Equity Strategy

US ELECTION: JUST A TRADE, NOT A REGIME SHIFT

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Assuming we get to the US presidential election with the US indices and valuations around current levels, we would tactically recommend a NEUTRAL stance expecting higher volatility around the event in case of higher chances of a Republican sweep. Strategically, we would remain OVERWEIGHT on the asset class throughout 2025 as recession risk remains negligible.

At the margin, we see Trump's victory as a trading opportunity rather than a radical shift in the paradigm that has driven US and global indices towards all-time highs. We still believe that the Growth/Quality sectors will strategically keep outperforming as long as the Fed remains in easing mode, the economy slows down without falling into recession, inflation keeps heading towards the target, and AI hype persists.

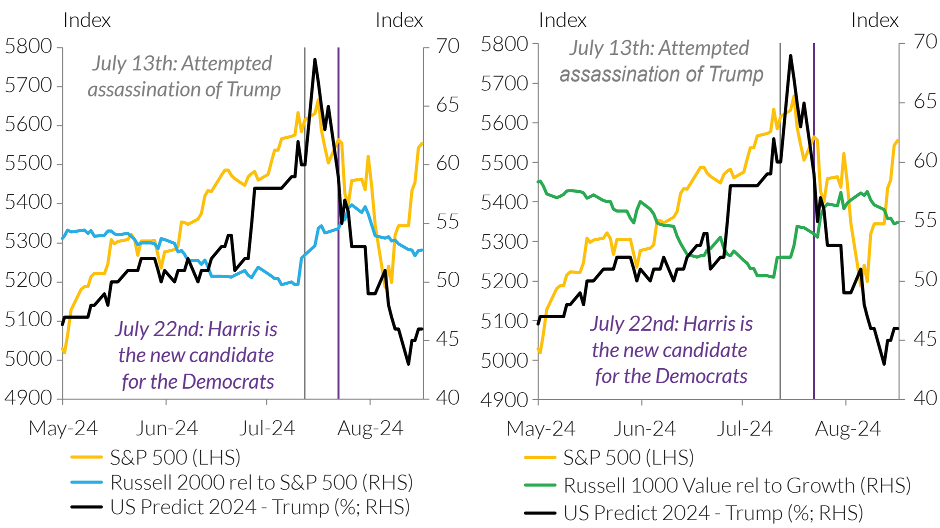
We acknowledge the possibility of quick and sharp rotations towards Value/Traditional Cyclicals and Small Caps, but our macro scenario does not support their sustainability over time in 2025. That said, we see a structural rotation from Growth/Quality to Value as detrimental for equities, as regime changes within the asset class are rarely painless, but we would take advantage of it.

Demystifying the Trump Trade

We disagree, at least from a strategic perspective, that former President Trump's victory would support the "Trump Trade". The odds of Trump's victory skyrocketed in the first weeks of July triggering a sharp rotation within the market that lost approximately 9% over the following three weeks. Both Small Caps and Value names outpaced their relative counterparties by 14pp, before giving back parts of the gains going through August (**Figure 1**). We saw similar dynamics back in 2016, when Small Caps and Value were outperforming while the S&P was rolling over as Trump experienced more and more favorable polls. Interestingly, back then the Trump Trade was short lived and exhausted itself within a month from the election (**Figure 2**). **So, the chance of a Trump victory fueled the Trump Trade, but Trump's actual victory halted it – we expect something similar to happen this time around, too.**

FIGURE 1.

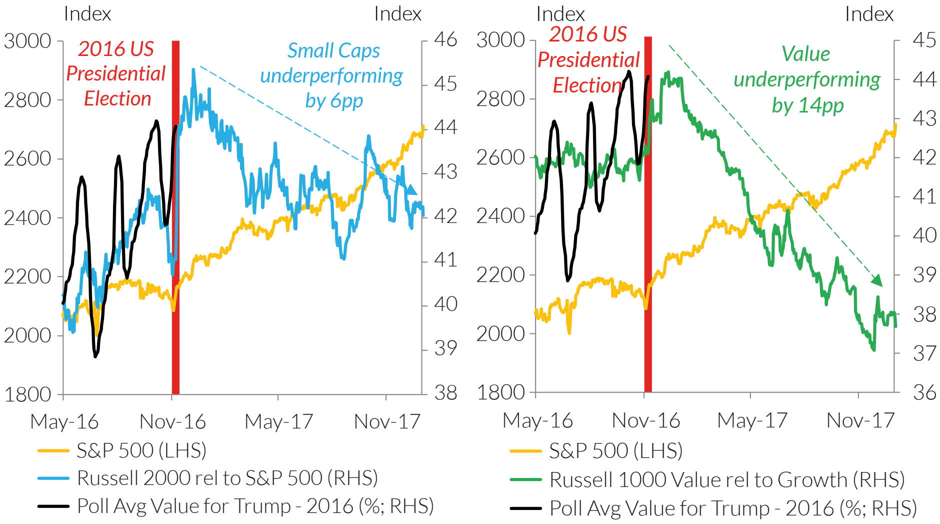
The Trump Trade in summer 2024: Small Caps (LHS) and Value (RHS)



Source: S&P, Russell, PredictIt, ANIMA Research

FIGURE 2.

The Trump Trade in the 2016 US presidential election: Small Caps (LHS) and Value (RHS)



Source: S&P, Russell, Real Clear Politics, ANIMA Research

We also disagree with mainstream thinking that Trump's victory would trigger a broadening of the market. The 2016 episode points out that such conviction is "fake news". In fact, the aftermath of Trump's first victory was the beginning of the unstoppable narrowing of the US bull market. In November 2016, the largest five companies in the S&P 500 accounted for approximately 12% of the total market cap, then their weight steadily increased over time up to 24% at the end of his mandate. Now they account for 28% of the index (Figure 3). We continue to see any eventual market broadening that may unfold following Trump's victory as short-lived, like that which materialized in 2022 with the post-Covid reopening and rising inflation.

FIGURE 3.

Cumulative weight of the largest 5 companies in the S&P 500

Source: S&P, BofA, ANIMA Research

We are not in 2016

In this section we explore in more detail the reasons that make us skeptical on strategically chasing the Trump Trade. Back in 2016 the macro and companies' fundamentals might have supported the idea of a lasting outperformance of Small Caps and Value, but we do not see those conditions now.

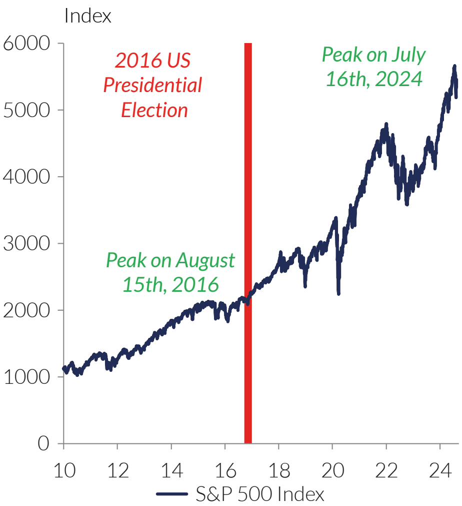
Below we highlight the main differences between now and 2016. We have checked for the underlying macro, equity prices, corporate fundamentals, and analyst forecasts.

MACRO BACKDROP: in a nutshell, **we are now in the late stage of the economic cycle rather than at the dawn of a synchronized worldwide GDP growth as was the case in October 2016**. Geopolitical headwinds are stronger today than eight years ago, governments have less room for fiscal easing after the national debts skyrocketed during the pandemic.

EQUITY PERFORMANCE AND VALUATIONS: **from a price standpoint the S&P 500 looks quite like it was back in October 2016.** In both cases, the US benchmark hovers around the relative peak (**Figure 4**). However, the index looks different from a valuation perspective. The S&P 500 is indeed more expensive now than it was eight years ago on all the most common metrics. Interestingly, the judgment changes when comparing multiples against their own last five years of history. This analysis highlights how the **S&P 500 was actually relatively quite expensive even at that time**, especially on Trailing Price to Earnings, whereas it was cheap and fairly priced on Dividend Yield and Equity Risk Premium (ERP). Nowadays, despite trading 26 times the EPS, the index does not look so expensive compared to its history, while it does on Price to Book and ERP (**Figure 5**). The latter especially seems to be quite stretched at 0.6% (**Figure 6**), offering little protection from a severe, but unlikely according to us, treasuries sell-off.

FIGURE 4.

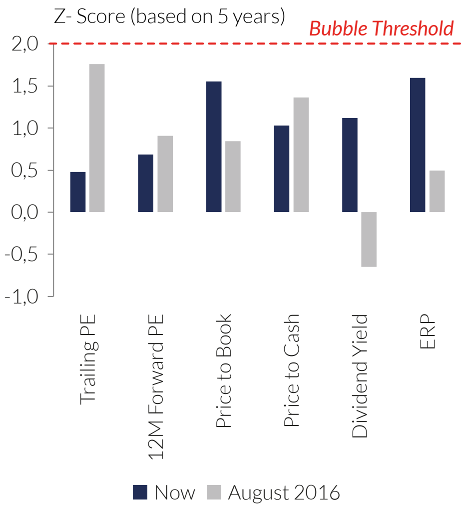
S&P 500 - Price



Source: S&P, ANIMA Research

FIGURE 5.

S&P 500 – Valuation relative to history



Source: S&P, MSCI, ANIMA Research

FIGURE 6.

S&P 500 – Now against end of October 2016

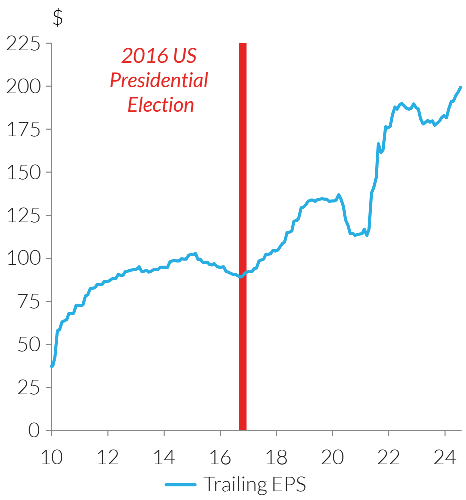
		Now	October 2016
Performance	S&P 500 Level	5635	2123
	From Previous Peak	-1%	-3%
	12M Forward Performance	na	21%
Valutation	Trailing PE	26	23
	12M Forward PE	21	17
	Price to Book	5	3
	Price to Cash	19	13
	Dividend Yield	1%	2%
	Equity Risk Premium (ERP)	1%	4%
Valutation vs the last 5 years (z-score)	Trailing PE	0	2
	12M Forward PE	1	1
	Price to Book	2	1
	Price to Cash	1	1
	Dividend Yield	1	-1
	Equity Risk Premium (ERP)	2	0
Fundamentals	Return on Equity	19%	12%
	EPS From Previous Peak	0%	-13%
	12M Trailing EPS Growth	11%	-8%
	12M Forward EPS Growth	14%	3%
	Net Margin	12%	10%
	Net Debt to EBITDA	2	2

Source: S&P, MSCI, ANIMA Research

TRAILING EARNINGS: From a profitability and fundamentals standpoint, US listed companies look in different shape. Corporate America now seems to be in a maturing cycle with earnings, margins, and Return on Equity at or still around their all-time highs. Back in 2016, US EPS was already contracting by 13pp compared to the previous peak recorded in March 2015 (**Figure 7**). At that time, 10 out of 24 sectors, especially commodities-related ones, were experiencing an earnings slowdown (APPENDIX). Consequently, even margin and RoE were in downward trajectories (**Figure 8** and **Figure 9**) whilst leverage was rising fast (**Figure 10**).

FIGURE 7.

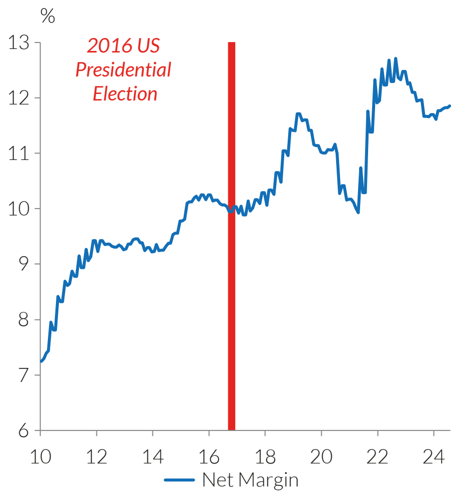
US Equities – Trailing EPS



Source: MSCI, ANIMA Research

FIGURE 8.

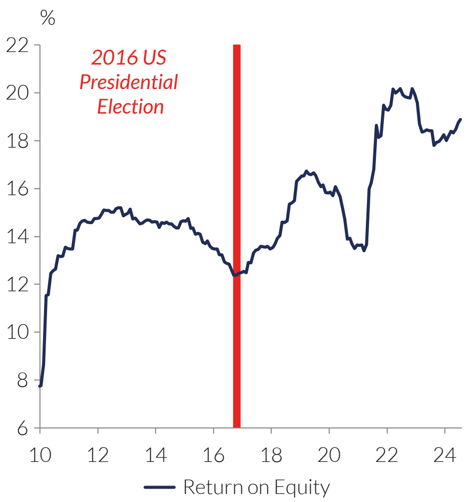
US Equities excl. Fins – Net Margin



Source: BofA, ANIMA Research

FIGURE 9.

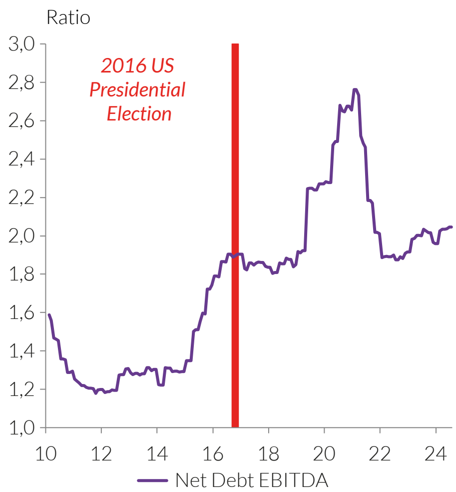
. US Equities – Return on Equity



Source: MSCI, ANIMA Research

FIGURE 10.

US Equities excl. Fins – Leverage



Source: BofA, ANIMA Research

EARNINGS EXPECATIONS: **This time around EPS growth expectations look to be more constructive than 2016.** That October consensus analysts were forecasting US EPS to increase by a paltry 3% over the following next 12 months, whilst now they foresee a cheerful 14% expansion. History points out that eight years ago analysts were too conservative, in fact 12 months later, US EPS grew by 15%, led by Energy, Diversified Financials and IT sectors (**Figure 11**). **Our current macro scenario suggests that nowadays analysts may be too optimistic in their double-digit forecasts**. Historically, 1pp quarterly GDP growth has translated to 4.5pp in EPS growth (excl. Fins), all else equal, since 1948. For H1 2025, on average, we expect growth at 1.9% q/q SAAR and 1.7% for H2 2025 – consistent with an annual growth rate of 2.1%. This would imply EPS growth in the high single digits next year.

FIGURE 11.

US sector EPS growth estimates now against October 2016

		Expected Forward EPS Growth		EPS Growth - Actual Data
		Now	October 2016	1yr Later - October 2017
USA		14	3	15
Cyclicals	Cons. Services	19	12	10
	Cons. Durables	5	9	6
	Comm. & Prof. Svcs	10	6	6
	Capital Goods	11	2	4
	Div. Financials	13	2	30
	Insurance	21	2	4
	Materials	-1	-1	25
	Real Estate	5	-1	-8
	Banks	8	-3	13
	Transportation	1	-4	-9
	Energy	0	-17	190
Growth	Semis	74	31	30
	Software	17	11	30
	Retailing	45	9	9
	Media & Ent.	35	6	8
	Tech	12	-2	1
	Auto	2	-4	-12
Defensives	Pharma	0	10	3
	Health Care	8	9	14
	Food, Bev, Tobacco	2	6	4
	Food & Staples Ret.	3	6	5
	Telecoms	4	4	5
	HH & Personal Products	9	3	19
	Utilities	9	0	33

Source: MSCI, ANIMA Research

Our macro baseline suggests Quality/Growth over Traditional Cyclicals

Below we introduce the implications for US equity under both scenarios: Split Congress (**Scenario 1**) and a Republican sweep (**Scenario 2**). We have checked for economic growth, inflation, and monetary policy.

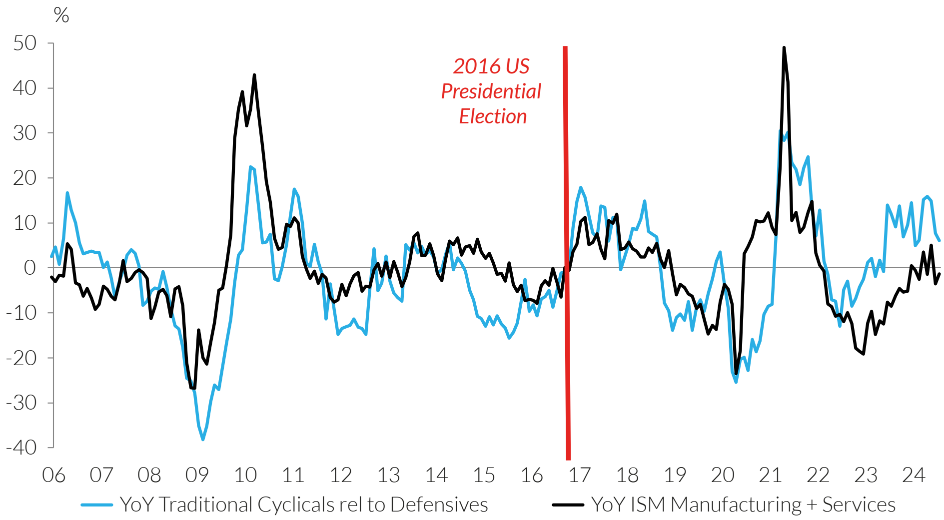
GROWTH: we do not expect much in 2025, beyond then will depend on the Congress outcome. In our view, the new Trump presidency will not provide any relevant impulse to the economic growth in 2025.

- **Scenario 1:** under a split Congress, we see no growth impulse in 2025, but downside risks mounting for 2026. Failure to extend in full the TCJA beyond 2025 will result in a slightly negative growth impact. This will weigh on equity prices and especially on high beta sectors, like traditional cyclical ones.

- **Scenario 2:** under a Republican sweep, we do not see further corporate tax cuts as likely. If anything, Trump will manage to cut by just 1% bringing the tax rate down to 20%. Last time he slashed it to 21% from the previous 35%. So, at the margin, the new, still unlikely, fiscal easing for corporates is not as favorable as during the first term. The extensions of the TCJA kicking in from the end 2025 would reduce downside risks embedded in Scenario 1. However, it would have only an incrementally negligible effect on personal consumption, being more of a maintenance of the status quo rather than an extra impulse to economic growth. For these reasons, we consider it to be unfounded to switch fully into traditional cyclical sectors (i.e. Energy, Materials, Industrials, Financials, Consumer Durables, and Consumer Services) going through 2025. In fact, a lasting reacceleration of the economic activity, proxied by rising ISM, is crucial to trigger a sustainable outperformance of Cyclicals over Defensives (**Figure 12**). When we check for the main macro variables, we see that none supports a cyclical rebound (**Figure 13**). We expect commodities prices not to rise from current levels, we do not expect Industrial Production and Retail Sales to pick up from here, and consequently ISMs should keep hovering around the current prints.

FIGURE 12.

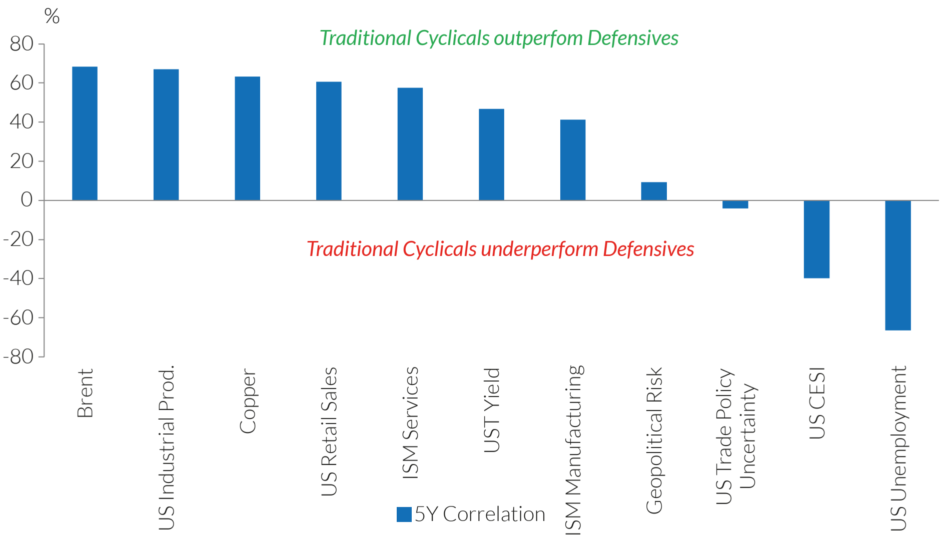
Traditional Cyclicals against Defensives and ISMs



Source: MSCI, ANIMA Research. Traditional Cyclicals: Energy, Materials, Industrials, Financials, Consumer Durables, Consumer Services. Defensives: Telecoms, Utilities, Health Care, Consumer Staples.

FIGURE 13.

Traditional Cyclicals against Defensives and main economic variables

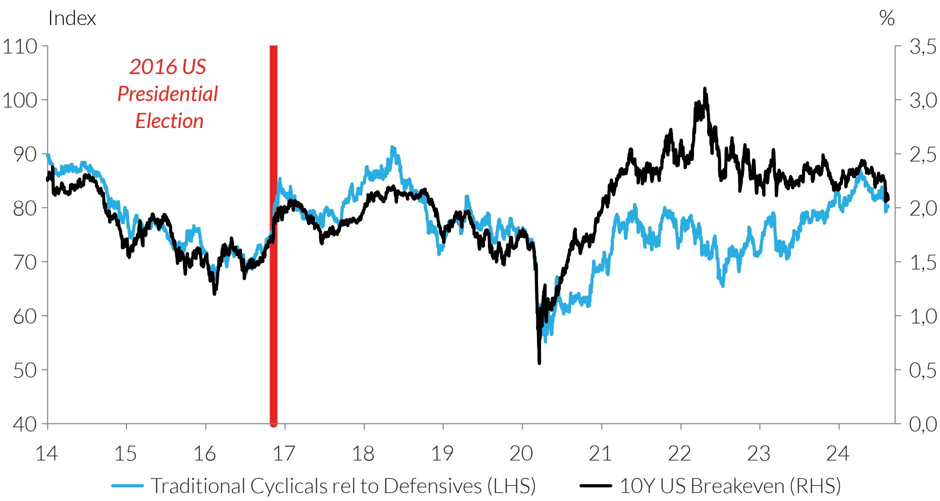


Source: MSCI, Datastream, ANIMA Research. Traditional Cyclicals: Energy, Materials, Industrials, Financials, Consumer Durables, Consumer Services. Defensives: Telecoms, Utilities, Health Care, Consumer Staples.

<u>INFLATION:</u> we expect no impulse in 2025, little through goods in 2026 and beyond. Such a view supports a sector allocation tilted toward a balanced mix of Quality/Growth and Defensives. Historically, and especially pre-Covid, the relative performance of Traditional Cyclicals is positively correlated with the Inflation Breakeven (**Figure 14**). Assuming it remains near the current 2% and considering our economic growth outlook, we do not anticipate Traditional Cyclicals to outperform.

FIGURE 14.

US Cyclicals relative to Defensives and US Breakeven

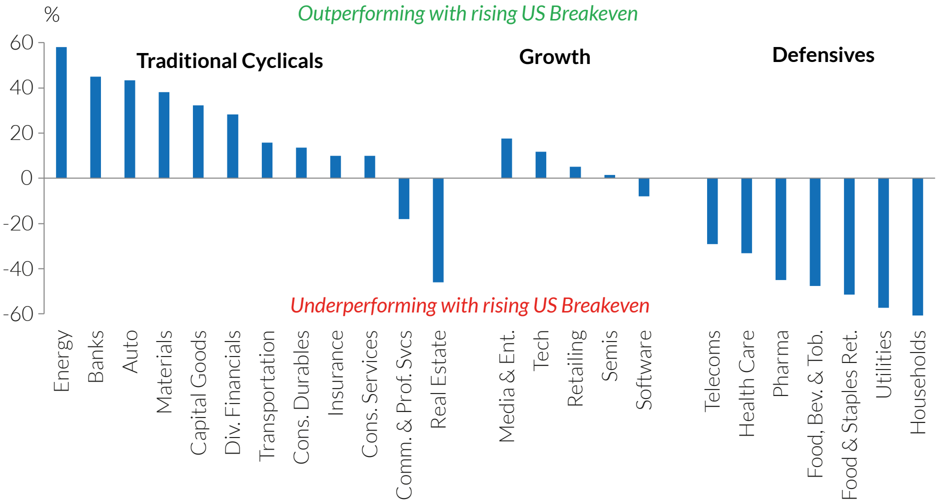


Source: MSCI, Datastream, ANIMA Research. Traditional Cyclicals: Energy, Materials, Industrials, Financials, Consumer Durables, Consumer Services. Defensives: Telecoms, Utilities, Health Care, Consumer Staples.

That said, we prefer to take exposure to cyclicality from Quality/Growth sectors, which are more agnostic to Breakeven movements (**Figure 12**).

FIGURE 15.

Correlations: US sector performances and US Breakeven – From Jan 2014 to Jun 2020

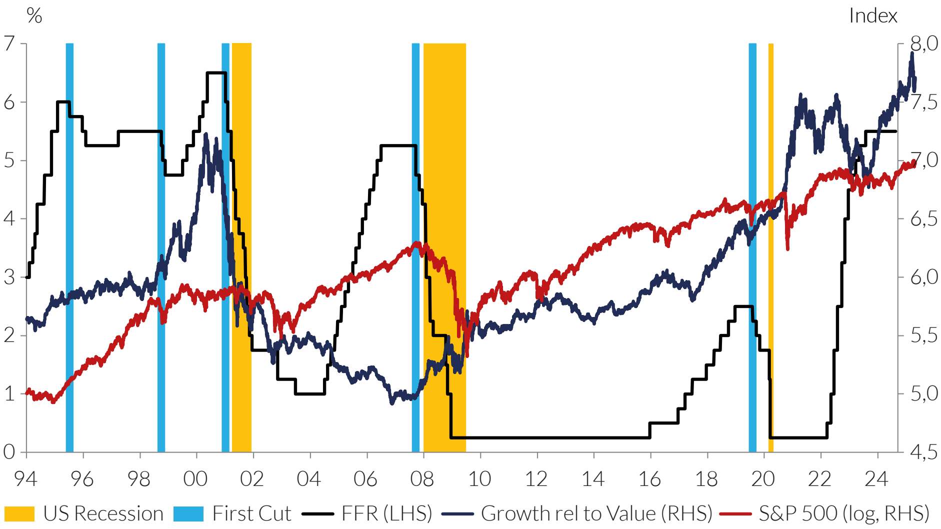


Source: MSCI, Datastream, ANIMA Research. Note: Tesla is not included in this analysis, as it was included in the US equity benchmark only in December 2020.

MONETARY POLICY: we see no impulse in 2025, little if any in 2026. Over the past three decades, barring a recession, an accommodative Federal Reserve has been favorable for the S&P 500. In terms of market sectors, except for the 2001 Tech Bubble, Growth stocks consistently outperformed Value stocks, whether or not a recession occurred (refer to **Figure 16** and **Figure 17**).

FIGURE 16.

S&P 500 and Growth relative to Value over the last 30 years



Source: S&P, Russell, Datastream, ANIMA Research

FIGURE 17.

S&P 500 and Growth relative to Value during the Fed's last 5 cuts

			Forward Performance (%)					
	First Cut Dates	Recession	1 week	1 month	3 months	6 months	9 months	12 months
S&P 500	Jul - 1995	No	2	2	6	13	20	20
	Sep - 1998	No	-6	2	17	22	27	22
	Jan - 2001	Mar 2001 - Nov 2001	1	5	-11	-4	-18	-10
	Aug - 2007	Dec 2007 - Jun 2009	4	5	3	-4	1	-8
	Jul - 2019	Mar 2020 - Apr 2020	-4	-3	1	9	-3	8
	Average		-1	2	3	7	5	6
	Hit Ratio		60	80	80	60	60	60

			Forward Performance (%)					
	First Cut Dates	Recession	1 week	1 month	3 months	6 months	9 months	12 months
Growth Relative to Value	Jul - 1995	No	0	0	1	-2	0	4
	Sep - 1998	No	-5	0	8	12	4	16
	Jan - 2001	Mar 2001 - Nov 2001	5	8	-14	-9	-17	-10
	Aug - 2007	Dec 2007 - Jun 2009	0	2	8	6	10	14
	Jul - 2019	Mar 2020 - Apr 2020	0	2	0	7	24	38
	Average		0	2	1	2	-1	6
	Hit Ratio		80	80	80	60	60	80

Source: S&P, Russell, Datastream, ANIMA Research

Tariffs and global sector exposure to the US

Non-US listed companies generate 14% of sales in the US (**Figure 18**). The largest and most exposed sectors are Pharma (34%), Software (30%), Semiconductors (22%), Auto (25%), and Tech (21%). Sectors towards the bottom of the ranking such as Retail, Utilities, Banks and Real Estate are more locally driven so they should be less affected.

Geographically, listed companies that generate a significant portion of their revenue from the US are predominantly located in Europe. Switzerland and the UK stand out due to the heavy weights of Pharmaceuticals and Health Care, garnering over one-fourth of their sales from the US market. Companies in the EMU see slightly less exposure at under 20%. In Emerging Markets, Asian businesses have the smallest overall dependency on US sales; however, those in IT-related industries are still notably vulnerable.

FIGURE 18.

Stock Market Sales Exposure to North America – Sector and Region

	Global ex North America	Switzerland	UK	EMU	Japan	LATAM	CEEMEA	EM ASIA
Pharma, Biotech & Life Sciences	34%	42%	47%	37%	35%		27%	10%
Commercial & Professional Services	32%	14%	46%	31%	14%			
Software % Services	30%	17%	45%	33%	7%			
Cons. Staples Distribution & Retail	30%			25%	40%	2%		
Automobiles & Components	25%			26%	37%			13%
Consumer Services	23%		57%	17%				2%
Semiconductors	22%			12%	11%			25%
Technology Hardware & Equipment	21%	35%	42%	31%	15%			21%
Household & Personal Products	20%		31%	22%	3%	2%		3%
Health Care Equipment & Services	19%	41%	52%	44%	23%			0%
Consumer Durables & Apparel	17%	20%	5%	23%	21%			7%
Food Beverage & Tobacco	14%	31%	25%	18%	9%	30%		2%
Telecommunication Services	14%			35%				0%
Energy	13%		38%	9%	3%	3%	10%	1%
Materials	12%	32%	24%	21%	9%	16%	5%	3%
Insurance	12%	29%	6%	10%	8%			
Capital Goods	12%	25%	40%	23%	16%	18%		2%
Media & Entertainment	11%		39%	31%	13%		10%	1%
Financial Services	11%	1%	9%	10%	2%			
Transportation	9%	28%		5%	2%	5%	7%	4%
Equity REITs	8%			10%				
Banks	7%		9%	4%	7%	1%	0%	0%
Utilities	4%		19%	4%				
Cons. Discr. Distribution & Retail	4%	8%	11%	0%	3%			0%
Real Estate Management & Dev.	2%				3%			0%
Grand Total	**14%**	**27%**	**26%**	**18%**	**16%**	**9%**	**6%**	**5%**

Source: Citi, Factset, ANIMA Research

APPENDIX

FIGURE 1A.

Trailing EPS growth

		12M Trailing EPS Growth	
		Now	October 2016
USA		11	-8
Cyclicals	Cons Services	104	22
	Cons. Durables	10	13
	Transportation	-9	12
	Banks	1	7
	Capital Goods	7	2
	Real Estate	4	2
	Comm. & Prof. Svcs	18	-4
	Div. Financials	61	-9
	Insurance	50	-22
	Materials	-24	-27
	Energy	-38	-125
Growth	Auto	11	42
	Media & Ent.	56	9
	Retailing	69	7
	Tech	8	2
	Semis	56	-2
	Software	33	-7
Defensives	Telecoms	2	65
	Pharma	-25	17
	Health Care	14	5
	Food, Bev. & Tobacco	17	4
	HH & Personal Product	8	-9
	Food & Staples Ret.	30	-10
	Utilities	19	-22

Source: MSCI, Datastream, ANIMA Research