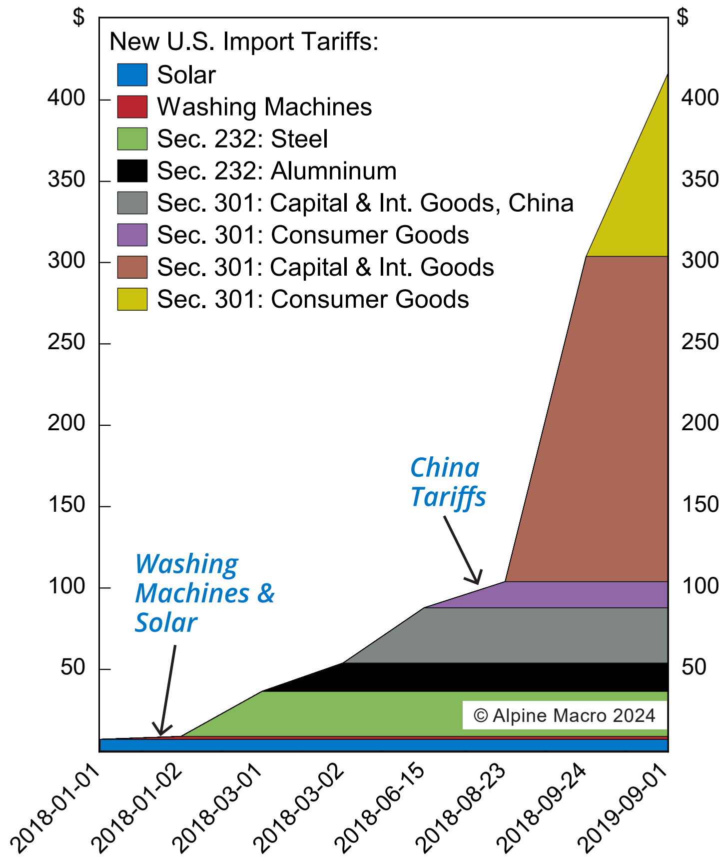
trade relationships that often resemble stages of game theory. A cooperative approach, in which barriers and costs are lowered, is the desired outcome, whereas tariffs represent the "defection punishment" to otherwise absorb. The Phase One agreement with China, albeit rife with unmet commitments, and USCMA were steps towards cooperation.

In our view, the probability of escalating tariffs is high but likely to be targeted and restrained relative to headline rhetoric given the President's sensitivity to inflation, tendency to view the stock market as a barometer, and past history. We'd expect the contours of the Phase One agreement to be reapplied, USMCA to be reviewed in 2026, and deals negotiated under threat of escalating barriers.

Four elements should be considered when positioning for trade risks:

1) Segments with greater international revenue and supply chains exposure face more risk. Industrials, Materials, and Autos underperformed the S&P 500 by 14%, 19%, and 34%, respectively, from 2018 to 2020. Meanwhile, Small Caps derive 76% of revenue domestically compared to Large Caps at 59%.

Chart 4 Running Out Of Capital & Intermediate Goods To Tariff



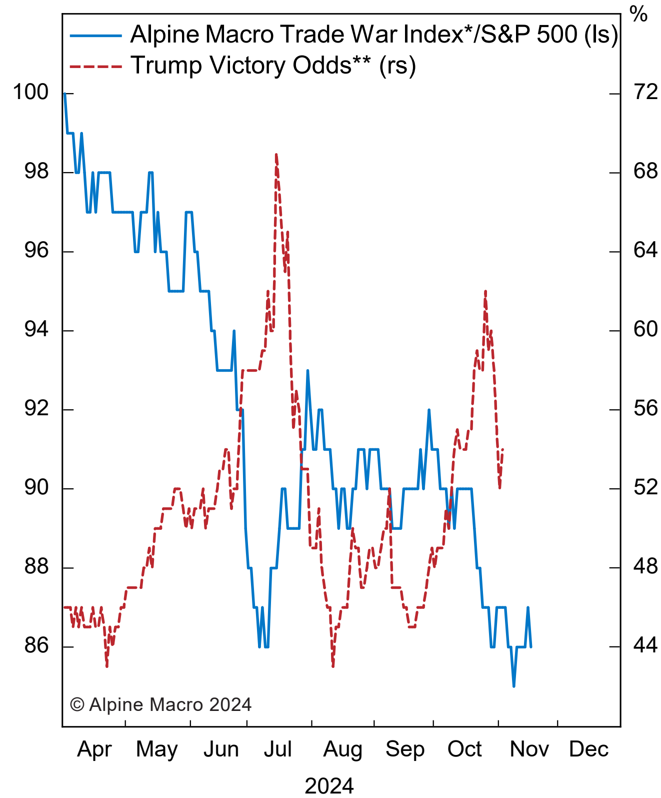
Source: Federal Reserve

2) Consumer goods could move into the crosshairs if the administration runs out of intermediate and capital goods exports to tariff. Trump was reluctant to apply tariffs on these products in his first term (**Chart 4**).

3) Household appliances, transportation/vehicle equipment, machinery, computer equipment, and agriculture chemicals were among the most vulnerable to supply chain cost increases and retaliatory tariffs during the 2018 trade war.

4) Our Alpine Macro Trade War Basket indicates that investors are already pricing in elevated trade tensions (**Chart 5**).

Chart 5 Market Pricing Increased Trade Tensions



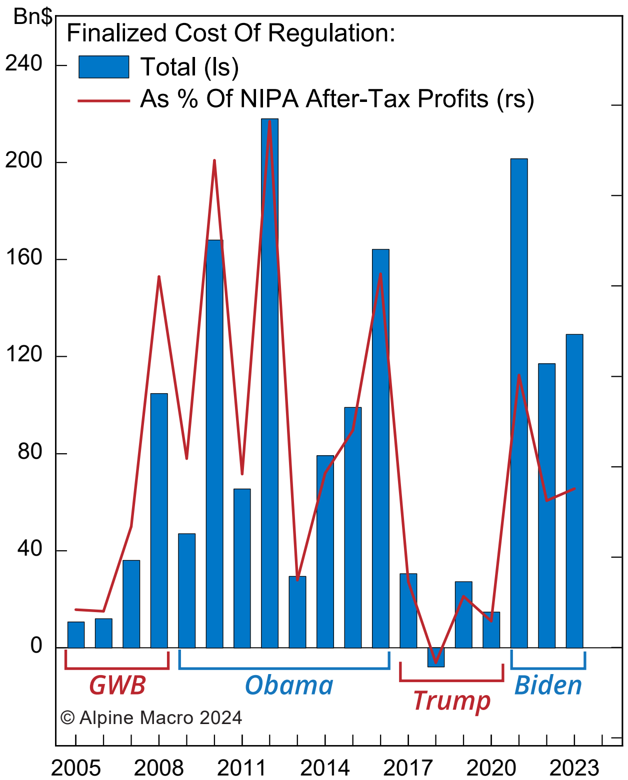
*Alpine Macro proprietary index
**Source: PredictIt

3. Regulation: Slow The Roll

The cost of regulation was dialed back during Trump's first administration— a boon for businesses— and we expect more of the same going forward. Annual net regulatory costs totaled $10bn during the Trump administration after averaging $111bn during the Obama terms, while the number of economically significant rules declined dramatically prior to the pandemic (**Chart 6**).

We expect Trump to center his deregulatory focus on the environment, construction, labor, finance, education, and health. The mergers and acquisition landscape should also thaw to a degree after stalling under the current leadership of the Federal Trade Commission.

Chart 6 Regulatory Costs Sank Under Trump 1.0



Source: BEA, American Action Forum

Trump has pledged to slow the transition towards EVs, including by removing subsidies, which will drag down legacy automakers. An emphasis will be placed on U.S. energy production, including coal and nuclear, which should boost certain Utilities and services while lowering input costs for energy-intensive industries. Homebuilding should benefit from lower energy costs in addition to easing environmental and coding requirements. Finally, a lighter regulatory touch should assist banks and companies with crypto exposure. Smaller companies with less economies of scale benefit more from regulatory relief.

Health Care could be a wild card as Trump has indicated support for Medicare Advantage plans, which would boost membership ranks of some insurers, while taking a less favorable view of the Affordable Care Act and enhanced Medicaid coverage, which is a net negative for others. The biopharma space should breathe a sigh of relief with a more favorable M&A backdrop, potential boosts to R&D tax treatment, and lower risk of price controls. However, skepticism from nominated Health and Human Services Secretary, Robert F. Kennedy Jr., is a risk.

4. Security: Give and Take

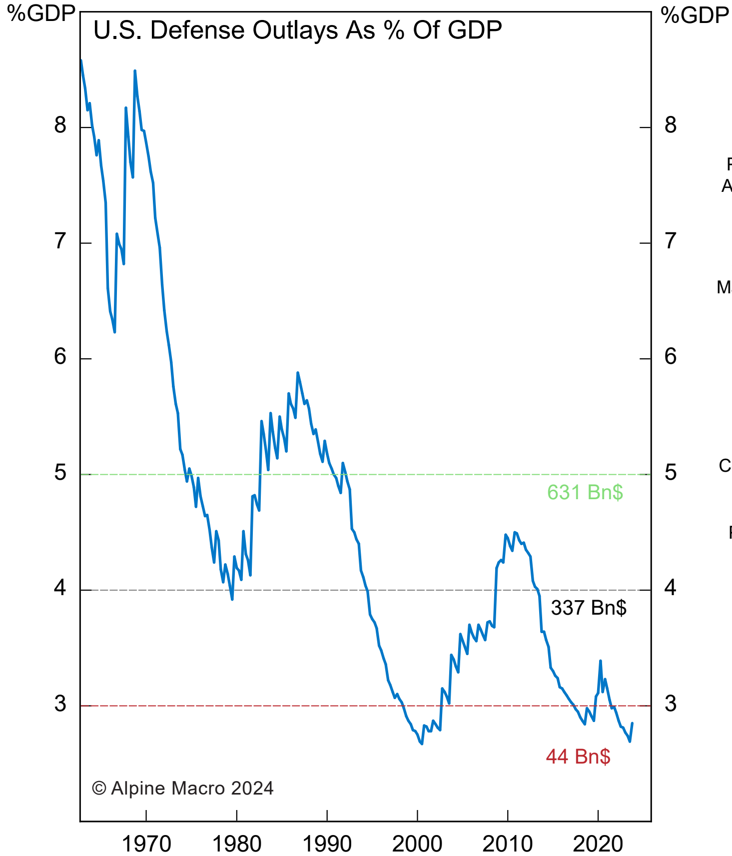
A consistent component of Trump's platform has been a strong approach to security matters including immigration and national defense which incorporate direct and indirect consequences for equities.

The Defense complex is in line for a funding uptick as was experienced during Trump's first term as budgetary outlays for defense increased by 9%—nearly $225bn above Obama-level projections. Senator Roger Wicker (R), who will likely Chair the Senate Armed Services Committee, has proposed increasing defense spending by $55bn in FY2025 while targeting a 5% of GDP spend level (Chart 7).

Emphasis will include procuring more aircraft, submarines, spacecraft, munitions, air & missile defense, and upgrading the basic facilities for armed forces. In the nuclear field, a focus on uranium enrichment particularly with smaller, modular facilities would have carryover commercial and consumer benefits by electrifying the grid and reducing energy costs.

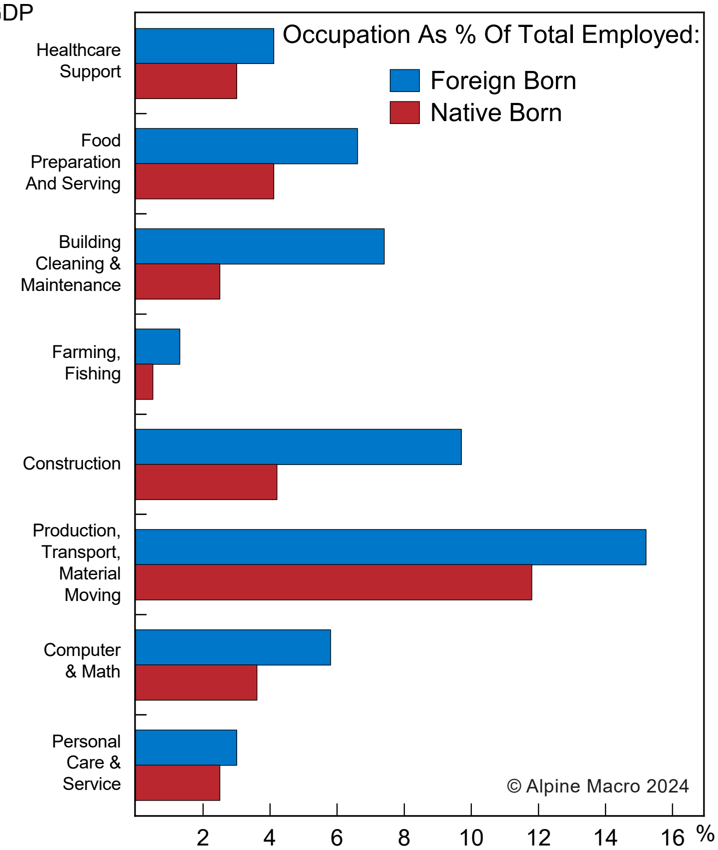
Building economic resilience by reshoring industrial capabilities is an adjacent policy prescription while we expect the domestic safeguarding of sensitive

Chart 7 Republicans To Target Increase In Defense Spend



Note: Horizontal lines denote incremental spend thresholds on current spending

Chart 8 Foreign Labor Tilts Towards Services & Building



technologies to accelerate. This is bullish for Industrials, while export controls could be an incremental negative for semiconductors.

Immigration is one area that could provide a headwind for industry groups. Targeted removal of individuals with deportation orders or criminal records is a base-case scenario and could encompass approximately 1mn migrants, which represents less than 1/3 of the total increase in the U.S. labor force since 2020. Measures to spur "self-deportation" by penalizing businesses employing undocumented workers could accelerate outbound migration (**Chart 8**).

Meaningful reduction in the working age population, particularly lower-skilled, would raise wages and prices while putting downward demand on lower-end consumption for goods and services including housing. Construction, food services, retail trade, health care, and smaller companies would experience more pressure. It remains to be seen if merit-based immigration will be altered, with material implications for technology.

Reflecting on First Term To Guide Trump Trades 2.0

An initial risk-on burst has since given way to a slight pullback in many segments as the market digests the implications of D.C.'s new power structure. This is a tell-tale signal that investors broadly lack conviction outside of a select few segments which are charting a similar pattern following Trump's surprise first-term victory.

Importantly, many trade trends which worked immediately following Trump's victory in 2016 did not persist through the duration of his Presidency and we expect a similar experience this episode given a high degree of policy uncertainty. In **Table 1** we show the Over/Underperformance of segments across time and observe the following:

1) Financials and Small Caps enjoyed outperformance until the growth scare of late-2018

2) Tariffs increasingly weighed on the performance of Industrials and Materials while tax reform was viewed as a major boon for Consumer Discretionary and Technology

3) Energy suffered as U.S. crude production spiked 52% while higher yields weighed on legacy telecom & media, dragging down Communication Services

4) Riskier exposures to Value and Beta initially outperformed but eventually ceded leadership to Quality and Growth

Conclusion

Given the application of our framework and in consideration of market trends during Trump's first administration we view Financials, Small Caps, and Quality as high conviction beneficiaries of the Trump 2.0 regime which we expect to be characterized by higher nominal growth, rates, and domestically oriented industrial policy.

Table 1 2016 Election Winners & Losers

Over/Underperformance Following 2016 Election	1 Wk	1 Yr	2 Yr	3 Yr
Financials	8%	15%	5%	3%
Industrials	4%	2%	-8%	-8%
Health Care	1%	-2%	4%	-4%
Materials	1%	4%	-13%	-19%
Energy	1%	-22%	-30%	-59%
Discretionary	1%	-4%	10%	10%
Comm. Services	-2%	-28%	-33%	-34%
Info. Technology	-3%	16%	23%	42%
Real Estate	-4%	-13%	-22%	-14%
Staples	-7%	-21%	-24%	-30%
Utilities	-7%	-8%	-19%	-13%
Growth	-1%	3%	13%	14%
Value	2%	0%	4%	-7%
Quality	-1%	2%	5%	13%
Beta	4%	4%	-1%	-10%

Other segments which we expect will benefit include Industrials and Technology while we expect Staples, Materials, and certain areas of Discretionary to face headwinds from trade and labor concerns. Paradoxically, Energy equities are likely set for underperformance as deregulatory efforts signal increasing supply and puts downward pressure on commodity prices and cash flows.

Finally, it's worth mentioning that a risk to monitor is the reflexive intersection of policy, rates, and equities. A lasting jump in yields is a headwind for equities on a fundamental and technical basis. That stocks have rallied as yields have moved higher is an encouraging signal of strength, for now, and we're mindful that a similar spike in yields occurred following the 2016 election.

In the **Appendix** we provide our Equity Implication Matrix which details the policy outlook for each S&P 500 sector and provide an overview of potential effects across industries.

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Sector	Policy Outlook	Policy Verticals	Trump Administration
Communication Services		Trade: N Taxes: + Regulation: + Security: +	Positive: CapEx/R&D expensing, regulation, security spend Negative: “Mega Media” anti-trust risk, higher yields Note: Favors Interactive Media & Enter. depending on “Mega Media” approach, Telecom on yield trajectory
Consumer Discretionary		Trade: -- Taxes: + Regulation: + Security: -	Positive: Taxes (R&D/CapEx spend), regulation (housing, autos, M&A) Negative: Immigration/Labor, trade, EV regulation, higher yields Notes: Bullish Broadline Retail (AMZN) and Homebuilders, bearish H/R/Leisure (labor), and certain legacy Autos/components
Consumer Staples		Trade: - Taxes: N Regulation: + Security: -	Positive: Taxes, regulation (M&A) Negative: Immigration/labor, trade Notes: Bearish Household and Food Products given labor and supply chain concerns. Bullish Tobacco. Trade deal would benefit Food.
Energy		Trade: - Taxes: + Regulation: N Security: N	Positive: Less regulation (permitting reforms), taxes Negative: Increased supply, trade (lower demand) Notes: Positive in short-term on positive headlines but paradoxically negative as supply lowers commodity prices.
Financials		Trade: + (Volatility) Taxes: + Regulation: + Security: N	Positive: Deregulation (Basel Endgame, Volcker), volatility, M&A, curve Notes: High conviction favored sector that prospered through first Trump term. Prefer Banks, Capital Markets, and Financial Services
Health Care		Trade: N Taxes: + Regulation: + Security: -	Positive: Taxes, R&D expensing, regulation (Med. Adv., drug pricing) Negative: ACA & Medicaid funding, trade (Equipment), regulation Notes: Biopharma is wildcard as price controls delayed/adjusted and M&A accelerates but RFK Jr. nomination is known unknown
Industrials		Trade: - Taxes: + Regulation: + Security: ++	Positive: Military, manufacturing, infrastructure, taxes (expensing) Negative: Trade (supply chains) Notes: Multiple tailwinds, although international supply chains and intermediate/capital goods exports carry trade risk
Information Technology		Trade: - Taxes: + Regulation: N Security: N	Positive: Taxes (level/intl/R&D), regulation Negative: Trade (high foreign revs/supply) Notes: Tax policy favors software as tariffs are risk for Hardware, Equipment & Semis. Skilled immigration and anti-trust is wildcard
Materials		Trade: - Taxes: + Regulation: - Security: N	Positive: Infrastructure, taxes, feedstock spread (petrochems) Negative: Trade (high foreign revs/supply), EV regulation Notes: Expanded manufacturing/energy base boosts U.S. chems and construction but tariff risk remains. Expect pull-forward of products
Real Estate		Trade: N Taxes: + Regulation: + Security: N	Positive: Regulation (homebuilding), taxes Negative: Trade (warehouses), immigration, higher yields Notes: Federal housing programs potentially at risk, industrial demand could pull-forward given fear of trade tensions
Utilities		Trade: N Taxes: + Regulation: + Security: +	Positive: Taxes, regulation, security (grid resilience) Negative: Clean Energy policy Notes: Deemphasis on clean energy generates headline risk but overall energy policy could provide unappreciated opportunities

Note: Green = Favorable Outlook, Red = Unfavorable Outlook, Grey = Neutral Outlook

Investment Recommendations				
Strategic Recommendations (6 - 12 months)				
Recommendations	**Open Date**	**Performance**		**Active Return**
		Vehicle	**S&P 500**	
Long S&P Industrials	5/29/2024	14.42%	12.14%	2.28%
Long S&P Utilities	6/12/2024	14.65%	8.96%	5.69%
Long S&P 600	6/24/2024	13.30%	8.43%	4.87%
Short S&P Materials	7/24/2024	1.74%	8.83%	7.09%
Long Regional Banks (KRX)	8/21/2024	16.98%	5.09%	11.89%
Long/Short S&P 500 Healthcare Equipment & Supplies/Providers & Services	10/23/2024	-1.32%		-1.32%

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