Global Product Solutions – Investment Strategy

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US elections: positioning in US equities

Quick read

Uncertainty calls for selectivity

With uncertainty and volatility likely to persist through the campaign cycle, we favour staying invested in US equities – but leaning into selectivity and quality through precision index exposures.

Outcome-neutral trades

We maintain conviction in sectors like US banks that are buoyed by fundamentals and a supportive election backdrop, and which we think could do well regardless of the outcome.

Pricing in risk

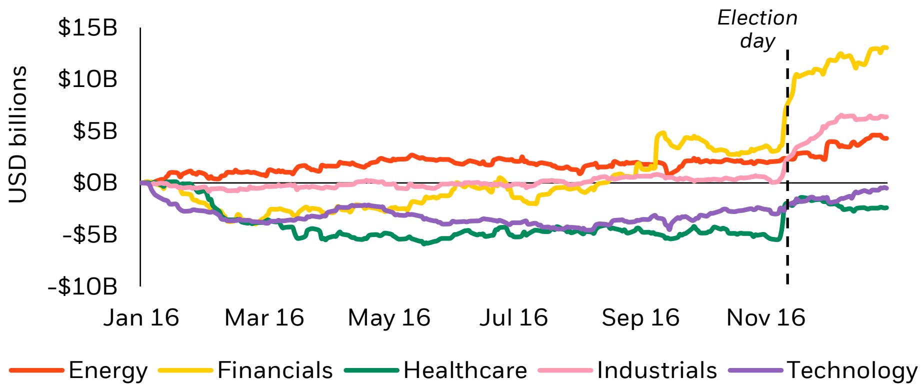
We see a potential inflation boost in the US regardless of who wins in November. Investors looking to prepare for the outcome may consider their exposure to areas likely to be impacted by proposed policy shifts.

The upcoming US elections have come sharply into focus this summer, driving newsflow and markets. Dramatic developments, including a change in the Democratic nominee from President Joe Biden to Vice President Kamala Harris, have set the stage for an unprecedented and unpredictable cycle. We expect political and market volatility to remain elevated – even versus previous election years – into November.

We remain constructive on US equities ahead of the vote. We expect the AI wave to keep pushing US stocks higher – though heightened volatility and dispersion under the hood call for selectivity and a quality bias, in our view. We look to stay invested in US equities, leaning into high-conviction alpha-seeking strategies and precision index exposures. We think recognising and adapting to changing US market regimes is key to managing risks effectively – and potentially enhancing returns.

In an environment of elevated uncertainty, volatility, and dispersion, we focus on 1) building resilience through quality, with a preference for fundamental and systematic alpha-seeking approaches; 2) outcome-neutral sector trades, such as US energy and banks; and 3) cautiously pricing in risk for 2025 and beyond, by preparing portfolios for proposed shifts in policy.

Chart 1: Global flows into sector ETPs, 2016



Source: BlackRock and Markit, as of 23 July 2024.

Looking up in quality to navigate uncertainty

We look up in quality to build resilience and identify long-term structural winners, with uncertainty likely to push higher as the election nears. When taking an index approach, we look to exposures with a quality tilt. Quality has remained in demand with investors this year, with inflows of US$22.3B globally YTD – making it the most popular factor in 2024 so far.[1] With the healthcare sector streaking ahead in the last US earnings season in terms of year on year EPS growth, healthcare is also a key tactical quality call in the current environment.

IOO	**iShares Global 100 ETF**
IQLT	**iShares MSCI World ex Australia Quality ETF**
IXJ	**iShares Global Healthcare ETF**

[1] Source: BlackRock and Markit, as of 23 July 2024. All figures in USD.

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Selectivity through outcome-neutral trades

We continue to look through fast-moving headlines in the US and focus on outcome-neutral trades in US equity sectors. We stay positive on US banks and broader financials, and look for index exposures with a strong weighting to this sector. As with US energy, this is not just an election-driven trade, but that backdrop is key to our view. We see little regulatory risk from the political backdrop for large-cap banks – though the risk may be higher for their regional peers. Overall, the sector looks cheap, at c.12x forward-looking P/E versus 22.9x for the broader S&P 500; the valuation gap versus European banks has widened; and earnings have been improving.[2] We see a further catalyst in an improved commercial real estate outlook, off the back of better financing costs.

We maintain our conviction in US banks despite looming rate cuts: banks have been reducing their interest rate sensitivity over the past year and should now see a smaller negative net interest income (NII) hit on lower rates. Moreover, we think that large-cap banks can weather lower NII, due to a robust loan book and the potential for investment bank dealmaking to pick up from a lacklustre 2023. According to our framework, which analyses returns and volatility since 1988, banks and broader financials score highly on a return and volatility-adjusted return basis in election years.[3] A tighter regulatory environment remains a risk, but we don't see meaningful change this year, given razor-thin majorities in Congress. We've seen $2.9B added to US financials sector ETPs globally so far in 2024.[4]

IVLU	**iShares MSCI World ex Australia Value ETF**
IJH	**iShares S&P Mid-Cap ETF**
IJR	**iShares S&P Small-Cap ETF**

Pricing in risk

We are closely watching potential changes on US trade, immigration and energy policy, and see a potential inflation boost no matter who wins the White House. Both Democrats and Republicans have adopted a protectionist stance in recent years, though the Republican nominee, former President Donald Trump's suggested 10% baseline import tariff – rising to 60% for Chinese goods – goes further than his Democratic rivals. Major changes to legal immigration would have implications for inflation, squeezing US labour supply against the backdrop of an ageing domestic workforce. Together, these proposed policies suggest a negative supply shock, putting upward pressure on inflation.

The potential for higher and broader tariffs could dampen sentiment towards Asian countries and sectors beyond China. A negative growth shock for China could impact Taiwan, Hong Kong, Korea the most.[5] This is in large part due to bilateral trade agreements and high revenue exposure to China in general for those markets. There is the added potential corollary of independent tariff implementation from the US to those markets in Asia that don't have Free Trade Protection agreements in place, including Taiwan, Thailand, Vietnam and Malaysia. India could be seen as one net beneficiary to increased China tariffs as a sourcing alternative to Chinese goods and net exports trending higher[6].

EMXC	**iShares MSCI Emerging Markets ex China ETF**

Want to know more?

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[2, 5, 6] Source: Bloomberg, as of 22 July 2024. All figures in USD.,[4] Source: BlackRock and Markit, as of 22 July 2024. All figures in USD.[3] Source: BlackRock, as of 22 July 2024.

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