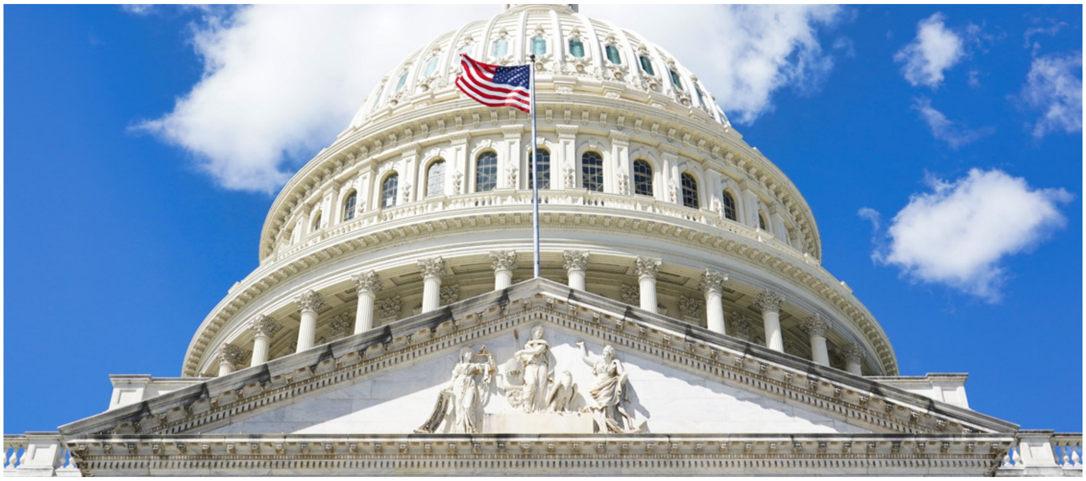
DoubleLine's Initial Thoughts on the Economic Impact of U.S. Election

Bill Campbell & Chris Stegemann | November 15, 2024



Leading up to Election Day in the U.S., markets started to react as it became more likely Donald Trump would win the presidency. As Mr. Trump's victory became clearer following Election Day, U.S. stocks reached all-time highs, the U.S. dollar strengthened, U.S. Treasury yields rose, and credit spreads tightened.

The promise of corporate (and individual) tax cuts, along with Mr. Trump's propensity for deregulatory policy, will likely boost growth prospects in the near term, hence the move higher in stocks. On the other hand, the promise of tariffs under the future administration, combined with the expectation of a brighter path of U.S. economic activity, boosted dollar strength and caused concern in currency markets. The combination of the prospects of new tariffs, more fiscal spending and more robust economic activity increased concerns about inflation risk. The potential fiscal impact of this pro-growth policy and risk around inflation have also caused a repricing of the Federal Reserve rate-cutting cycle, which was exemplified by the move higher in Treasury yields.

The market impact was seemingly amplified when it became clearer that Mr. Trump's victory would come alongside a Republican majority in the Senate and the potential for the Republicans to keep a narrow majority in the House of Representatives. A split government would have limited the ability for either presidential victor to make sweeping changes and thus dulled initial market reaction.

On Nov. 7, DoubleLine CEO-CIO Jeffrey Gundlach appeared on CNBC following Fed Chair Jerome H. Powell's post-Federal Open Market Committee (FOMC) meeting and the Fed's announcement of a 25-basis point rate cut. Mr. Gundlach deemed the election "incredibly consequential" while the FOMC meeting was "one of the least consequential, with a repetition of the idea that the Fed is plodding towards their goals. … However, the December [FOMC] meeting and first [FOMC] meeting of January are going to be very important."

Growth

The incoming Trump administration will likely look to implement a pro-growth agenda. DoubleLine expects expansionary fiscal policy, largely via tax cuts, and deregulation to be the underlying drivers of growth. Sectors that will likely benefit include traditional energy and banking/financials. Deregulatory efforts could likely be implemented rather swiftly once the new administration takes over in January while changes in fiscal policy should take longer to implement. One risk to growth is the implementation of tariffs. How quickly new tariffs are implemented and their size and scope will have to be monitored closely for their potential impact on growth, as will any retaliatory responses by other countries.

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Inflation

While tariff talk raises inflation concerns, the extent to how impactful tariffs would be will be highly dependent on how they are implemented.

Tighter immigration policy could also be a risk to the labor markets and thus be inflationary. At this juncture, changes to immigration policy are largely conjecture, with the potential reinstatement of a "Remain in Mexico"-type policy and heightened southern border enforcement being floated by the incoming Trump administration. Beyond labor markets and inflation, tighter immigration policy could also affect other areas of the economy, which we will continue to monitor at DoubleLine.

Potential offsets to inflation concerns include:

- This would not be the first time countries have faced tariff pressure under a Trump presidency.
  - It is likely that countries have already devised responses and potential negotiating points to any potential tariffs and trade negotiations.
  - It is possible that tariffs might be applied more surgically and for a shorter duration than currently expected.
- Dollar strength and higher Treasury rates could help offset the inflationary pressure of tariffs.
- Potential deregulation in the energy sector and agreements on postponement of OPEC+ production cuts would likely send oil prices lower, which could also be an offset to the inflationary impact of tariffs.
- Near term, DoubleLine believes base effects will be a tailwind to bringing inflation lower, particularly on the core Consumer Price Index (CPI), as higher prints will be rolling off. This would provide a buffer in the near term for core CPI.

Fiscal

The starting point for the new administration is poor: a debt-to-GDP ratio of 120% and a deficit as a percentage of GDP of negative 6.3%. As stated by Fed Chair Powell at his Nov. 7 press conference, "U.S. fiscal policy is on an unsustainable path. The level of our debt, relative to the economy, is not unsustainable. The path is unsustainable." The word "path" is significant.

Initial comments by President-elect Trump and his campaign trail promises, including corporate tax cuts, are a headwind for the fiscal outlook and one that DoubleLine will be monitoring closely.

Potential offsets to fiscal concerns, particularly corporate tax cuts, include:

- Tariffs, on the margin, would generate revenue
- Reduction of government headcount
- Deregulatory policy could reduce some expenditures
- The danger of an exploding deficit could end up limiting how far Republicans in Congress will go on tax cuts.

DoubleLine Positioning

DoubleLine invests with our 12-24-month economic outlook in mind, assessing where we see the most-attractive relative value in markets.

Jeffrey Gundlach: "It is right to see the Trump victory as reducing the odds for near-term recession. However, I do not like the way [fiscal expansion] is going to be accomplished because that will lead to the problem in long-term bonds."

DoubleLine has generally remained shorter duration relative to pertinent benchmarks. We continue to believe the fiscal outlook remains challenged, and the need for increased issuance to fund ongoing fiscal deficits will continue to put pressure on interest rates, particularly at the longer end of the Treasury curve.

As it relates to duration positioning, DoubleLine has been positioned for a bull steepener within intermediate-duration portfolios with underweights to both the 10-year note and 30-year bond while maintaining an overweight to the two-year note, relative to the Bloomberg US Aggregate Bond Index.

During Mr. Gundlach's Nov. 7 appearance on CNBC, he states, "We have a great volume of bonds that are rolling off with very low interest rates from three to five years ago that are being refinanced at substantially higher rate levels. This is going to continue to be a supply problem for the bond market. For this reason, we are not positive on long-term Treasury bonds, in spite of the fact that the economy is sort of gradually slowing down." Mr. Gundlach also notes that he "thinks it is right to see the Trump victory as reducing the odds for near-term recession. However, I do not like the way [fiscal expansion] is going to be accomplished because that will lead to the problem in long-term bonds."

With the reset higher in interest rates, today's fixed income markets offer attractive yields for investors ranging from over 5% for investment grade (IG) corporate bonds to 7% to 12% for below-IG securities in the corporate and securitized credit markets. There is a compelling case for adding fixed income in client portfolios as both a complement and competitive investment to equities given current valuations. We believe an active and diversified approach to fixed income is the best solution for investors and has the potential to generate better risk-adjusted returns than passive or single-asset strategies. ■

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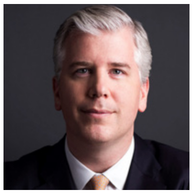

Bill Campbell

Portfolio Manager

Mr. Campbell joined DoubleLine in 2013. He is a Portfolio Manager for the DoubleLine Global Bond Strategy and is a permanent member of the Fixed Income Asset Allocation Committee. He covers Developed Markets, Central & Eastern Europe, Middle East and Africa (CEEMEA), and China. Prior to DoubleLine, Mr. Campbell worked for Peridiem Global Investors as a Global Fixed Income Research Analyst and Portfolio Manager. Previous to that, he was with Nuveen Investment Management Company, first as a Quantitative Analyst in their Risk Management and Portfolio Construction Group, then as a Vice President in their Taxable Fixed Income Group. Mr. Campbell also worked at John Hancock Financial as an Investment Analyst. He holds a B.S. in Business Economics and International Business, as well as a B.A. in English, from Pennsylvania State University. Mr. Campbell holds an M.A. in Mathematics, with a focus on Mathematical Finance, from Boston University.

Chris Stegemann

Manager, Client Portfolio Management

Mr. Stegemann joined DoubleLine in 2017. He is a Client Portfolio Manager and Manager of the Client Portfolio Management team. In this capacity, Mr. Stegemann is responsible for communicating DoubleLine's macroeconomic views and portfolio positioning via client engagement, published market commentary and dedicated strategy content, with a focus on DoubleLine's Fixed Income Asset Allocation strategies. Prior to DoubleLine, Mr. Stegemann was in mutual fund distribution for Putnam Investments. He holds a B.S. in Finance and minors in Accounting and Economics from Elon University's Martha & Spencer Love School of Business. Mr. Stegemann holds the FINRA Series 3, 6, 7 and 63 licenses.

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