Yardeni Research

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Morning Briefing

Is Trump 2.0 Bullish Or Bearish?

Check out the accompanying chart collection.

Executive Summary: With economic growth robust and the stock market at a record high, we're living the Roaring 2020s now. The economy's resilience has been remarkable considering the headwinds it has faced. While the outlook under Trump 2.0 involves lots of moving parts, we don't see the net effects of his policies jeopardizing the Roaring 2020s' continuation. In this scenario (with our 55% subjective probability), Trump 2.0 might boost productivity and economic growth, keep inflation subdued, shrink the federal government, slow the growth of government spending, and narrow the federal deficit. Among the biggest of the many challenges ahead: not inciting the Bond Vigilantes. … Dr. Ed's movie review: "The Rifleman" (+ +).

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Trump 2.0 I: Lots of Moving Parts. So far, it has been the Roaring 2020s for the US economy and US stock market. Real GDP is at a record high, and so is the S&P 500. That's impressive considering that the global economy was hit by a pandemic at the start of the decade, there was a radical regime change from Trump 1.0 to the Biden administration in 2021, the Fed raised interest rates significantly from March 2022 through August 2024, and there have been two major geopolitical crises that remain unresolved. Oh, yes: There was also that widely anticipated recession that never happened.

The economy has been resilient. Will it remain so during Trump 2.0? That's the #1 question that Eric and I have been fielding ever since Election Day resulted in a Republican sweep.

The naysayers continue to raise doubts about the resilience of the economy. Some of them concede that they were wrong about expecting a recession in response to the tightening of monetary policy over the past three years. However, they blame their error on fiscal policy, which they (now) correctly observe has been very stimulative but doubt it will be for long. (We've identified several additional reasons for the economy's resilience over the past three years.)

Since the start of 2022 through October of this year, total federal government spending is up $192 billion (using the 12-month sum) to $6.9 trillion (*Fig. 1*). Government spending on Health, Medicare, and Social Security rose $623 billion to a record $3.3 trillion over this period. There was a big drop in government spending on income security by $806 billion to $0.7 trillion, but that was almost completely offset by a $139 billion increase in defense spending to a record $0.9 trillion and, even more significantly, by a $510 billion increase in net interest outlays to a record $0.9 trillion (*Fig. 2*).

Focus on those numbers for a minute. The decline in the government's spending on pandemic-related income support after the contagion abated has been largely offset by the government's outlays on net interest as the federal debt and interest rates have soared (*Fig. 3*). Most of those interest payments have boosted personal income. Since January 2022 through September of this year, personal interest income has soared by $432 billion to $1.94 trillion (*Fig. 4*). Over the same period, personal nonmortgage interest payments rose $278 billion to $0.6 trillion.

The bottom line is that federal government spending remains very stimulative, and so do government deficits. Government spending that is deficit financed rather than paid for with tax revenues is more stimulative than spending based on a pay-as-you-go budget rule.

In the past, the ratio of federal government spending to federal budget receipts tended to fall during economic expansions (*Fig. 5*). It tended to rise during recessions and recoveries. This time, the ratio rose from 1.2 during summer 2022 to 1.4 during October of this year even though there was no recession. In other words, fiscal policy, which was usually countercyclical during periods of economic growth, has been procyclical this time, stimulating a growing economy.

Now that President Donald Trump and his Republican Party have won a clean sweep on Election Day, the question is whether fiscal policy will remain stimulative or turn restrictive. Nondiscretionary spending (including net interest outlays) accounts for roughly 85% of total outlays (*Fig. 6*). It will certainly go up, and so will defense spending. The corporate tax rate is likely to be cut, and so are individual income taxes on tips, overtime, and Social Security. All of those tax cuts will widen the federal deficit. It's possible that the Republicans will reduce some of the spending authorized by the so-called Inflation Reduction Act.

Notably, in Trump 2.0, fiscal policy isn't just about government spending and tax revenues.

It is also about revenues raised from higher tariffs, which might increase the risks of a global trade war. It is also about deregulation, which should be stimulative by lowering the costs of doing business. The administration's goal of reducing the size and scope of the federal government will pare the government's headcount, which could weigh on payroll employment. Deportation is another major policy issue that could reduce the labor force with inflationary consequences unless productivity offsets the resulting labor shortage. Last, but not least, is the question of whether Trump's energy policies will boost oil and gas production, thus keeping a lid on their prices.

In other words, there are lots of moving parts in Trump 2.0. On balance, we expect that Trump 2.0 will boost productivity and economic growth, keep inflation subdued, shrink the size of the federal government, slow the growth of government spending, and narrow the federal deficit. On second thought, we don't expect all that will happen, but we do believe it all has a good chance of happening, and we hope it mostly does. There's certainly no shortage of "known unknowns" in the outlook under Trump 2.0. Nevertheless, our base case for the remainder of the decade, with Trump 2.0 running Washington over the next four years, remains the Roaring 2020s.

As we've often observed in the past, we are constantly amazed by how well the US economy has been able to perform despite Washington's meddling.

Trump 2.0 II: Taxes, DOGE, Tariffs, the Fed & Bond Vigilantes. As noted above, there are lots of moving parts to Trump 2.0. Here are some of our more specific observations on this matter:

(1) Under Trump 1.0, the Tax Cut and Jobs Act (TCJA) included a sharp reduction in the corporate tax rate from 35% to 21% (*Fig. 7*). Individual income tax rates were also lowered. Most of the provisions of the act were implemented in 2018. Total federal government receipts were at $3.34 trillion during the 12 months through December 2017 and little changed at $3.33 trillion in 2018 before climbing to $3.50 trillion during 2019 (*Fig. 8*). The decline in corporate tax receipts during this period was more than offset by higher individual and payroll tax receipts.

Under Trump 2.0, most of the provisions of the TCJA, which are set to expire in 2025, are likely to be extended. In addition, the corporate tax rate is expected to be cut to 15%. Taxes on tips, overtime pay, and Social Security might also be cut.

(2) All these measures will bloat the federal deficit and risk inciting the Bond Vigilantes.

Hopefully, Trump's new team of economic advisors will alert the President to this prospect, much as President Bill Clinton's advisors warned him about the need to placate the Bond Vigilantes. Clinton did so. Trump may be signaling that he gets it by appointing cabinet secretaries that are set to cut their departments' budgets and headcounts rather than to bloat them. That could weigh on payroll employment, though federal government payrolls haven't been a source of employment growth, holding steady around 3.0 million employees for many years.

Trump has also created the Department of Government Efficiency (DOGE), headed by Elon Musk and Vivek Ramaswamy. They have been tasked with reducing waste and fraud in the federal government. Previous presidents have attempted to do so without much success. The problem is that about 85% of the federal budget is for mandatory spending including Social Security, Medicare, health care, income security, national defense, and net interest outlays. That leaves about $1 trillion in nondiscretionary government spending. Nevertheless, rooting out waste and fraud in all categories of government spending could produce a significant reduction in overall spending.

(3) Trump also intends to impose a 10%-20% tariff on US imports to raise revenues. Under Trump 1.0, federal government revenues from customs duties doubled from about $40 billion in 2017 to almost $80 billion in 2019 (*Fig. 9*). A 10%-20% tariff on all US imports of goods and services would generate $400 billion to $800 billion in revenues (*Fig. 10*). That's assuming that these higher tariffs don't reduce imports significantly or start a global trade war.

(4) Finally, here's a friendly word of caution to the President: If you beat up on Fed Chair Jerome Powell to lower the federal funds rate, the Bond Vigilantes will only get madder. At his last press conference on November 7, Powell once again stated that "fiscal policy is on an unsustainable path" and "the level of our debt relative to the economy is unsustainable." He indicated that once the new administration provides enough information on fiscal policy, the Fed's staff will "start to model it" and "estimate the likely effects on the economy." It is certainly conceivable that the Fed's economic model will signal that Trump 2.0 is likely to boost economic growth while increasing the risk of higher inflation.

The Bond Vigilantes haven't needed a model to come to the same conclusion. The 10-year Treasury bond yield has soared from 3.62% on September 18 to 4.41% on Friday. Of that 79bps increase, the TIPS yield rose 49bps and the inflation premium rose 30bps (*Fig. 11* and *Fig. 12*).

Trump now needs to win over the Bond Vigilantes to make Trump 2.0 a success. He has proudly observed that the stock has been rising since he won the election on November 5 (*Fig. 13*). He should also watch the bond yield, which could impact the stock market's valuation multiple. When he won his first term on November 8, 2016, the forward P/E of the S&P 500 was 16.0 (*Fig. 14*). Last week, it was 21.9. He should know that there is more downside than upside in the P/E over the next four years unless his policies win over the Bond Vigilantes.

Movie. "The Last Rifleman" (+ +) (*link*) is a heartwarming true story about an Irish soldier who survived the Normandy invasion. Pierce Brosnan ably plays Artie Crawford, the World War II vet who lives in a nursing home in Northern Ireland. After his wife passes away, he sets off by himself to France to attend the 75th anniversary of the D-Day landing. Along the way, he finds some peace of mind as he comes to terms with his traumatic experience.

Calendars

US: Mon: Dallas Fed Manufacturing Index; Chicago Fed National Activity Index. **Tues:** Consumer Confidence 112.0; New Home Sales 730,000 units; Richmond Fed Manufacturing Index; FOMC Minutes; API Crude Oil Inventories. (FXStreet estimates)

Global: Mon: Germany Ifo Business Climate Index, Current Assessment, and Expectations 86.0/85.5/87.3; Japan Leading Indicators 109.4; Nagel; Lane; Dhingra. **Tues:** Japan Core CPI 1.8%y/y; McCaul; Pill. (FXStreet estimates)

Strategy Indicators

Global Stock Markets (US$ Performance) (*link*): The US MSCI index rose 1.9% w/w to 0.4% below its record high on November 11. The AC World ex-US index rose 0.3% w/w and is now 8.4% below its June 15, 2021 record high after being just 0.7% below at the end of September. EMEA was the best performing region last week, with a gain of 0.6%, and the only region to outperform the AC World ex-US. EMU was the worst regional performer, with a drop of 1.1%, followed by Europe (-0.1%), EAFE (0.0), EM Asia (0.1), EM (0.2), and EM Latin America (0.3). Nine of the 18 major selected country markets that we follow rose last week. The Korea MSCI performed the best, with a gain of 3.4%, followed by South Africa (2.9), Canada (2.8), and the United States (1.9). China was the worst performer, falling

1.8%, followed by Spain (-1.4), France (-1.4), and Hong Kong (-1.3). The US MSCI's 25.5% ytd gain remains well ahead of the AC World ex-US index's (4.1). EM Asia is still ahead of the pack as the leading region ytd with a gain of 10.4%, followed by EM (6.2) and the AC World ex-US. The worst performing regions so far in 2024: EM Latin America (-21.8), EMU (-0.9), Europe (-0.1), EAFE (1.7), and EMEA (1.8). Looking at the major selected country markets that we follow, Taiwan is the best ytd performer with a gain of 30.6%, followed by the United States (25.5), Canada (15.5), India (12.7), and China (12.5). The worst performing countries ytd: Mexico (-27.0), Brazil (-22.8), Korea (-16.5), France (-8.5), and Hong Kong (-5.0).

US Stock Indexes (*link*): All 48 major US stock indexes that we follow rose w/w, up from just two a week earlier. The Russell 2000 Growth index was the best performer, with a gain of 5.5%, ahead of S&P 400 MidCap Pure Growth (5.3%), Russell MidCap Growth (5.1), S&P 400 MidCap Growth (4.6), and Russell 2000 (4.5). The Dow Jones 20 Transports index was the worst performer, albeit with a gain of 0.8%, followed by S&P 500 Transports (0.9), S&P 100 MegaCap (1.2), S&P 500 Growth (1.4), and S&P Industrials (1.6). Looking at their ytd performances, all 48 indexes are now positive so far. The S&P 500 LargeCap Pure Growth index is now in the top spot as the best performer so far in 2024, with a gain of 33.0%, ahead of S&P 500 LargeCap Growth (32.6), Russell 1000 Growth (30.0), Russell 3000 Growth (29.7), and Russell MidCap Growth (28.6). The worst performing major US stock indexes ytd: S&P 500 Transportation (8.2), S&P 600 SmallCap Pure Value (8.4), Dow Jones 20 Transports (9.2), S&P 400 MidCap Pure Value (10.5), S&P 600 SmallCap Value (11.7), and S&P 600 SmallCap Equal Weighted (11.7).

S&P 500 Sectors Performance (*link*): All 11 S&P 500 sectors rose last week, and seven were ahead of the S&P 500's 1.7% gain. That compares to two sectors rising a week earlier when five were ahead of the composite index's 1.3% decline. The outperformers last week: Utilities (3.1%), Materials (2.4), Energy (2.3), Consumer Staples (2.1), Information Technology (1.8), Real Estate (1.8), and Financials (1.7). The underperformers last week: Consumer Discretionary (0.4), Communication Services (0.4), Industrials (1.1), and Health Care (1.5). The S&P 500 is up 25.1% ytd, with all 11 sectors in positive territory and four sectors ahead of the index. During the September 6 week, a ytd high of five sectors were ahead of the index for the first time since mid-May. Financials wears the crown as the best ytd performer, with a gain of 34.5%, ahead of Information Technology (34.1), Communication Services (32.6), and Utilities (28.8). These sectors are lagging the S&P 500 so far in 2024: Health Care (5.5), Materials (8.9), Real Estate (8.9), Consumer Staples (15.3), Energy (15.4), Consumer Discretionary (21.9), and Industrials (23.1).

US Economic Indicators

Leading Indicators (*link*): The Index of Leading Economic Indicators (LEI) fell again in October, sinking for the eighth straight month, by 0.4% in October and 3.0% over period. The LEI has plunged 16.1% from December 2021's record high, falling to its lowest level since March 2016. Over the six-month period between April and October 2024, the LEI fell 2.2%, slightly more than the 2.0% drop over the six-month period between October 2023 and April 2024. The Conference Board notes that the two largest negative contributions to the October's LEI came from manufacturers' new orders, which remained weak in 11 out of 14 industries, while manufacturing hours worked posted its largest decline since December 2023. Of the 10 components of the LEI, six contributed negatively, while three contributed positively, with nondefense capital goods orders ex aircraft unchanged. New orders (-0.18 ppts) was once again the largest drag on the LEI, followed by average weekly hours (-0.12), the interest rate spread (-0.09), initial claims (-0.03), consumer expectations (-0.02), and building permits (-0.02). Partially offsetting these declines were stock prices (+0.12), the leading credit index (+0.05), and consumer goods orders (+0.01).

Coincident Indicators (*link*): The Coincident Economic Indicators (CEI) index was unchanged at a record high for the second month in October. The CEI expanded 0.8% during the six-month period ended October 2024, above its 0.5% growth rate over the previous six-month period. Two of the four components of October's CEI—personal income less transfer payments and manufacturing & trade sales—once again contributed positively to October's CEI but were offset by the second successive decline in industrial production; payroll employment was virtually unchanged.

Consumer Sentiment Index (*link*): Consumer sentiment is showing some signs of life, moving higher for the fourth straight month. Post-election interviews were 1.3 points below the pre-election reading, moderating from the mid-month reading. *Consumer sentiment* climbed from 66.4 in July to a seven-month high of 71.8 in November—softer than the preliminary reading of 73.0. Sentiment is now 43.6% above June 2022's trough. *Current conditions* fell to 63.9 in November, after rising from 61.3 in August to 64.9 in October, while *expectations* climbed to 76.9—the highest since March. Consumers' perception of their expected financial situation rose to a seven-month high in November. *Turning to inflation*, *year-ahead* inflation expectations eased to 2.6% in November—the lowest since December 2020—and sits within the 2.3%-3.0% range seen in the two years prior to the pandemic. Expectations for inflation over the *next five years* increased from 3.0% to 3.2% this month—the highest since last November. *Turning to politics*, the report notes, sentiment among

Republicans surged, posting its highest reading since 2021, while sentiment among *Democrats* sank to more than a one-year low. Confidence among *Independents* eased. “Ultimately, substantial uncertainty remains over the future implementation of Trump’s agenda, and consumers will continue to re-calibrate their views in the months ahead,” according to the report.

Existing Home Sales (*link*): “The worst of the downturn in home sales could be over, with increasing inventory leading to more transactions. Additional job gains and continued economic growth appear assured, resulting in growing housing demand,” according to Lawrence Yun, chief economist of NAR. Existing home sales jumped 3.4% during October to 3.96mu from 3.83mu in September, which was the lowest since October 2010. Meanwhile, sales were up 2.8% y/y—the first annual increase since July 2021. *Single-family* sales jumped 3.5% during October to 3.58mu and were 4.1% higher than a year ago, while existing condominium and co-op sales rose 2.7% to 380,000 units, though were 7.3% below a year ago. *Regionally*, existing home sales, both on a monthly and yearly basis, rose in three of the four regions, with the Midwest posting the largest monthly gain and West the largest yearly gain: Midwest (6.7% m/m & 1.1% y/y), West (+1.3 & +8.5), South (2.9 & 2.3), and Northeast (2.2 & 0.0). October’s increase in existing home sales was boosted by more inventory of existing homes on the market, with unsold inventory climbing to 1.37mu last month—19.1% above a year ago. Unsold inventory was at a 4.2 months’ supply in October at the current sales pace, down from 4.3 months September but above last October’s 3.6 months.

Global Economic Indicators

US PMI Flash Estimates (*link*): “Output growth accelerates as business mood brightens and inflation cools” was the headline of the November report. Business activity in the US remained robust this month, with the *C-PMI* (to 55.3 from 54.1) jumping to a 31-month high, once again led by the service sector. November’s *NM-PMI* (57.0 from 55.0) showed service activity at a 32-month high, while the *M-PMI* (48.8 from 48.5) showed manufacturing activity continued to contract, though at a slightly slower pace, moving closer to the breakeven point of 50.0. Meanwhile, the M-PMI Output Index (46.3 from 49.2) is in a tailspin, sinking to its lowest reading since December 2022. The promise of greater protectionism and tariffs has boosted confidence in the goods producing sector, which is already favorably impacting higher factory employment, according to the report. The rise in the headline flash PMI indicates that economic growth is accelerating in the fourth quarter. *Turning to prices*, the November price gauge covering goods and services showed only a marginal increase in prices this month, “pointing to consumer inflation running well below the Fed’s 2% target,” according to the report.

Eurozone PMI Flash Estimates (*link*): Business activity in the Eurozone moved back into contractionary in November, on widespread weakness. The *Eurozone’s C-PMI* (to 48.1 from 50.0) shows business activity in the Eurozone moved back into contraction this month, for the second time in three months, sinking to a 10-month low. The service sector joined the manufacturing sector in negative territory. The NM-PMI (49.2 from 51.6) dropped below the breakeven point of 50.0 in November for the first time since the start of this year, sinking to a 10-month low, while the M-PMI (45.2 from 46.0) fell to a two-month low, remaining below 50.0 for the 29th successive month. The two largest Eurozone economies were the main source of weakness once again. *Germany’s* C-PMI (to 47.3 from 48.6) continued to contract, falling to a nine-month low in November, with the NM-PMI (49.4 from 51.6) falling into contractionary territory for the first time in nine months, while the M-PMI (43.2 from 43.0) remains deep in negative territory, though did tick up to a four-month high. Meanwhile, *France* continued to contract on widespread weakness, with the C-PMI (to 44.8 from 48.1) the NM-PMI (45.7 from 49.2), and M-PMI (43.2 from 44.5) all falling to 10-month lows. *Growth in the rest of the region* saw business activity continue to increase, though the rate of growth was small and the slowest in 11 months. Turning to pricing, *input prices* in the overall Eurozone increased at the fastest pace in three months in November but slower than the average over 2024 so far. *Output prices* also rose at a faster rate than last month, though also were softer than the average over the past 11 months.

Japan PMI Flash Estimates (*link*): Private-sector activity in Japan contracted for the second consecutive month in November. The *C-PMI* (to 49.8 from 49.6) contracted, but barely, this month, with the index remaining just below the breakeven point of 50.0. The NM-PMI (50.2 from 49.7) saw a modest renewal in growth this month, ticking just above 50.0, while the M-PMI (49.0 from 49.4) was in contractionary territory for the fifth successive month. Within the manufacturing sector, both output and new orders fell, with the former the weakest since April. Meanwhile, employment levels fell for the first time since February. *Turning to prices*, the report notes that *input* inflation remained high, though eased to a seven-month low, while the rate of *output* prices was the strongest since July.

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