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POLITICAL PULSE

Our Hot Take on the Election

Wednesday, November 6, 2024

Donald Luskin

Market reactions in the aftermath all point to faster growth.

We were right: Donald J. Trump has been elected president, winning the popular vote (see "Our Fearless Forecast" November 5, 2024). *The Republicans have taken control of the Senate* (see, among many, "2024: Deflation, Election, and No Recession" January 3, 2024). We don't really know about House control yet.

We were wrong: it wasn't especially close. But it was close. To be sure, Trump swept the seven battleground states (though as of this writing, three remain to be called even though Trump appears to be leading decisively). *But no other state result differed from 2020. When just seven states elect the president for all of us, that's close. It's just not hanging chads close, and that's what we had feared* (see "Oh Come All Ye Faithless" October 25, 2024). It looks like Trump's margin of victory in the Electoral College will be 86, substantially identical to his 77 in 2016 and Joseph Biden's 74 in 2020, both of which we consider close elections. As of this writing, Trump's 3.5% winning margin in the popular vote, in absolute terms, is in between his 2016 losing margin of 2.1% and Biden's 2020 winning margin of 4.5%.

Very close Senate races not officially called as of this writing – in Arizona, Michigan, Nevada, Pennsylvania and Wisconsin – may yet be subject to acrimonious recounts, disputes and accusations of fraud. But the presidential election appears to be settled. And those Senate races will not be determinative of control, with the GOP already at 52 seats for sure, even if it loses all five of the undecided races. The GOP is ahead, as of this writing, however narrowly, in Nevada, Michigan and Pennsylvania.

- We think the only major headline risk remaining in this election is Trump's scheduled November 26 sentencing in New York's so-called "hush money" case. We can't rule out that the president-elect could be thrown in jail, then and there. As weird and unsettling as that would be at this point, there is nothing in the Constitution that would mean Trump could not still be sworn in as president.
- Far be it from us to suggest that the Democrats and Republicans try to get along a little better for the sake of the nation and the economy. But if they wished to do so, *the best thing that could happen would be for Biden to immediately issue a blanket presidential pardon to Trump, and then for Trump to issue one for Biden upon assuming office in January*.

Update to strategic view

US POLITICS, US MACRO, US STOCKS, US BONDS, FEDERAL RESERVE, OIL: Trump won, and the Republicans took Senate control, as we predicted. The election was close, but not razor-close as we had expected and feared. The presidential election is settled, but five Senate races are still possibly subject to dispute. Headline risk still ahead is Trump's New York sentencing on November 26, which could potentially see him jailed. Biden and Trump should reciprocally pardon each other. State-level polls, prediction markets, evidence of strong GOP early voting and the Fair model proved to be the best predictors of the election. Stocks, rates, yields, and TIPS breakevens are higher in the aftermath, and oil prices are lower. Small cap stocks and financials are outperforming, as we predicted. This is all simply indicative of faster growth – not market-implied fears that Trump will bust the budget, ignite inflation with tariffs or corrupt the Fed.

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- A presidential pardon from Biden would only apply to federal matters and would not directly affect the New York case (or the Georgia case). But it would set a tone that the respective prosecutors and judges may well respect – and because both state cases depend on a nexus to federal election matters, the Supreme Court could ultimately rule that the pardon would, in fact, apply.

Of all the various conflicting indicators we reviewed yesterday, four stand out as being most accurate, at least directionally.

- The state-level polls in the seven battleground states, on average, had Trump in the lead. They too underpredicted – showing Trump would win five of them, when it appears he will sweep all seven. But even five would be decisive.
- The prediction markets had Trump with about a 60% probability of winning going into election day.
- Evidence of strong Republican early voting and fewer mail-in ballots pointed correctly to an enthusiasm gap in Trump's favor.
- The granddaddy of all presidential prediction models, that of econometrician Ray Fair, based on economic inputs, predicted Trump would win the popular vote by a margin of 0.53%. The model underpredicted, but was directionally correct in making a very out-of-consensus call.

What about impact on markets and economic policy? With Trump president and the Senate under GOP control, we won't know whether there will be gridlock in Washington until House control is settled. As of this writing, it appears the GOP will hold narrow control, so *we will assume that Trump will have at least two years of one-party rule* – and we will assume that markets are thinking the same thing.

- As the election unfolded last night, and as of this writing the next morning, equities rallied, Treasury yields rose across the board, the yield curve steepened, TIPS inflation breakeven spreads widened, and oil prices fell.
- *All this is consistent with their respective trends over the last month as the Kamala Harris campaign lost momentum. We think the simplest explanation is that markets anticipate an economic environment under Trump of higher growth and reduced regulatory burdens, particularly on energy* (see "Video: What you're not hearing about who the market is voting for, and why" October 30, 2024).
- You are sure to hear today that long-term bond yields are rising because Trump will be worse than Harris would have been on debts and deficits. When Trump was president, he wasn't worse than Biden was, and his silly campaign promises are no more budget-busting than Harris's silly campaign promises. So we see no good reason to impute this conclusion to markets (again, see "Video: What you're not hearing about who the market is voting for, and why"). More likely markets just expect higher economic growth rates, which ought to be logically associated with higher yields.

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- You are sure to hear today that TIPS breakeven spreads are widening because Trump's tariffs will be inflationary. We don't see why tariffs ought to be inflationary, from first principles (see "Trumponomics II, The Sequel" July 17, 2024). Trump's tariffs in 2018 and 2019 do not appear to have been inflationary. And inflation has fallen in 2024 while Biden has added his own tariffs on top of Trump's. With narrow control of the Senate and probably even narrowed control of the House, if any, it's not clear Trump can even deliver on his sweeping tariff promises. So here, too, a simpler and more likely explanation is that markets are looking for higher growth rates under Trump. The causal connection between growth and inflation does not show up in the historical record – the opposite does – but the belief in this nexus at the Fed and among market participants is so deeply embedded, we can believe that's what markets are thinking this morning in the wake of Trump's win.
- And you are sure to hear today – and we predict Fed Chair Jerome Powell will be asked about it in today's FOMC press conference – that Trump will corrupt the Fed with hectoring for lower policy rates. But markets are actually pointing to the opposite – short term rates are rising, as they have been for the last several weeks while Trump's probability of election steadily improved.
- And as of this writing, small cap stocks are strongly outperforming large cap stocks, as we predicted yesterday (see "Our Fearless Forecast"). What better evidence that a Trump victory can ignite animal sprits at the grass roots of the economy – by being an effective cheerleader for entrepreneurship, and cutting regulations to facilitate entrepreneurship.
- And as of this writing Financials are the best-performing S&P 500 sector. As we predicted (again, see "Trumponomics II, The Sequel"), there is great scope for Trump to relax smothering over-regulation of banks that has been in place since the Silicon Valley Bank failure
- We're sure many of our clients are delighted that Trump won, and many will be disappointed and dismayed. But set personal preferences and personalities aside, either way. *In our roles as investors, let's all appreciate that this is a very pro-growth development – and that's the message right now in all the markets*.

Bottom line

Trump won, and the Republicans took Senate control, as we predicted. The election was close, but not razor-close as we had expected and feared. The presidential election is settled, but five Senate races are still possibly subject to dispute. Headline risk still ahead is Trump's New York sentencing on November 26, which could potentially see him jailed. Biden and Trump should reciprocally pardon each other. State-level polls, prediction markets, evidence of strong GOP early voting and the Fair model proved to be the best predictors of the election. Stocks, rates, yields, and TIPS breakevens are higher in the aftermath, and oil prices are lower. Small cap stocks and financials are outperforming, as we predicted. This is all simply indicative of faster growth – not market-implied fears that Trump will bust the budget, ignite inflation with tariffs or corrupt the Fed.