ISSUE 41 — THIRD QUARTER 2024

INVESTMENT INSIGHTS

A NEW GOVERNMENT WITH THE SAME FISCAL CHALLENGES

Labour has promised "no austerity" but needs to find a way to balance taxes and spending as it looks to make a difference after 14 years out of office

A watershed moment
Interest rates are set to fall at last now inflation has eased

Looking up
Political stability is good news for the UK stock market

Fresh or stale?
Labour's climate policy has implications for investors

An unpredictable election
Prepare for the unexpected when America votes

RATHBONES

10

FOREWORD

Welcome to the latest edition of *Investment Insights*, which comes in the middle of a significant year for elections around the world. As we head into the second half, we explore what could be on the horizon for the UK's new Labour government – and look ahead to a very unpredictable US Presidential election in November.

While *Insights* is usually more reflective of our global investment approach, we've made an exception in this special election edition to focus on the first Labour government in 14 years. Our lead article on page 4 looks at the fiscal challenges awaiting its Chancellor, Rachel Reeves. Her party's manifesto pledged "no return to austerity", yet she is inheriting plans containing significant spending cuts, and her room for manoeuvre is limited.

Our next article on page 6 tackles interest rates and how they could be set to fall now that inflation has eased. The recent period of high inflation and rising rates has been a key factor in this year's elections around the world. Incumbent parties have seen support dwindle as households have struggled with the higher cost of living. What's next and are we out of the woods?

On page 8, we look at why political stability could be good news for the UK stock market. Whatever your political persuasion, it's difficult to deny the UK has endured a turbulent period since its departure from the EU became a realistic prospect. In just nine years between the general elections in 2015 and 2024, there have been five Prime Ministers and seven Chancellors. What does a new Labour government mean for financial markets?

In our next article on page 10, we explore the implications of Labour's climate policy. What can we expect from the new government when it comes to green investment – and what does this mean for investors?

The US Presidential election in November is unpredictable, which we examine on page 12. How do the candidates and their parties compare where policies like corporate tax and trade are concerned? We explain why there are big differences between the Republicans and Democrats in key policy areas.

We hope you enjoy this issue and look forward to updating you in the coming months. We always welcome your questions about what's happening in the world today and how it affects your investments. If you'd like to find out more, please visit rathbones.com or contact your investment manager.

Liz Savage and Ed Smith
Co-chief investment officers

A NEW PARTY WITH THE SAME FISCAL CHALLENGES

As Rachel Reeves moves into Number 11 Downing Street, she faces a fiscal conundrum. Her party's manifesto pledged "no return to austerity", yet she is inheriting plans containing significant spending cuts, and her room for manoeuvre is limited. She's pledged not to increase the four taxes that raise most revenue, and to retain fiscal rules that limit her scope to borrow. Squaring this circle won't be easy. However, the situation is better than the gloomier prognoses suggest, and we're still happy holding UK government bonds.

How did we get here?

A little history helps to explain Rachel Reeves' bind. Since the late 1990s, the UK government has set itself fiscal rules designed to keep borrowing within sensible limits. The precise form of these rules has changed many times, as they have been overtaken by events. But this time, the Starmer administration has pledged to retain the same key rule (the 'fiscal mandate') as its predecessor. This rule states that public debt must be projected (in the Office for Budget Responsibility (OBR) official forecasts) to fall relative to the size of the economy in five years. The spectre of the market turmoil that followed former Prime Minister Liz Truss' ill-fated 'mini budget' has quelled any appetite for big changes to this framework any time soon.

Fiscal rules are great in theory, especially with memories of Liz Truss's 'mini budget' still fresh. However, in practice, they sometimes have significant unintended consequences. The debt rule has been no exception, which requires debt to be projected to fall relative to the size of the economy only in the fifth year of the forecast (and not over the period as a whole). This meant Rachel Reeves' predecessor Jeremy Hunt could offer tax cuts ahead of the vote, while meeting the rule by pencilling in spending restraint after the election. This respected the letter of the law, but not the spirit of it, kicking the can down the road for the next government.

Adjusted for inflation, the plans that Labour is inheriting leave spending per person on public services unchanged over the next five years. Since spending on the NHS is highly likely to rise by much more than inflation, that implies sharp inflation-adjusted cuts elsewhere. Areas like justice and local government, which are already under severe strain, in principal face reductions of more than 2% a year. That's before factoring in the desire to raise defence spending to 2.5% of GDP.

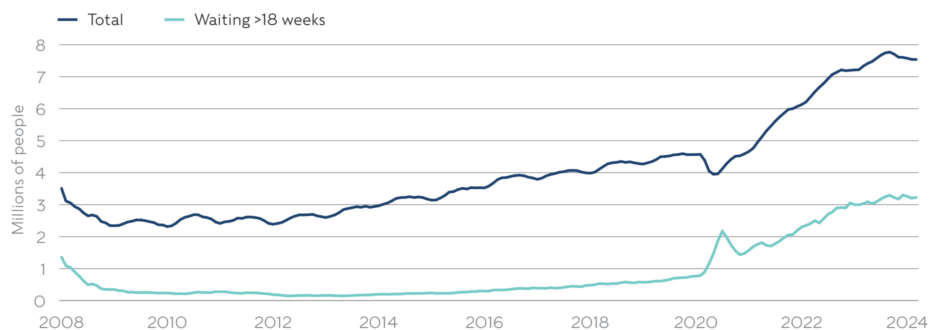
The Institute for Fiscal Studies describes these plans (inherited from the previous government) as "fiscal fiction" and argues they are not possible "while maintaining the current range and quality of public services". The new government will be unable (even with a large majority) and unwilling to push through what would be austerity 2.0. Doing so would do more harm than good, given signs that public services are still reeling from the impact of the pandemic on top of the original austerity programme. Hospital waiting times are far longer today than in the early 2010s (figure 1). Local government funding remains much lower now than in 2010 (after adjusting for inflation), contributing to problems including the growing number of car accidents caused by potholes. The justice system is under pressure too, with the backlog of Crown Court cases the longest on record.

Potential solutions

Therefore, Rachel Reeves needs to find a way to increase planned spending (figure 2). In doing so, she faces several constraints. Labour has consistently emphasised its commitment to fiscal rules and included them explicitly in its manifesto. This limits her ability to borrow to fund more spending. The party also promised in its manifesto not to raise the rates of income tax, national insurance, VAT and corporation tax – which together account for two-thirds of all government revenue.

The Chancellor hopes that stronger economic growth will lend her a hand. If the economy performs better than the OBR's projections, all the trade-offs she faces become much easier. Economic expansion lifts revenues without the need to raise tax rates. With that in mind, Labour aims to support growth in three ways. First, by delivering the stability and predictability in policymaking which has been missing since the fallout of the 2016 EU referendum. Second, by directing more pension fund capital into UK companies. Third, by reform, especially of the planning system.

Figure 1: Hanging around
NHS waiting lists haven't fallen much recently despite government pledges.
Source: NHS and Rathbones



The value of investments and the income generated by them can go down as well as up.

These goals are sensible enough. Investment in the UK has been held back by the post-2016 turmoil in domestic politics and in relations with our biggest trading partner. Pension funds invest much less than they could in UK firms, and the UK's unusual planning system is clearly a barrier to growth. If delivered, these changes may indeed help increase the long-term rate of growth in the UK economy. Yet there are serious limits to this strategy when it comes to resolving the current fiscal bind.

One problem is that, even if all these proposals are enacted, any impact on growth may not be evident for years. In the coming quarters, blind luck will play a bigger role. As an open economy, the UK is highly exposed to global developments which are entirely out of the government's hands. Whether the nascent economic recovery in the euro area flourishes or falters, for example, will probably make more difference in the short term than any of the domestic reforms floated. A prudent working assumption is that there will be no surprise boost to growth in the next year or so, meaning the government will have to resort to a combination of other strategies.

One such strategy is to increase taxes not explicitly frozen in the manifesto. Capital gains tax and council tax are possible targets. They're the biggest 'unfrozen' revenue raisers. While Labour officials may have said that they have no plans to change them, that can change.

A more left field idea (with advocates all the way from the *Financial Times* to Nigel Farage) is to change the way the Bank of England pays interest on reserves to commercial banks, reducing the amount it pays out. This would be a de facto tax on banks. Rachel Reeves has sounded lukewarm when asked about this option, and Bank of England Governor Bailey wasn't enthusiastic either. But again, it can't be ruled out entirely given the circumstances.

Another likely strategy is to test the flexibility of the fiscal rules. Ignoring them entirely, à la Kwasi Kwarteng, would be foolish and is not on the table. But many other Chancellors have found ways to bend the rules to suit their objectives. Like Jeremy Hunt, Rachel Reeves could maintain as little 'headroom' against the rules as possible. Like Gordon Brown, she could use partnerships with the private sector to exempt some investment from the public borrowing statistics. A further option this time around is to make a technical change to the way the Bank of England's large holdings of government debt are treated in the fiscal rules. The independent Resolution Foundation estimates that this would allow the Chancellor an additional £16bn of space against the debt rule – a significant difference.

Will markets care?

Treating the fiscal rules in this way may sound too clever by half. But experience suggests that markets will be forgiving. The rules are now in their tenth iteration since 1997, so alterations of this kind are the norm, not an aberration. There's a category difference between pushing the flexibility of the rules versus ignoring them entirely as Truss and Kwarteng did.

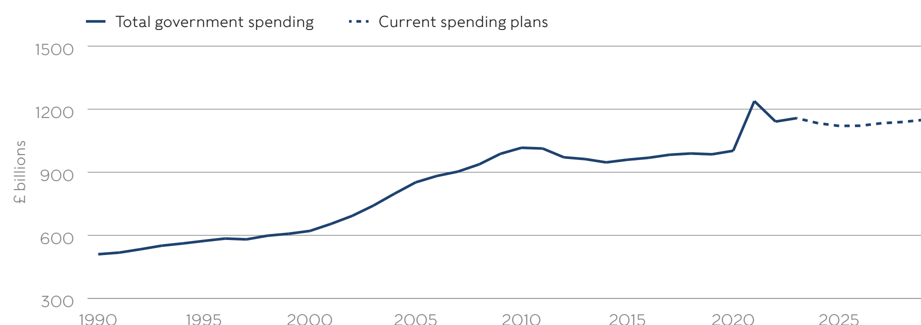
Markets are also likely to judge any extra borrowing based on its purpose. Borrowing to invest in the public services which underpin the economy is likely to be far more palatable than Truss-style unfunded tax cuts that today's economic literature suggests were unlikely to boost growth. Numerous studies of the UK and its peers have found that slashing public services proved to be a false economy in the 2010s, failing to prevent debt from rising. By hurting investment and growth, it ultimately weakened the government's ability to meet its financial obligations. Avoiding a re-run would be a good thing.

With all of that in mind, we remain comfortable holding UK government bonds in portfolios. Yes, the spending restraint currently pencilled in almost certainly won't happen, and the Chancellor may find ways within the rules to borrow more than current plans imply. However, investors have long been aware of the "fiscal fiction" in these plans and are likely to tolerate some deviation from them. The global backdrop is also becoming more favourable for government bonds generally, with inflation back under control and interest rates starting to fall, which we explore in more detail in the next article on page 6.

Figure 2: Total government spending

Labour is inheriting a spending plan that leaves little room for manoeuvre due to existing fiscal rules about how much debt is acceptable.

Source: OBR, LSEG and Rathbones



The value of investments and the income generated by them can go down as well as up.

INTEREST RATES ARE SET TO FALL AT LAST NOW INFLATION HAS EASED

The recent period of high inflation and rising interest rates has been a key issue in this year's elections around the world. Incumbent parties have seen support dwindle as households have struggled with the higher cost of living. National leaders may be taking the blame, but elevated inflation and relatively high interest rates have been an international phenomenon, driven mostly by large shocks to the global economy. With these pressures now fading, the victors in this year's elections are on course to inherit a more favourable outlook.

Inflation has fallen back a long way in the UK, US and euro area, leaving it not far above the 2% rate that most central banks target (figure 3.) Energy prices were the first to fall, putting downward pressure on inflation. They have been followed by the cost of food and other consumer goods. Where they haven't fallen, the pace of price rises for these items has at least slowed to a crawl. That's largely because price hikes caused by the war in Ukraine and post-pandemic supply disruptions have dropped out of the annual comparisons used to calculate inflation.

Inflation risks remain

We aren't completely out of the woods — services prices are still rising much faster than they were before the pandemic, which is a worry for central banks. However, the employment market suggests services inflation should continue to ease. Wages are a major cost for firms in the services sector, and they have been rising at a slower pace in recent months. Indicators that give us a steer on how wage growth might evolve, such as the number of vacancies or salaries advertised on job boards, suggest pay growth will continue to ease. Firms are saying they expect this to happen too.

In some countries, the situation has allowed central banks to start cutting interest rates. In Switzerland, Sweden, Canada and the euro area, policymakers have been comfortable enough that inflation is returning to target to do so. They have suggested they will proceed with caution, but this marks a watershed moment after the most aggressive rate hikes in decades. The Bank of England and US Federal Reserve may need a bit more convincing, but we think they will begin to cut rates later this year.

Markets share that view, but they expect both central banks to tread carefully. At the time of writing, they are only anticipating around two 0.25 percentage point cuts by December, and just three or four more over the whole of 2025. That's a far cry from the start of this year when investors were expecting six or seven quarter-point cuts in 2024 alone.

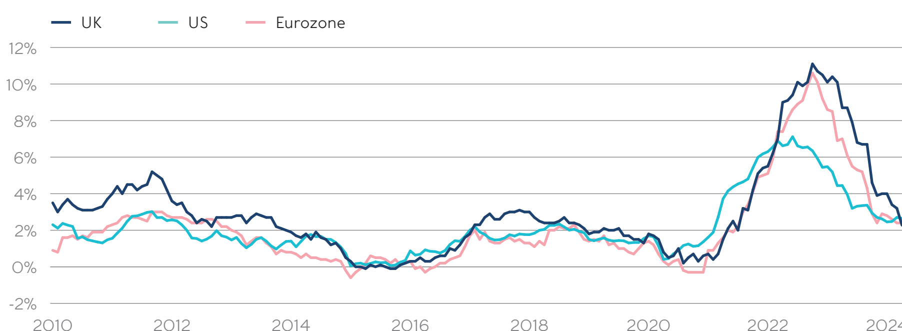
Too far, too quickly

To an extent, that paring back of expectations for cuts is justified. Inflation has so far proven a bit more persistent than most were expecting at the turn of the year. However, there's a chance that markets have now moved too far, partly because services inflation seems well-placed to fall further over the second half of the year. At the same time, the US economy appears to be slowing, while the UK economy is still fragile. This all suggests there is a material risk that central banks could cut interest rates faster than markets expect.

As a result, we think allocating to government bonds is appealing. If the global economy holds up, interest rates will probably still fall a little, in line with market expectations, given the progress on inflation. The higher yields now available from bonds suggest they'll still deliver moderate returns in these circumstances. Alternatively, if the global economy takes a turn for the worse, interest rates are likely to fall by more. That should mean stronger returns from government bonds, which would also help offset any accompanying weakness in stock markets.

> **Inflation has so far proven a bit more persistent than most were expecting at the turn of the year**

Figure 3: Fading away
Headline inflation rates in most major regions and now at or nearly at the 2% targets most central banks prefer.
Source: LSEG and Rathbones
* Inflation measures are those targeted by central banks: US is PCE, UK is CPI and the euro area is HICP.



The value of investments and the income generated by them can go down as well as up.

Hartley's
Jelly
no added sugar
80c
SPECIAL OFFERS
4 For
€3.00
€1.05

Chivers
Jelly
Raspberry Jelly
Orange Jelly
Strawberry Jelly
80c

Chivers
9 cal
per pot
Jelly
Raspberry Jelly
99c

Ambrosia
Rice Pudding
Apple Rice Pudding
Devon Custard
Light
Banana Devon Custard
Strawberry Devon Custard
Angel Delight
No added sugar
Strawberry
Bird's
94c
90c
€1.05

Ambrosia
Rice Pudding
Devon Custard
Light
mini rice
mini custard

2 For
€4.00
€2.75
Fruit Cocktail
Lustre
Fruit Cocktail in Natural Juice
Fruit Cocktail in Syrup
Pear Halves in Natural Juice
Peach Slices in Natural Juice

POLITICAL STABILITY IS GOOD NEWS FOR THE UK STOCK MARKET

Whatever your political persuasion, it's difficult to deny that the UK has endured a particularly turbulent period since its departure from the EU became a realistic prospect. In the 18 years between the 1997 and 2015 general elections, the country had three Prime Ministers and three Chancellors. In just nine years between the general elections in 2015 and 2024, there have been five Prime Ministers and seven Chancellors.

What's more, despite hailing from the same party, each recent Prime Minister has tried to take the country in a different direction to their predecessor. Theresa May attempted to deliver an orderly exit from the EU, before Boris Johnson opted for brinkmanship to 'get Brexit done'. Johnson also oversaw an expansion of the state and took the tax burden close to a post-war high, before Liz Truss tried to reverse that with aggressive tax cuts. Rishi Sunak and Jeremy Hunt changed direction again just a few months later.

Shunned and unloved

This uncertainty seems to have had real-world consequences. One of the most visible examples has been in the UK stock market. We've made the argument before that many investors have shunned UK equities since the Brexit vote, when the era of uncertainty began. UK listed companies saw their valuations (measured by share prices relative to earnings, known as the PE ratio) decouple from those of companies in other countries around 2016 (figure 4). This has left them much cheaper than their counterparts in other countries, including the US.

Simply comparing PE ratios alone is a fairly crude approach. For example, many US listed firms have greater growth potential and are more profitable, justifying higher valuations. However, at the start of 2024, we used a statistical technique to adjust for these fundamental factors and industry composition and we still found a large discount that wasn't there before 2015. Our findings tallied with surveys of fund managers, which showed a deterioration in sentiment towards UK shares in the second half of the 2010s. In our view, this all suggests that persistent political uncertainty has weighed on the valuations of UK companies since 2016.

More recently though, there are tentative signs that investors are beginning to view the UK stock market more favourably. Surveys of fund managers in the past few months suggest as much. Perhaps reflecting a realisation of just how cheap UK companies have become relative to their peers elsewhere, there has been a marked increase in the number of acquisition bids for them this year, especially from foreign buyers and private equity funds.

The benefit of stability

What could drive a further improvement in sentiment towards UK equities? It's conceivable that greater political stability — both at home and in relations with our largest trading partner — could help. As we've just demonstrated, the wedge between the valuations of UK and US equities was far smaller before 2016. Stability could look increasingly attractive in a world where moderate incumbents in Europe are vulnerable and uncertainty surrounding the outcome of the US election is enormous, as we discuss below.

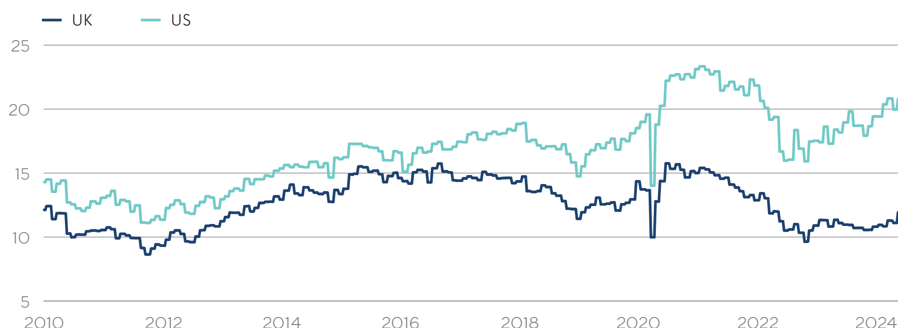
To be clear, we shouldn't expect investors to be won over immediately. There is a long road ahead for the UK to rebuild its reputation for political stability, and there will be big economic challenges along the way. That said, the bar for success is low. The discount on UK equities is still close to its largest on record. We thought that it seemed excessive before the election, and greater political stability would only strengthen the case. UK equities may continue to trade at a large discount for a while yet, but eventually, we think there are good reasons to believe the discount will narrow. All else equal, that would be good news for many UK equity investors.

> **Stability could look increasingly attractive in a world where moderate incumbents are vulnerable**

Figure 4: Mind the gap

There's a substantial different between the valuations of the US and UK stock markets. This chart shows prices for both indices relative to forecasts for their earnings over the next 12 months.

Source: LSEG and Rathbones



The value of investments and the income generated by them can go down as well as up.

LABOUR'S CLIMATE POLICY HAS IMPLICATIONS FOR INVESTORS

It seemed, at times, that Labour's Green Prosperity Plan— a pledge to invest £28 billion a year into greening the economy— was destined for death by a thousand cuts. In the end it limped, wounded, into the manifesto. But the taming of Labour's initial ambition has prompted questions about the party's devotion to the climate cause.

Now that Labour has secured a landslide victory in the general election, we explain what to expect from the new government on climate policy – and what this could mean for investors.

Leading the way

The Climate Change Act 2008 set an exacting target for the UK: reducing greenhouse gas emissions by 80% from 1990 levels by 2050. It has since cut emissions faster than any other country in the Group of Seven (G7) bloc of large, advanced economies.

In 2019 UK premier Theresa May made Britain the first major economy to commit to net zero emissions by 2050. However, Boris Johnson's ousting from office in 2022 marked a notable shift in government messaging, with Rishi Sunak U-turning on several key green policies in September 2023. Despite this, the net zero target has remained.

Before becoming Prime Minister, Keir Starmer said climate action was "at the heart of his economic vision for the UK". Last year, Rachel Reeves, the then shadow Chancellor, declared that she wanted to become Britain's "first green Chancellor." But what can we really expect from the new government?

Stretching the purse strings

Labour has reduced its green investment plans from £28bn a year of additional spending – above what is already spent – to just under £5bn. That totals £23.7bn over the five-year parliamentary term. But we still think the new government will pursue a climate policy markedly different from the old government's.

Central to the Green Prosperity Plan is an eye-catching mission to decarbonise the UK's entire electricity grid by 2030. This means all – or virtually all – electricity coursing through the grid must come from renewable sources. That deadline is five years ahead of the 2035 date set by Johnson's government. The UK has already made a great deal of progress here (figure 5).

This is based on major updates to the grid, and a faster expansion in solar and wind generating capacity – both offshore and onshore – than under Conservative plans. Labour has also pledged to reinstate the 2030 ban on the sale of new petrol and diesel cars, though some analysts have raised doubts about whether this is feasible. Although the Conservatives had introduced the deadline, they later pushed the date back to 2035.

Switching on Great British Energy, a publicly-owned company in the mould of France's EDF Energy, also promises to be an important pillar of Labour's plans. GB Energy is, in partnership with the private sector, tasked to help fund the development of nascent – and therefore riskier – green technologies. Examples are floating offshore wind, green hydrogen and tidal power.

Labour has also promised to invest more in insulating homes. The party has set aside £6.6bn – less than an earlier number, but still double the previous government's allocation – for its Warm Homes Plan over the course of its term.

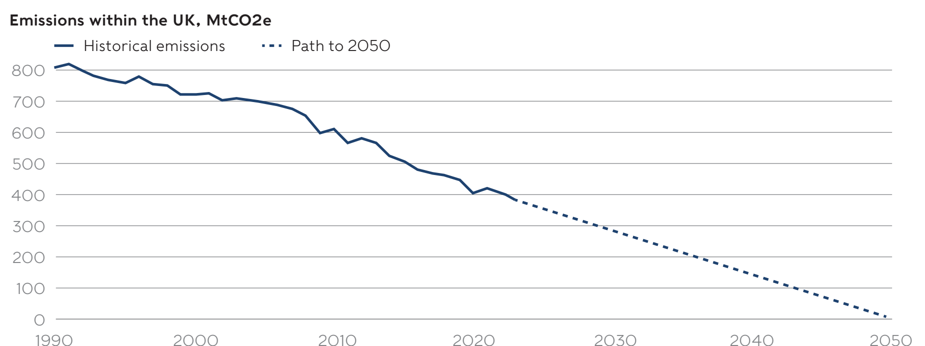
Labour has also pledged to honour North Sea oil and gas licences granted by the previous government. But new oil and gas licenses, new coal plants and fracking – a controversial technique for extracting oil and gas from rock – are off the table. Labour says it will fund its plans through an increase in the windfall tax rate on 'excess' oil and gas profits, known as the Energy Profits Levy. It also wants to close 'loopholes' in the Levy.

The vastly curtailed sum of green investment now planned by Labour has prompted analysts to question how far and how fast the new government can actually go on net zero. Nevertheless, Starmer and Reeves insist that through pragmatic policymaking and prudent spending, Labour can still deliver on its promises.

Figure 5: An ambitious target

UK emissions would need to fall by 14 million tonnes of carbon dioxide equivalent (MtCo2e) every year to reach net zero by 2050.

Source: Department for Energy Security and Net Zero and Carbon Brief analysis



The value of investments and the income generated by them can go down as well as up.

Pragmatism or poverty of ambition?
How do Labour's net zero policies stack up against those of other parties? The short answer: Labour sits somewhere in the middle. We can expect the new government to go further on climate than its predecessor. But it's unclear as yet quite by how much. Moreover, its policies and spending promises are considerably more restrained than the Liberal Democrats' or the Green Party's. Labour's caution probably stems from a desire to shake off its image as a high-tax, high-spending party.

The Lib Dems had a manifesto pledge to achieve net zero emissions by 2045— five years sooner than promised by Labour. They also promised £8.4bn a year to tackle climate change and protect the environment. The Green Party said it wanted to achieve net zero carbon 'as soon as possible.' It promised to fund its £40bn-a-year spending pledge to create a green economy through a multimillionaire wealth tax.

These policies increase pressure on the Starmer government not to renege further on its already diluted climate plans – not least because parties that want to green Britain faster could win disaffected Labour voters in the next general election.

The green finance capital of the world
What does this all mean for investors in the UK? In March's Mais lecture to City grandees, Reeves saw government playing a bigger role in the UK economy in the future. When it comes to climate policy, this is borne out by its intentions for GB Energy. This has triggered concerns about the competitive landscape for private-sector utilities and renewables companies. Will they be less attractive investments?

We think Labour is likely to be more of a help than a hindrance to the UK's clean energy industry. Its manifesto talked about GB Energy as a partner to existing energy companies in helping foster the growth of young and high-risk renewable technologies, as well as in scaling up more established ones such as wind power and solar. This is encapsulated in Labour's undertaking to make the UK 'the green finance capital of the world'.
This won't transform the prospects of renewables companies – not least because the UK is already an attractive place for them, especially for offshore wind. However, if the new government puts real resources into GB Energy, this could lower the cost of capital for companies such as SSE that develop renewables.

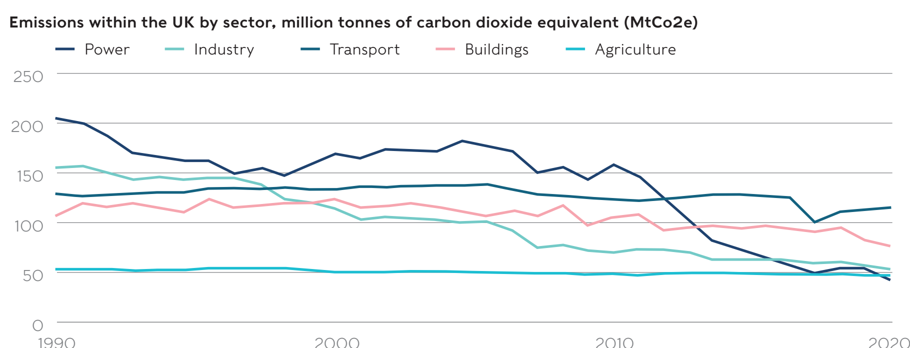
In a recent podcast for Kepler Trust Intelligence, published by finance firm Kepler Partners, Stephen Lilley, fund manager at Greencoat UK Wind, described his conversations with Labour Party ministers as "all very sensible". He did not see the new government as a source of disruption. Moreover, National Grid's decision to tap shareholders for nearly £7bn in a rights issue— which found willing backers – underscored its optimism about the post-election backdrop.

Playing our part
Back in 2021, Rathbones made a commitment to become net zero across its business operations and portfolios by 2050. Fighting climate change is important because it helps protect the value of our portfolios against the damage from climate change to companies' earnings and balance sheets. We need to engage with businesses and the government to press them to go in the right direction on climate.

With this in mind, our stewardship team has outlined UK energy market reform as a priority area for our engagement. We believe it can create investment opportunities, in time lifting productivity by increasing access to cheap and efficient forms of energy. Meanwhile, it can help to guard against the financially material risks of volatile fossil fuel prices. Once the post-election dust has settled, we'll join those pushing the new government to deliver on the wide-reaching overhaul of the UK's transmission network grid set out in the 2023 Winser Review. We'll also work with other investors to press the government not to forget its important ambition to deliver clean power across the UK by 2030.

"Procrastination is the thief of time", wrote the English poet Edward Young back in the eighteenth century. As we ponder how few years Britain has to reach net zero, we heartily endorse the sentiment.

Figure 6: Going places
Transport remained the UK's highest-emitting sector in 2023, while power likely dropped to fifth-largest.
Source: Department for Energy Security and Net Zero and Carbon Brief analysis



PREPARE FOR THE UNEXPECTED WHEN AMERICA VOTES

Americans go to the polls on 5 November to vote for their President, a major event in this bumper year of elections. In contrast with the foregone conclusion of the UK election, the race for the White House is highly uncertain and the contests for the Senate and House are very tight. There are also big differences between the Republicans and Democrats in consequential policy areas, and no clear view on which outcome markets would prefer – that's likely to vary from issue to issue. In this context, it doesn't make sense to premise investment decisions on any single outcome – we need to be prepared for a range of possibilities.

Following President Joe Biden's faltering performance in his televised debate with former President Donald Trump, his re-election campaign has been in turmoil. Before the debate the two Presidents were within two percentage points of each other in the national polling averages. His disastrous debate performance may have tipped the scales in Trump's favour, but so far Biden has survived calls to step aside as the Democratic nominee. Meanwhile, polls are suggesting a split Congress. The Democrats have a slight edge when it comes to the House of Representatives (an estimated 59% chance of getting a majority), but the Republicans are favourites for the Senate (61% chance). In the past, markets have tended to prefer a split Congress, which can moderate the extremes in either party, but this outcome is far from guaranteed.

Economic differences

In the run-up to the election, we'll be publishing a report exploring the differences between the economic platforms of the two parties in more detail. In the meantime, it's worth highlighting the contrast in a couple of areas to illustrate the extent of the uncertainty.

Take corporate tax, which is an issue we know had a major bearing on the stock market during Trump's original term in office. In this area, markets are likely to prefer what the Republicans have to offer. Trump has proposed to extend the corporate tax cuts he introduced in the 2017 Tax Cuts and Jobs Act (TCJA), which are otherwise due to expire next year. The TCJA reduced the corporate tax rate significantly, from 35% to 21% (figure 7), and in turn provided a boost to US equities. Trump's campaign has also suggested going even further and cutting the corporate tax rate all the way to 15%. That could increase US firms' post-tax earnings by around 8%. In contrast, Biden's plans include increasing the headline corporate tax rate to 28% (and raising various minimum corporate taxes). This might reduce post-tax earnings by approximately 9%.

The picture is precisely the other way around on trade, with markets likely to be more sympathetic to Biden's offer. It's true that both parties broadly favour a tough stance on China and supporting domestic production of strategic goods – Biden has continued and extended the trade war Trump started when he was President.

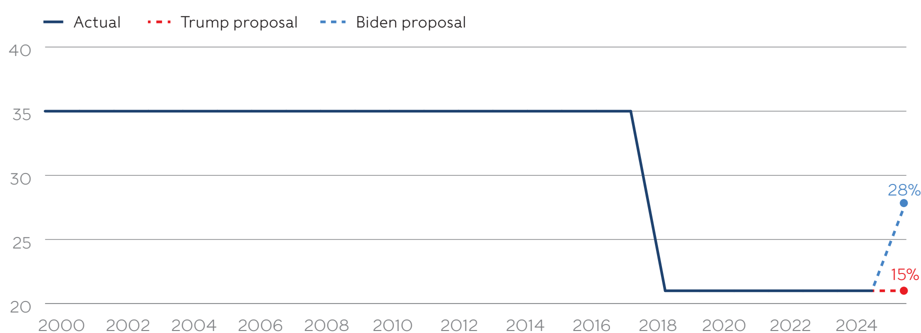
Radical trade tariffs

Trump's proposals for next steps are much more radical than Biden's. He has floated plans to hit all Chinese goods with a 60% tariff and to impose a 10% 'universal' tariff on all other imports. This universal approach would be a dramatic escalation from the targeted measures used to date. It would take average US tariff rates to their highest since the 1940s, which would probably push inflation up and hurt economic growth.

It's possible that Trump plans to use the threat of this universal tariff as a bargaining chip to extract concessions from other countries, given that he used similar negotiating ploys during his first term. So there's a good chance that we never see the full universal tariff. Yet the threat alone suggests a willingness to go much further than his Democratic rival.

We're only scratching the surface here – we'll cover other important areas like the deficit, immigration and geopolitics in our full US election report. The most significant point is that the outcome of the US election remains highly uncertain, and neither candidate would be unambiguously positive or negative from an investor's perspective. Against this backdrop, a diversified, long-term investment approach makes more sense than one that's overly dependent on the roll of the election dice.

Figure 7: Taxing times
The S&P 500 index's median tax rate could move in completely different directions depending on who is in the White House next year.
Source: LSEG and Rathbones



The value of investments and the income generated by them can go down as well as up.

FINANCIAL MARKETS

While global growth remains sluggish by past standards, the US economy continues to perform well compared with other major regions. Closer to home, the UK exited the recession it fell into at the end of last year faster than expected. The euro area is also starting to recover after more than a year of near stagnation.

Rising geopolitical tensions in the Middle East and stubborn inflation mean it was an eventful beginning to the quarter for markets, which were buoyed by signs of broadening earnings growth. Many stock market indices reached record highs and bond markets rallied amid hopes of rate cuts in the US and other major economies.

The strength of the US economy, fading inflation, robust corporate profits, and trust in the Fed helped boost investor confidence and push US stocks higher. Earnings growth is also moving beyond the 'Magnificent Seven' technology stocks and broadening out into other sectors.

Reaching new highs

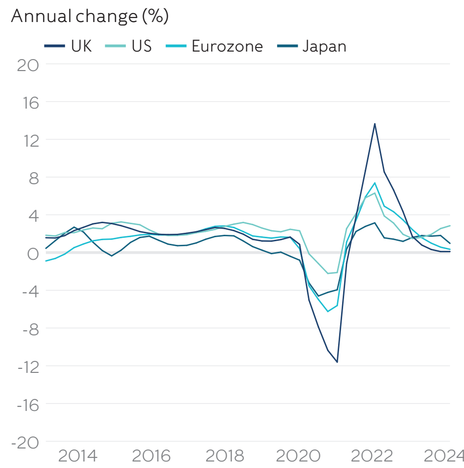
The UK's FTSE 100 was among the indices that reached a new high. At quarter end, the index had risen by about 6% in the year to date, compared to its return of 3.8% for the whole of last year. Improving economic data, easing inflation and expectations of interest rate cuts all contributed.

Europe's main share index notched a record high too, also helped by earnings growth and fading inflation worries, though it pared some of this year's gains into the end of the quarter. The Asian market was also given a boost, with Chinese stocks rallying following the announcement of fresh measures to revive the ailing property market.

Gold prices hit a record high amid high inflation and geopolitical tensions. A weaker dollar and purchases by central banks also helped to drive prices higher. After peaking at the beginning of April, crude oil prices dipped as worries over conflict in the Middle East eased and US demand slowed.

GDP growth

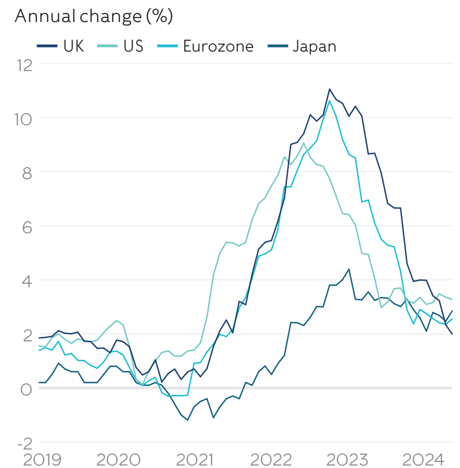
Annual change (%)



Source: Factset and Rathbones

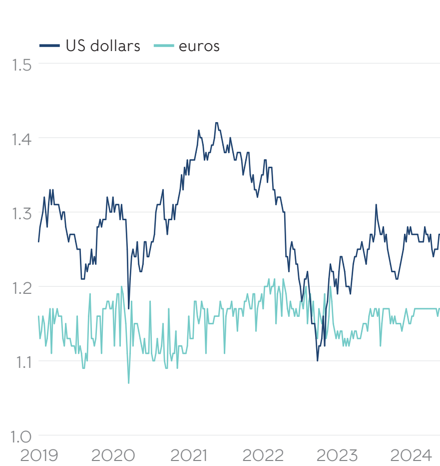
Inflation

Annual change (%)



Source: Factset and Rathbones

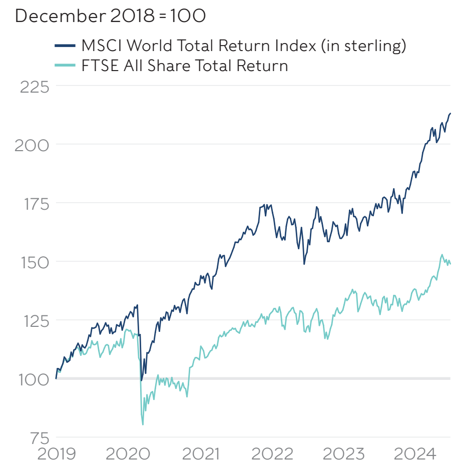
Sterling



Source: Factset and Rathbones

Equities

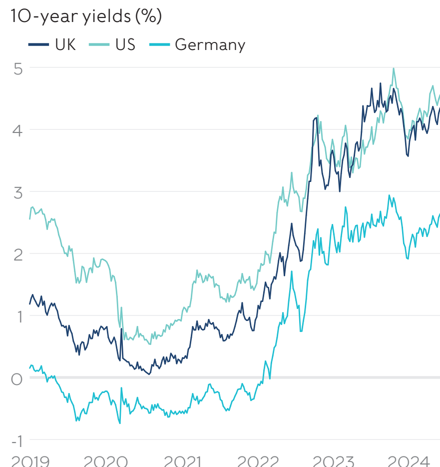
December 2018 = 100



Source: Factset and Rathbones

Government bonds

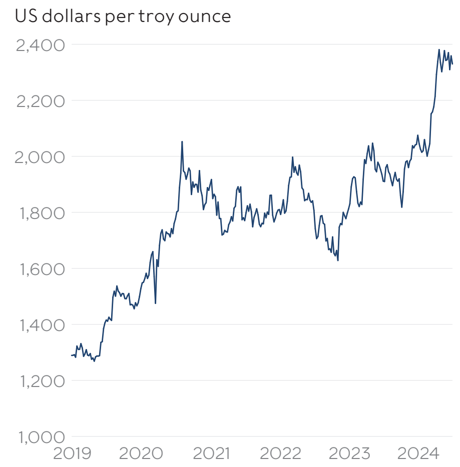
10-year yields (%)



Source: Factset and Rathbones

Gold

US dollars per troy ounce



Source: Factset and Rathbones

Past performance is not a reliable indicator of future performance.

ADDITIONAL INFORMATION

Information valid at 30 June 2024, unless otherwise indicated. This document and the information within it does not constitute investment research or a research recommendation. The value of investments and the income generated by them can go down as well as up.

Rathbones Investment Management International is the Registered Business Name of Rathbones Investment Management International Limited, which is regulated by the Jersey Financial Services Commission. Registered office: 26 Esplanade, St. Helier, Jersey JE1 2RB. Company Registration No. 50503.

Rathbones Investment Management International Limited is not authorised or regulated by the Prudential Regulation Authority or the Financial Conduct Authority in the UK. Rathbones Investment Management International Limited is not subject to the provisions of the UK Financial Services and Markets Act 2000 and the Financial Services Act 2012; and, investors entering into investment agreements with Rathbones Investment Management International Limited will not have the protections afforded by those Acts or the rules and regulations made under them, including the UK Financial Services Compensation Scheme.

This document is not intended as an offer or solicitation for the purchase or sale of any financial instrument by Rathbones Investment Management International Limited. The information and opinions expressed herein are considered valid at publication, but are subject to change without notice and their accuracy and completeness cannot be guaranteed. Not for distribution in the United States. Copyright ©2024 Rathbones Group Plc. All rights reserved. No part of this document may be reproduced in whole or in part without express prior permission.

Rathbones Greenbank and Greenbank Investments are trading names of Rathbones Investment Management Limited, which is authorised by the PRA and regulated by the FCA and the PRA. Registered Office: Port of Liverpool Building, Pier Head, Liverpool L3 1NW. Registered in England No. 01448919. Rathbones Investment Management Limited is a wholly owned subsidiary of Rathbones Group Plc.

If you no longer wish to receive this publication, please call 020 7399 0000 or speak to your regular Rathbones contact.

Call
For contact details of your nearest office please visit
rathbones.com/about-us/our-offices

Visit
rathbones.com

Email
enquiries@rathbones.com

For specialist ethical, sustainable and impact investment services
Greenbank Investments
0117 930 3000
enquiries@greenbankinvestments.com
greenbankinvestments.com

For offshore investment management services
Rathbones Investment Management International
01534 740 500
rathboneimi.com

@RathbonesPlc

@rathbonesgroup

Rathbones Group Plc

RATHBONES