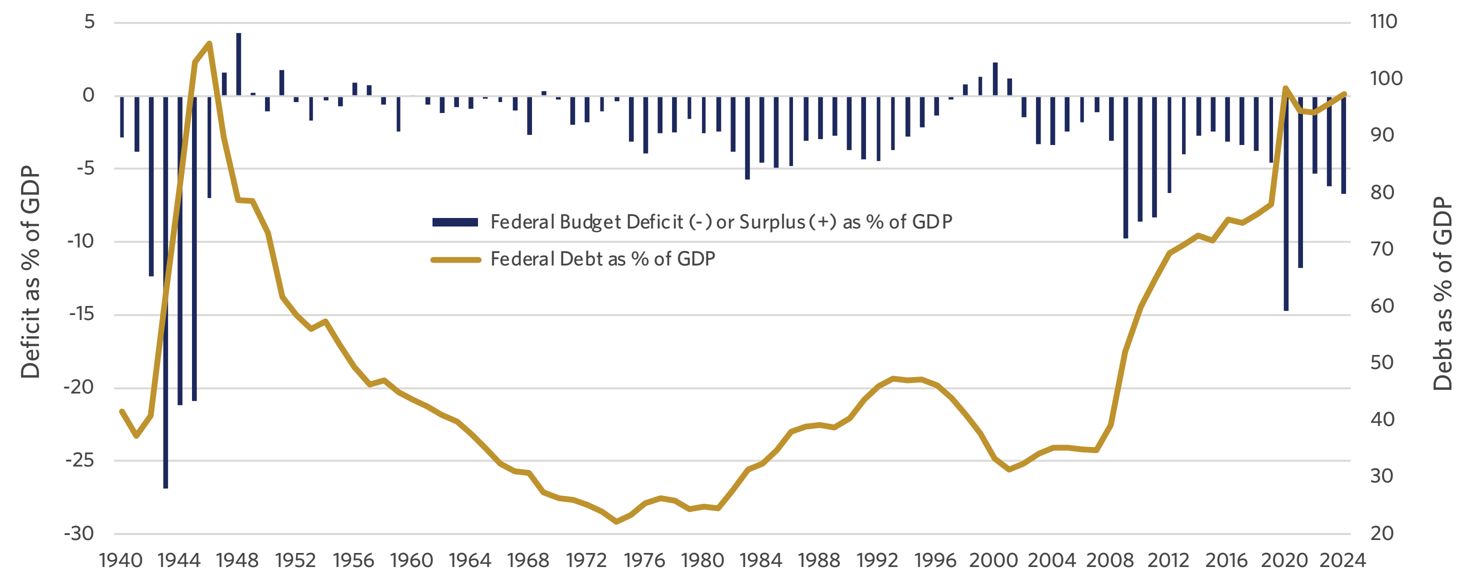
U.S. Federal Debt and Budget Deficits as % of GDP



Source: St. Louis Fed, Congressional Budget Office. Federal debt held by the public.

U.S. election issues and implications

We believe several issues will be raised during the U.S. presidential campaign that connect to fundamental factors important to the economy and markets, including government debt, Federal Reserve (Fed) policy and trade. The election's outcome shouldn't dramatically alter the course of markets or economy, but these factors may have some implications.

Debt and deficits: A slowly approaching train - U.S. budget deficits have run north of 6% in recent years. We've seen larger, rising U.S. deficits as a percentage of GDP (mid-'70s, early '80s, early 90s, 2008–2010), but these accompanied periods of economic weakness. Today's sizable deficits are occurring with above-average GDP growth. We believe this could require more fiscal restraint ahead. While the U.S. government's $35 trillion-and-growing debt is an astronomical number, as a percentage of GDP, it's not yet at a level that would limit the government's ability to borrow at reasonable rates. Favourable economic policies can help delay or lessen those risks, but we think the solution will require fiscal spending and tax adjustments. But we don't expect either candidate this year to pursue material policies to address long-term debt issues.

Tariffs and trade in focus - We expect the campaign trail to include tough talk on trade with China. The U.S. economy's growth does not rely dramatically on trade, but the use of tariffs does present an inflationary risk. While such tactics were leveraged during former President Trump's term, they occurred within a much more benign inflation environment. We think tariff policies will instigate some trade war anxieties for the markets ahead, but we think domestic consumption and investment trends will be the more powerful influence on economic outcomes.

The Fed will move independent of the election - We are confident the Fed will act solely under the direction of incoming inflation and economic data. But the timing of such moves will likely occur around the election, with moderating inflation and softening employment conditions likely to support a case for a rate cut in the September–December window. We also could see some election-driven uncertainty around the future of Fed Chair Jerome Powell's role, if Trump were to propose a new Fed chief.

▶ Action for investors

We recommend an overweight allocation to U.S. equities. Also, consider treating an election-driven market pullback as a buying opportunity.

An investment in equities involves risk. The value of your shares will fluctuate and you may lose principal.

