POLICY AND POLITICS:
PLAYING THE TRUMP CARD

The Republican clean sweep in Washington has set the stage for what many are calling "Trumponomics 2.0." With the deck now stacked in their favor, we're being dealt a new hand of economic policy as focus shifts from the drama of the election's outcome to its impacts. While the timing and scope remain up in the air, we expect a wave of policy moves including potential tax cuts, deregulation, tariffs, and revisions to immigration to ripple through various markets and sectors in 2025.

Markets wasted no time reacting to a decisive Trump victory. The post-election rally reflected not just optimism but, more importantly, clarity. Small caps and financials surged, benefiting from the prospect of industry deregulation and a stronger pro-U.S. growth stance. Fixed Income, on the other hand, took a hit with yields climbing on potential tariff policy and increased projections for fiscal deficits. Although policy posturing garners headlines, action and fundamentals will have the final say in 2025 and beyond.

Additionally, there is no clear correlation between which side of the aisle wins the White House and market outperformance as in either case the market typically responds with gains. This year, uncertainty around what policy shifts will be enacted and when they will come to fruition will generate fatter tails on both sides of the return distribution – suggesting a higher probability of extreme outcomes.

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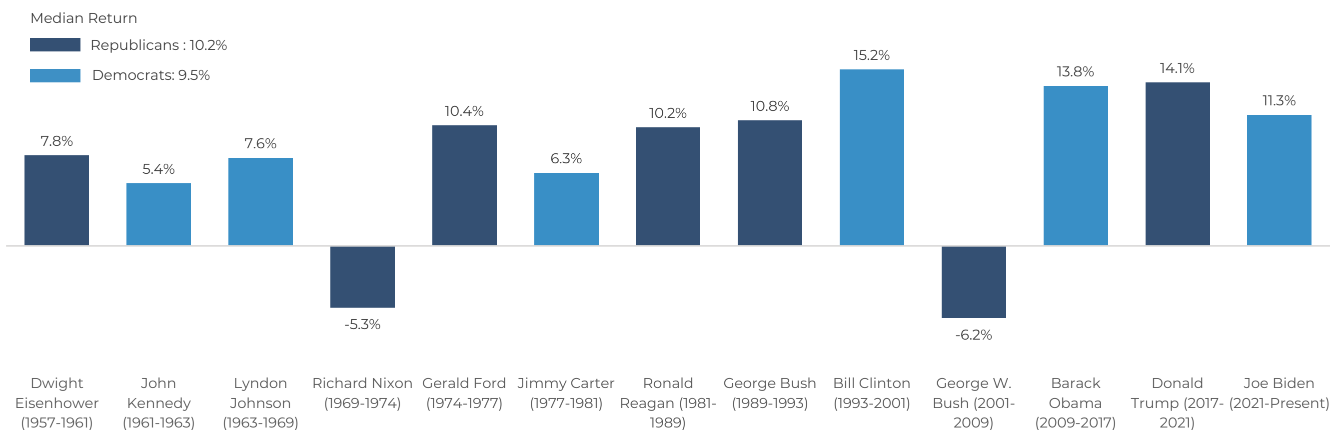
S&P Performance by President: Compound Annual Growth Rate



Source: The White House Historical Association, YCharts, Bloomberg, Waterloo Capital. Inuaguration was used as the start and end date for full terms. Data as of 12/31/2024

Trump's plan to stimulate economic growth once inaugurated includes tax cuts, expanded deregulation, a pro-U.S. focus, and improving government efficiency.

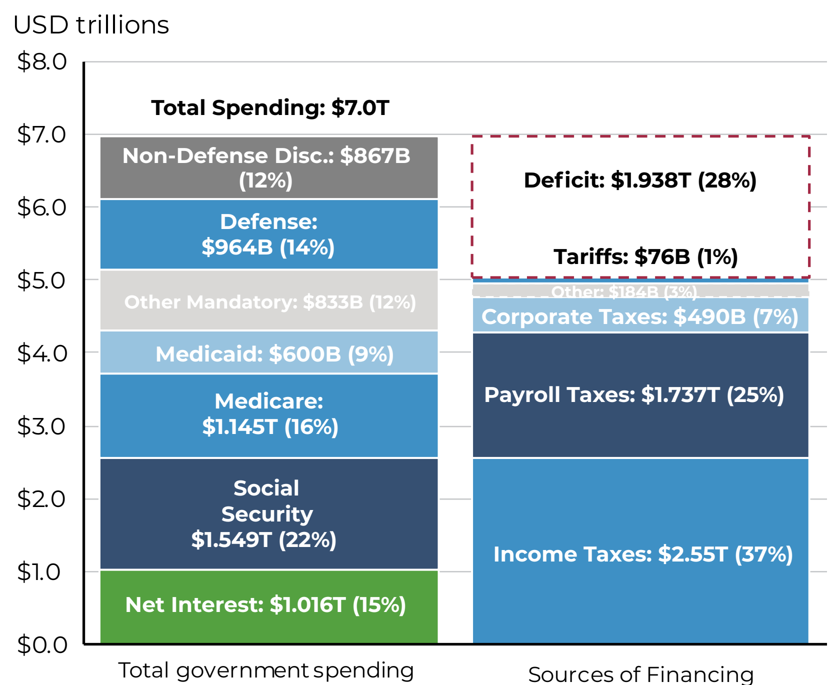
The Tax Cuts and Jobs Act (TCJA), passed by a Republican-majority Congress in 2017, marked the largest tax code overhaul in decades, but is set to fully expire at the end of 2025. If the TCJA provisions end, Brookings estimates a 1.8% reduction in after-tax income for the average taxpayer, with the top 1% of earners shouldering a 3% cut. On the other hand, the Congressional Budget Office projects that expiration could raise government revenues by $4.6 trillion over the next decade, approximately 1.3% of projected GDP, creating a large inflow for federal coffers. We believe that with both chambers of Congress under Republican control, an extension of most TCJA provisions appears likely towards the end of 2025, even with tight margins. However, certain measures, such as the SALT deduction cap and the reduced corporate tax rate are expected to face significant resistance. The full effects of these tax changes won't be felt until 2026, but if Republicans succeed in securing an extension, we can anticipate another shot in the arm for the American consumer which has consistently driven economic growth and resilience the last few years.

Trump's return to the White House leads us to believe that his administration will revert to the pro-growth, deregulatory agenda that characterized its first term. During that period, eased regulations for banking, fintech, and startups created a more favorable business environment. Such policies, if reprioritized, could benefit sectors like Financials the most. Deregulation's ripple effects will likely spark a resurgence in mergers and acquisitions (M&A) activity, potentially benefiting larger companies searching for targets. The crypto space could also be a benefactor as Trump plans to ramp up investments into digital assets and appointed David Sacks as his "Crypto Czar", seen by many as a bullish sign for the asset class. While deregulation is a powerful catalyst for market opportunities, it isn't a one-size-fits-all solution as the effects will vary significantly across industries and companies.

In an exciting move aimed at addressing the ballooning federal deficit, the Trump administration has introduced an innovative initiative: the Department of Government Efficiency (DOGE). While not a formal federal department, DOGE represents a bold attempt to streamline government spending and cut waste, with the ambitious target of slashing $2 trillion in federal expenditures. At the helm are business giants Elon Musk and Vivek Ramaswamy. The concept behind DOGE is straightforward - create a leaner, more efficient government. Yet, we believe executing this vision will be anything but simple. Unlike traditional government agencies, DOGE will operate independently, acting as a temporary advisory body and disbanding by Summer 2026. Its recommendations will be just that: advice. The real power to implement spending cuts lies with Congress, which must navigate political realities and constitutional constraints.

The biggest challenge?

Tackling the nation's most significant and politically protected programs. These regarded "untouchable" programs make up over 60% of spending. Additionally, interest payments on our nation's debt account for another 15%. Achieving meaningful deficit reduction to the tune of their $2 trillion target without addressing these systems would require austerity measures on a scale not seen since the post-World War II era.



Source: J.P. Morgan Guide to the Markets

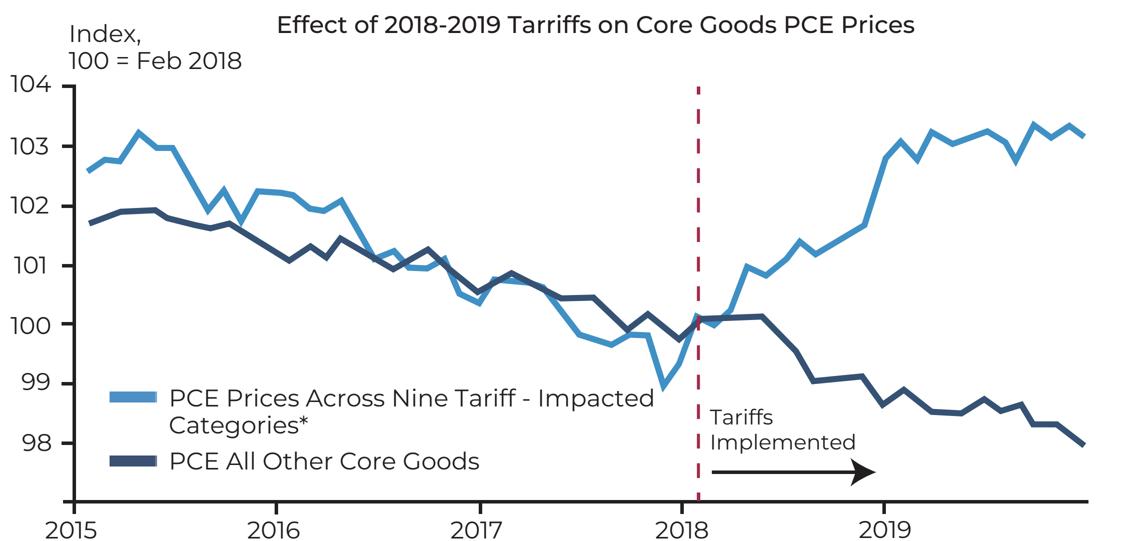
Historically, efforts to reduce government waste have had mixed results, and DOGE's success hinges on more than ambition. Early discussions have floated potential workarounds to bypass Congressional roadblocks, but these remain

speculative and vulnerable to legal challenge. For now, the initiative has sparked a necessary conversation about shining a light on inefficiencies and fiscal discipline, even if the path to tangible results appears unclear.

The Trump administration's proposed policy measures, unfortunately, can have large trade-offs, hence our positioning that 2025 will be the year of fatter tails. They will have a hard time striking a delicate balance as the growth initiatives could have tangible economic consequences.

At the center of this uncertainty is one of the most impactful and divisive policy areas: tariffs. Shortly after the election, Trump announced plans to impose a 25% tariff on all imports from Mexico and Canada, along with an additional 10% tariff on goods from China. This is the Trump Administration’s pitch to ensure an “America First” agenda, theoretically increasing US based firms’ share of the domestic marketplace. But the ripple effects are hard to ignore. For many domestic producers, imports are vital as manufacturing inputs. Slapping higher tariffs on these goods raises production costs, which often trickle down to consumers in the form of higher prices. If history is any guide, the lessons of the 2018 trade war under "Trumponomics 1.0" suggest that such tariffs could quickly put upward pressure on inflation in certain categories, eroding purchasing power and complicating growth prospects.

Tariffs Boosted Consumer Prices During the Last Trade War



*Includes laundry equip. & other appliances, furniture, bedding & floor coverings, autoparts, motorcycles & sport vehicles, housekeeping supplies, sewing equipment, and materials. Items are weighted by relative importance to headline index.

Source: Haver Analytics, Goldman Sachs Global Investment Research

Retaliation from key trade partners could deepen tensions, creating a substantial drag on global trade and growth. For now, and into the first half of the new year, we see many of these tariff threats, as real as they are, as more posturing than policy. A calculated negotiating tactic with limited immediate bite. If the administration refrains from escalating these measures into a full-blown trade war, the pro-growth effects of other Trump policies, such as deregulation and tax incentives, could outweigh the negatives of tariffs. Still, the stakes are high, and this downside risk is being underpriced by markets. Investors should prepare for volatility, as the tug-of-war between policy intentions and their potential consequences plays out.

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Adding to the uncertainty are talks of immigration reform. The president-elect has said he will declare illegal immigration a national emergency. He has also vowed to end birthright citizenship, which will likely face legal challenges. His new choice for border Czar, Tom Homan, has said that Congress should provide major funding increases for immigration enforcement.

These developments leave many questions unanswered:

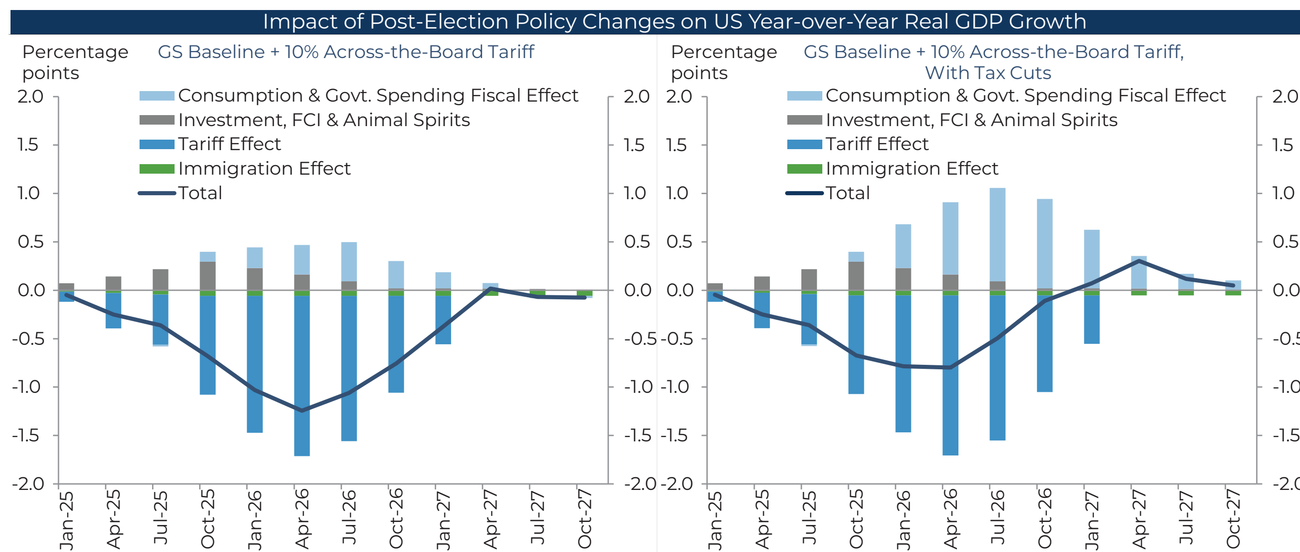
How extensive will these policies be?

Who will they affect?

And most importantly, what will be the economic ramifications?

Undocumented immigrants play a large role in the U.S. economy, with Pew Research recently estimated 8.3 million undocumented workers in the labor force, accounting for 4.8% of all U.S. workers. A sharp reduction in the workforce would likely disrupt labor markets, slow GDP growth, and create inflationary pressures. Additionally, the potential lost tax revenues would deepen fiscal deficits, compounding challenges for government budgets. The scale and specifics of the policies remain extremely foggy, yet it is reasonable to assume that if the Trump administration implements a sweeping and indiscriminate approach, it will undeniably reshape the economy.

Tariffs Outside of Baseline Could Cause a Growth Shock



Source: Goldman Sachs Global Investment Research

As we look ahead to 2025, the new administration may be met with initial optimism and animal spirits, but it's important to keep an eye on the bigger picture. Markets will likely be in for a ride on the volatility rollercoaster as each policy decision, from tax cuts to tariffs to immigration, sparks debate and ripples through the economy. While some measures may deliver short-term wins, they come with significant trade-offs: rising deficits, inflationary pressures, and potential slowdowns in growth. It's important to recognize that these outcomes are a mixed bag for GDP growth as some policies may be stimulative, while others could prove restrictive. However, the common thread is the upward pressure they place on inflation.

Given this dynamic, we believe rates are likely to stay elevated for longer as this brings about a new risk to Federal Reserve policy, potentially handcuffing them in their fight against inflation.

Beyond the shiny promises of new policies also lies a structural problem that has outlasted any single administration since the turn of the century: an addiction to debt-fueled spending. This is a bipartisan reality. For years, both sides of the aisle have contributed to ballooning deficits, kicking the can down the road and increasing long term risks we can't afford to ignore. This problem will continue to undermine fiscal sustainability, putting additional upward pressure on interest rates as borrowing costs increase. The slow burning, but critical issue, should stay in the back of investors' minds in 2025 and beyond as it will define the years to come.

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