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U.S. policy under Trump: What investors need to know

From the Field

Key Insights

- President Donald Trump's second term is bringing significant changes in trade, tax and fiscal policy, and regulation.
- These policy shifts could have important implications for markets, the economy, and specific industries in the U.S. and around the world.
- In this dynamic environment, a top-down approach to asset allocation can be powerful when it's combined with deep insights into individual companies.

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President Donald Trump's second term in the White House has brought a barrage of executive orders, along with an extremely aggressive approach to trade policy that has raised concerns about a potential resurgence in inflation.

Current tariff proposals are significantly larger in scope than those put in place by the first Trump administration in 2017. Then, the focus was almost entirely on China. This time, it includes nearly all U.S. trading partners. In 2017, only a few specific products were targeted—most notably aluminum and steel. The scope is much broader this time around.

The situation is fluid, but, at this juncture, even the most moderate version of Trump's proposals would represent a significant increase from the effective tariff rate that was in place at the start of the year.

We should not assume that the ultimate goal of negotiations is to reduce tariff rates in aggregate. The administration has clearly expressed a desire to use tariffs to bring manufacturing back to the U.S. However, it is not clear if they hope to bring back manufacturing in targeted industries or more broadly.

Tax and fiscal policy is another area of focus. Republican majorities in the Senate and House of Representatives suggest that expiring tax cuts, passed during Trump's first presidential term, are likely to be extended. Whether a further reduction in the corporate tax rate can make it through Congress remains to be seen, as do the specifics of any potential cuts in government spending.

In this dynamic environment, a top-down understanding of the interplay between government policy, the economy, and the outlook for different asset classes can be especially powerful when it's combined with deep insights into industries and individual companies in the U.S. and beyond.

The following table highlights some of the key policy areas we're watching and some of the possible implications for asset allocation.

Policy considerations and investment playbook

	What we're watching	Potential implications
Tariffs	• If the Trump administration's tariffs were to persist for an extended period, they could threaten the resiliency of the U.S. economy and global growth while stoking fears of inflation. • Disruptive trade policies could put pressure on central banks to make the uneasy choice to cut interest rates despite the risk of higher inflation, which is most pronounced in the U.S. • The tariff hikes could prove temporary in instances where the administration and trade partners can reach a deal. Long, drawn-out trade negotiations would increase headline risk and market volatility. • Rising geopolitical tensions also pose a risk.	– The unprecedented level of trade uncertainty increases the risk of volatility and could warrant caution on **equities**. – Should the trade war persist, the U.S. economy could face significantly more risk than the rest of the world—a relative headwind for **U.S. equities**. – We are cautious on **emerging market assets**. A slowdown in global trade could weigh on corporate earnings in these export-focused economies and add to pressure on local currencies and fiscal management. + We see relative opportunity in **international value** and **international small caps**, especially in regions where fiscal spending is increasing and where monetary policy is still dovish. **European** and **UK** equities look attractive in this regard. + **Floating rate bonds** could be relatively appealing because of their shorter duration.[1] + **Cash** offers relatively attractive yields, stability, and liquidity. Longer-duration U.S. Treasury bonds offer an attractive hedge against recession, but the outlook for Treasuries is clouded by concerns that tariffs could result in elevated inflation. + Signs of any de-escalation on tariffs would be viewed positively in affected markets.
Tax and fiscal policy	• By and large, the tax cuts from Trump's first term are likely to be extended, resulting in further deficit spending. • The already elevated budget deficit and need for congressional support could make it hard to pass further corporate tax cuts. • That said, potential tariff revenue, government efficiency initiatives, and concerns about the U.S. economy might open the door for some tax reductions and business incentives.	– Increased issuance of **U.S. Treasuries** to finance deficit spending could lead to upward pressure on yields. + **Small caps** and **value stocks** could benefit if corporate tax rates were cut further, although potentially slowing economic growth is a risk.
Immigration	• Stricter immigration policies could tighten the U.S. labor market, putting upward pressure on wages and prices later in 2025 and beyond.	– Concerns about a resurgence in inflation could drive significant **volatility** in stocks and bonds. Such a scenario would also warrant caution on **intermediate- to longer-duration assets**. **Small caps** would also be more vulnerable to rates rising or remaining higher for longer. + **Floating rate bonds** could be relatively appealing because of their shorter duration. Equities linked to **real assets**, such as energy and metals, historically have acted as a hedge against inflation. Still, economic weakness would be a concern for oil and industrial metals.

[1] Duration measures a bond's sensitivity to changes in interest rates.

Policy considerations and investment playbook (cont.)

	What we're watching	Potential implications
Deregulation	• Trump's first-term record suggests that regulatory burdens will be reduced, cutting business costs. • After his first term, the number of pages in the Federal Register, which tracks the flow of government regulations, fell sharply, from over 97,000 in 2016 to under 62,000 in 2017.	+ A more business-friendly regulatory environment could favor **smaller companies and value stocks**. Both would be sensitive to economic weakness. + A leadership changeover at key federal agencies could bring a lighter touch to regulation and supervision of the **financials sector.**[2]
Energy	• Trump is likely to renew his push to reduce the regulatory burden on fossil fuels in his second term. Rolling back tighter emission rules and drilling restrictions advanced by the Biden administration would likely be on the agenda. Permitting reform could also place more of an emphasis on fossil fuel-related infrastructure. • The Trump administration could seek to curb spending on tax credits for electric vehicles and renewable energy that were included in the Inflation Reduction Act (IRA), a signature piece of legislation passed during Biden's presidency.	+ A more supportive regulatory environment could help the **oil and gas** industry at the margin. However, significant growth in domestic hydrocarbon production could be a challenge because of industry consolidation and a maturing resource base. Economic weakness would be a headwind. — Companies in the **electric vehicle** supply chain could encounter demand headwinds. **Utilities** and **renewable energy** developers would also face uncertainties.
Health care	• Fears surrounding potential policy headwinds could weigh on investor sentiment toward the sector. At this juncture, it is difficult to tell the signal from the noise.	— Potential cuts to Medicaid could be a headwind for **managed care** companies with more exposure to this market. — **The pharmaceutical industry** could face challenges if the administration takes an aggressive approach to pricing negotiations for certain drugs under the Inflation Reduction Act. Tariffs also create uncertainty. — Any funding cuts for agencies that give research grants and approve drugs represent headwinds for **life science tools** companies. Tariffs also create uncertainty. — Rising interest rates historically have been a headwind for **biotech** stocks, especially earlier-stage companies. + Positive surprises on any of these fronts would serve as tailwinds.

[2] Gil Fortgang, an associate analyst who covers Washington and regulatory policy for T. Rowe Price Investment Management, explored this topic at length in "How the U.S. Election Could Impact the Financials Sector."

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Fixed-income securities are subject to credit risk, liquidity risk, call risk, and interest-rate risk. As interest rates rise, bond prices generally fall. **Small-cap stocks** have generally been more volatile in price than the large-cap stocks. Because of the cyclical nature of **natural resource companies**, their stock prices and rates of earnings growth may follow an irregular path. Investments in **bank loans** may at times become difficult to value and highly illiquid; they are subject to credit risk such as nonpayment of principal or interest, and risks of bankruptcy and insolvency. While **U.S. government-backed securities** generally are considered to be among the highest credit quality, they are subject to market risk. The primary source of risk is the possibility of rising interest rates, which generally cause bond prices to fall. **Financial services companies** may be hurt when interest rates rise sharply and may be vulnerable to rapidly rising inflation. **International investments** can be riskier than U.S. investments due to the adverse effects of currency exchange rates, differences in market structure and liquidity, as well as specific country, regional, and economic developments. These risks are generally greater for investments in **emerging markets**. The **value approach** to investing carries the risk that the market will not recognize a security's intrinsic value for a long time or that a stock judged to be undervalued may actually be appropriately priced. **Health sciences firms** are often dependent on government funding and regulation and are vulnerable to product liability lawsuits and competition from low-cost generic product. All charts and tables are shown for illustrative purposes only.

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