

After Biden: What Comes Next?

July 22, 2024

Larry Adam, CFA, Chief Investment Officer

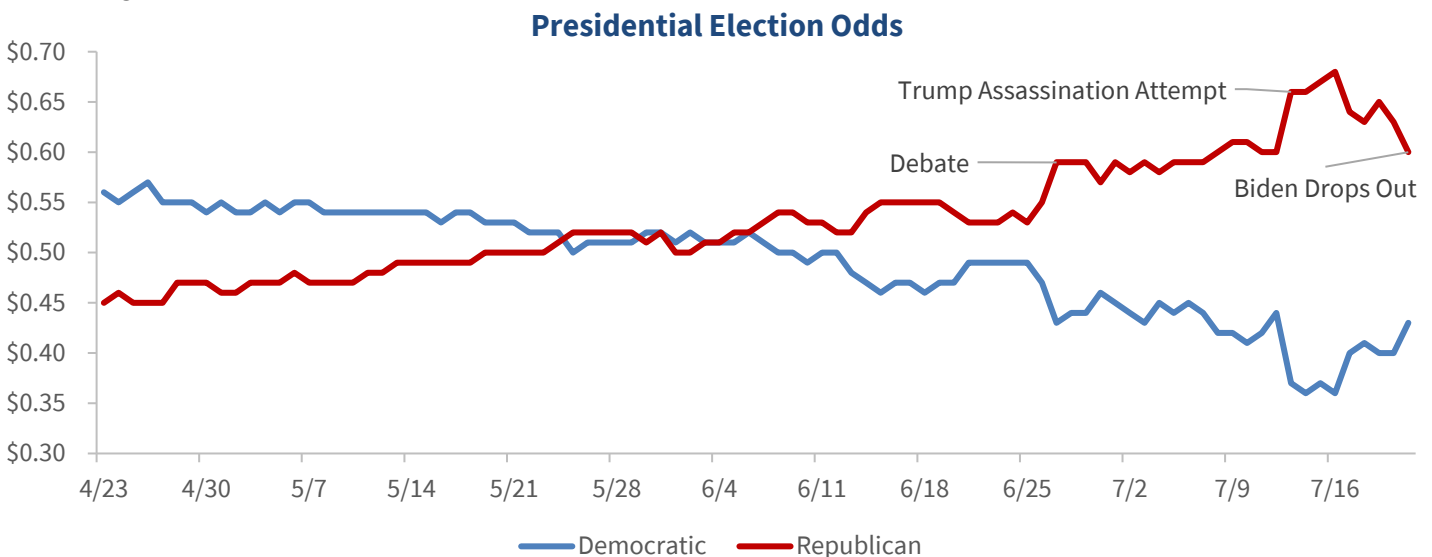
Election cycles are always unpredictable. This 2024 presidential election cycle has proven to be no exception. With President Biden choosing to drop out of the 2024 Presidential election, see below for answers to key questions we have received over the last 24 hours.

What Happened with President Biden’s Reelection Ambitions?

On Sunday, President Biden abruptly announced (at 1:46 pm) via a tweeted letter that he was ending his reelection campaign and subsequently endorsed Vice President Kamala Harris as the nominee. This is the first time since Lyndon B. Johnson in 1968 that a sitting president will not formally seek reelection. While this rarely happens in a presidential race, Biden’s withdrawal was highly anticipated ever since the June 27 debate with former President Trump that brought into question his physical and mental capacity to serve an additional four years. Attempts by the Biden team to turn the tide with interviews and campaign events were unsuccessful as his Democratic colleagues (namely Nancy Pelosi, Chuck Schumer, and James Clyburn) called on him to step aside due to weakening poll numbers (for himself and some down-ballot Congressional candidates), softening fundraising figures, and major donors suspending or re-allocating their funds away from President Biden’s candidacy.

Does this Announcement Change the Status of the Race?

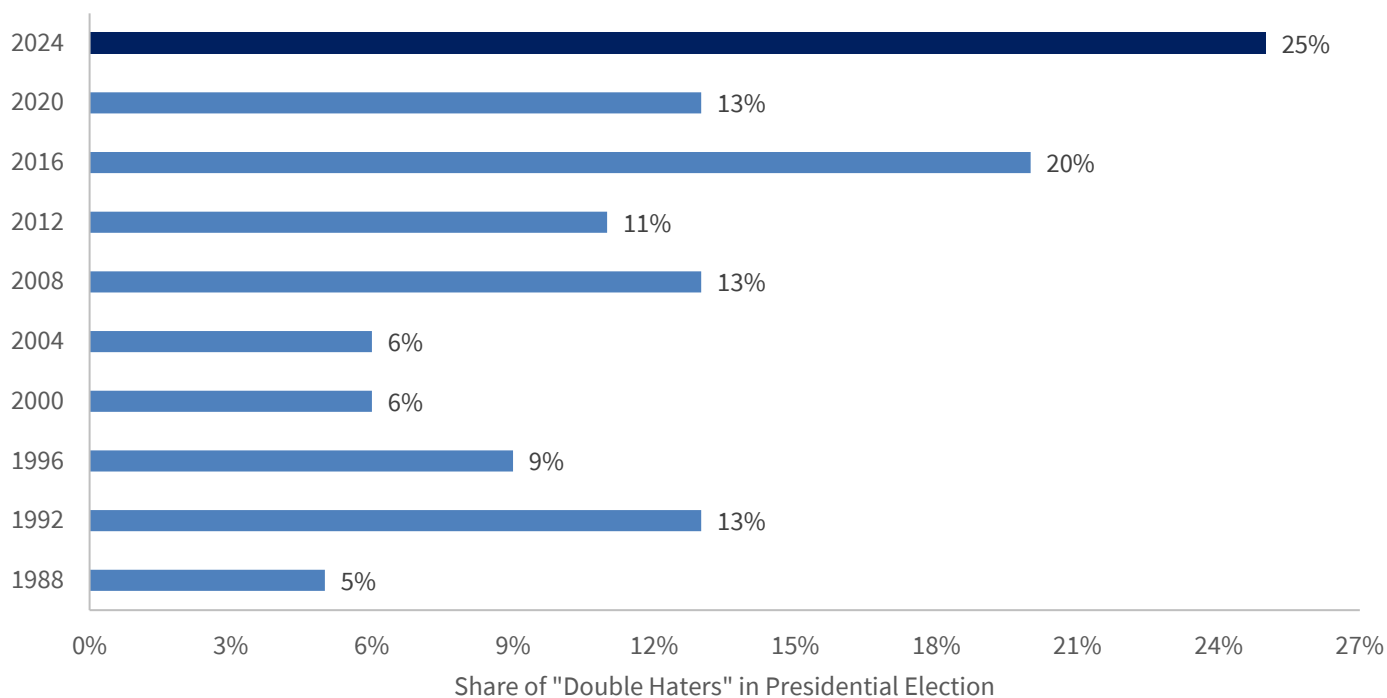
Biden’s exit adds another level of uncertainty to an already unpredictable race. While the Democratic party appears to be coalescing around Vice President Harris, the nomination will not be decided until the Democratic National Convention from August 19-22 in Chicago, IL. At this juncture, Trump remains the frontrunner in the race as betting markets continue to reflect a 60% probability of him reclaiming the White House (down from 63% before Biden dropped). However, this race is far from over and there are a number of factors that could lead to a narrowing in the polls:



Source: PredictIt, 7/22/2024

- 1. Trump Still Not Above 50% in the Polls** | In general, former President Trump remains a fairly unliked candidate as he holds an approval rating of only 38%. Additionally, while Biden’s polls weakened following Biden’s poor debate showing and the assassination attempt on Trump, Trump’s polling numbers did not significantly rise or sustainably reach above 50%. The big beneficiary appeared to be third-party candidates like Robert Kennedy Jr.
- 2. Enthusiasm Waned For Biden, Could Reverse With Harris** | A recent poll suggested that only 33% of Democrats were satisfied with having Biden as their nominee. With Vice President Harris the likely candidate, she could potentially increase Democratic enthusiasm (particularly among a younger demographic, women, and African American voters) and reverse the recent declines in Biden’s poll numbers.
- 3. Double-Haters May Have Another Option** | 25% of voters before Biden dropped out reported liking neither him nor Trump (e.g., the ‘Double-Haters’)—the most on record. If Harris could prove herself and win over a portion of these voters, it could re-shape the race.

Unfavorable Views For Both Candidates At A Record High



Source: FactSet, 7/22/2024

The point: While former President Trump appears to have the advantage and polls released in the next few days should bolster that sentiment as receives the traditional post-convention bounce, the presidential race remains far from over and is likely to narrow as the Democrats unify around a new candidate. With ~105 days to go to election day, in many ways, this race is just beginning.

Assuming a Harris Democratic Nomination, What Other Factors Could Shape the Race?

- Harris’ Likely VP Pick** | We still expect this race will ultimately be decided in key swing states—especially Pennsylvania, Michigan, and Wisconsin. As a result, the Democrats will likely look to a swing state governor or Senator as the vice-presidential nominee to help shore up support in these key states. Josh Shapiro, governor of Pennsylvania, Roy Cooper, governor of North Carolina, Michigan governor Gretchen Whitmer, and Arizona Senator Mark Kelly will likely be considered given their strength in these swing states. Kentucky governor Andy Beshear is also in the running.

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- **Fundraising** | Money is paramount in running an effective national campaign. VP Harris has the benefit of inheriting the funds already raised for the Biden/Harris ticket which is a big advantage over other potential nominees. We have already seen an uptick in fundraising as the Democrats' fundraising arm ActBlue has already raised over \$90 million in less than 24 hours following Biden's announcement, and other major Democrat donors have pledged an additional \$150 million in donations. To put that in perspective, President Biden's fund raising was only \$111 million in June. Prior to Biden dropping out, the Trump campaign had a larger balance of cash on hand at \$285 million vs. \$240 million for the Biden campaign.
 - **Democratic National Convention** | Just like former President Trump is likely to see a boost in post-convention polls, Democrats should receive the typical 4-5 point boost in the polls following the convention. If Democrats can continue to coalesce around Vice President Harris, this could provide an additional boost for Democrats in polling. Unity and enthusiasm will be critical at the convention.
 - **Second Presidential Debate** | We have seen through this election cycle how debates can swing the trajectory of a race. Currently, the second presidential debate is scheduled for September 10. Given the expected tightness of the race, any potential errors or key positive moments could be meaningful.
 - **First Vice Presidential Debate** | While VP debates are usually viewed as less important in presidential elections, this election is unique and the personalities and policies on each side could potentially sway a few voters. This debate is likely to occur after the Democratic National Convention.

What is the Impact on the Economy?

As Vice President Harris likely represents a continuation of President Biden's policies, there is no real change in our short-term economic outlook. With limited capacity for additional government spending on the horizon given budgetary constraints, the consumer will need to be the driving force of the economy. A softening labor market, rising delinquencies and a slowdown in travel-related spending is likely to lead to weakness in spending moving forward. As a result, we expect two Federal Reserve (Fed) interest rate cuts this year likely beginning in September to help the economy avoid a recession. While political rhetoric will abound if the Fed cuts, we view the Fed as apolitical and doing what it believes is in the best interest of the economy, not the political class. Longer term, the extension of (or lack thereof) the 2017 tax cuts is likely to impact the economy, but that does not occur until the end of 2025.

What is the Impact on Fixed Income?

We expect the bond market to be driven by the fundamentals of economic growth and inflation. And with both likely on a downward trajectory, interest rates (particularly the 10-year Treasury yield) are likely to move lower by the end of this year toward 4%. With the Fed expected to begin cutting interest rates, the yield curve is likely to steepen with shorter-term rates falling faster than longer-term rates.

However, we are mindful of the burgeoning risks associated with the supply/demand dynamics. The trajectory for policy and the impact on government spending should not change with Vice President Harris entering the race. Admittedly, neither Republicans nor Democrats have really focused on containing the national debt. Both administrations added significantly to the overall level of debt (Trump +\$8 trillion, Biden +\$7 trillion). The good news: until now, the bond market has absorbed the additional issuance from increased spending as retail investors have picked up their pace of buying. Until demand starts to wane (not our base case yet but we continuously monitor), the market should remain reliant on the fundamentals of growth and inflation.

What is the Impact on the Equity Market?

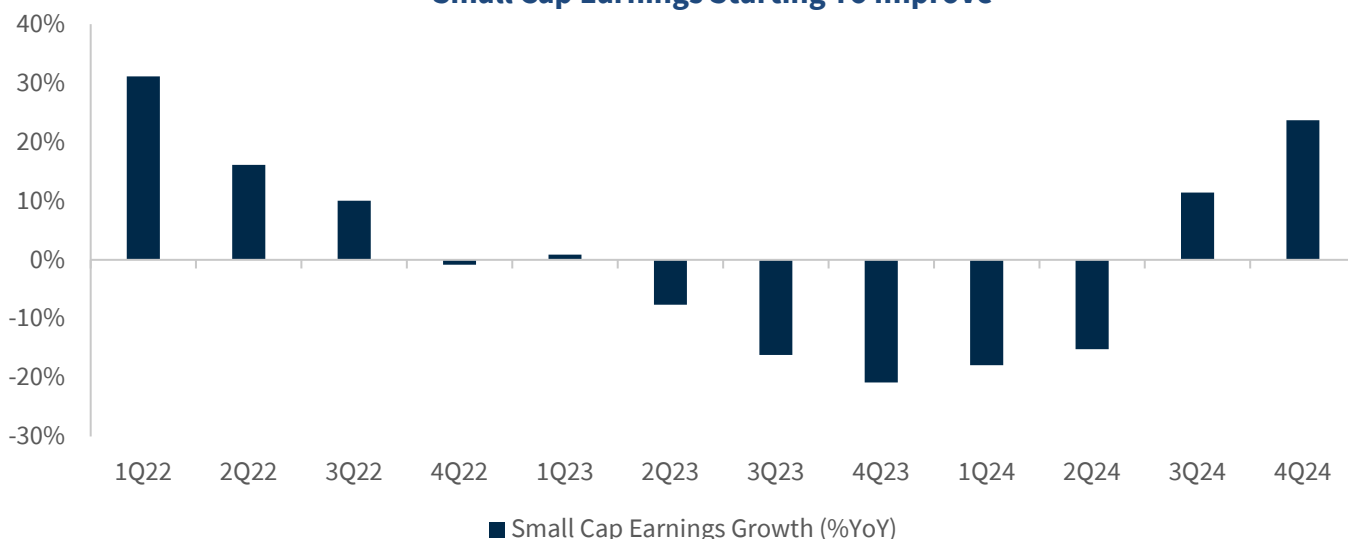
Going forward, with Harris likely entering the race against Trump, our short- and long-term equity market views remain unchanged. With valuations in the 93rd percentile relative to history, we remain cautious on the equity

market in the near term as a lot of good news has been priced into the market and investor optimism has reached extreme levels. However longer term, with earnings likely to move higher (as we do not forecast a recession), \$6 trillion of cash on the sidelines, and as we are in the infancy of this current bull market, we would use any periods of weakness as an opportunity. The 2Q24 earnings season that ramps up this week and next will be very important to assessing the health and earnings growth of companies going forward.

We cannot emphasize enough that politics is only one of ten factors in our equity outlook framework. While politics can drive headlines and induce short-term volatility (both up or down), it only ranks eighth in the ranking of the most influential driving factors. The reason? Macro factors such as economic growth and Fed cuts, and fundamental metrics such as earnings growth and valuations are more important in determining the trajectory of the market. Case in point: the Energy and Financials sectors were the two best-performing sectors in the week following Trump’s election, as a deregulatory agenda boosted expectations for these sectors during his Presidency. But they ended up being the worst performing sectors, as macro factors such as reduced demand because of COVID pressured the energy sector and record low interest rates were a headwind for Financials.

Fast forward to today, the recent rotation into small-cap stocks has been explained by market pundits as “the market pricing in a potential Trump victory”. We see this as misguided. Instead, we believe the rally has been fundamentally justified as interest rates have fallen (and small-cap companies rely on debt financing), imminent Fed rate cuts (as inflation reports have shown a significant slowdown in pricing pressures), and the potential for small-cap stocks to exhibit their first quarter of positive EPS growth in six quarters in 3Q24. In many ways, the recent increase in the probability of a Trump win (and sweep) is coincidental with the fundamental improvement in small-cap stocks prospects.

Small Cap Earnings Starting To Improve



Bottom Line

President Biden electing to drop out of the presidential race does not materially impact our view of the current standing of the race. The view of our political team continues to favor former President Trump; however, the potential for a Republican sweep probably gets more challenging as the shift at the top of the ticket is likely to help some down-ballot candidates. However, with over three months to go, the race is far from over and a lot can change between now and November 5. From an asset class perspective, our views are unchanged as current macro factors such as economic and earnings growth and a likely Fed cut in September remain intact. As always, as we approach election day, we will keep you apprised of our latest thinking and how it could impact on the economy and financial markets.

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The Consumer Price Index (CPI) | is a measure of inflation compiled by the US bureau of Labor Studies.

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HIGH YIELD | Bloomberg US Corporate High Yield Total Return Index: The index measures the USD-denominated, high yield, fixed-rate corporate bond market. Securities are classified as high yield if the middle rating of Moody’s, Fitch and S&P is Ba1/BB+/BB+ or below.

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KBW REGIONAL BANKING INDEX | The KBW Regional Banking Index is a benchmark stock index for the regional banking sector representing small to medium U.S. national regional banks.

RUSSELL 2000 INDEX | The Russell 2000 Index is a small-cap U.S. stock market index that makes up the smallest 2,000 stocks in the Russell 3000 Index.

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Source: FactSet, as of 7/22/2024

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880 CARILLON PARKWAY // ST. PETERSBURG, FL 33716 // TOLL-FREE: 800.248.8863 // RAYMONDJAMES.COM

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