WELLS FARGO
Investment Institute

Policy, politics & portfolios

What federal budget, regulatory, and trade decisions could mean for investors **February 20, 2025**

Trump economic policy 2.0

Michael Taylor, CFA
Investment Strategy Analyst

Promises made, promises kept

Two focal points of President Trump's economic policy are trade and immigration. Although his proposed steel and aluminum tariffs look like long-term measures to reshore production to the U.S., his other tariff rhetoric has appeared targeted and transactional — to secure concessions from trade partners that range from purchasing more U.S. energy to stemming illegal border crossings and fentanyl inflows to the U.S. Even tariffs on China have been measured.

Deportations of undocumented immigrants also have started in a targeted way, focusing first on those apprehended for breaking laws. We anticipate tariff-driven trade policies to continue and immigration policy to encompass larger-scale deportations, but, so far, both tactics have had limited capital-market impact.

Going forward, we expect that neither set of policies will move in a straight line, and we foresee two implications for investors. First, we expect significant noise — news reports of grandiose plans that then give way to more incremental steps. Second, we anticipate that incrementalism will get another impulse as the administration weighs policy goals against the economic costs that tariffs and deportations create, particularly on inflation.

Tariffs and foreign trade

We prefer to focus on the destination rather than the twists and turns that dominate newscasts. First, Trump views China's trade policies as a barrier for U.S. economic growth. Chinese subsidies give local firms an advantage over competitor U.S. firms,[1] and China's antimonopoly laws could be used to undercut successful U.S. firms operating in China, for example.[2] Closer to home, Trump has demanded that Mexico and Canada halt illegal immigration and flows of fentanyl to the U.S. More tariff threats are likely for Europe, China and other countries, but the administration may present these threats as incentives to buy more U.S. products. Tariffs are a means of leverage to negotiate an array of goals involving countries that sell more to the U.S. than they buy.

The timeline and scope of the administration's foreign-trade policy remain unclear, but the early signals are that Trump is prepared to negotiate, in many cases. If tariffs follow through for a prolonged period, the economic implications would be damaging. Fortunately, there are offsetting factors that should discourage aggressive tariff increases. Mitigating factors include the U.S. dollar's strength against other currencies and the potential for other countries' suppliers to bear at least part of the tariff. U.S. firms also might reduce their profits somewhat to cover part of the levy. U.S. consumers ultimately may shoulder part of the burden through higher prices, the more aggressive the levies are and the longer they stay in place. Even so, it is worth remembering that reversing inflation and promoting economic growth also are important goals for the administration. Moreover, Trump's reliance on the International Economic Emergency Powers Act may prompt blowback from the courts or Congress.

1. The Wall Street Journal, "G-7 Nations Criticize Chinese Subsidies, High-Tech Exports," June 14, 2024, and Voice of America, "China Spends Billions of Dollars to Subsidize Favored Companies," May 24, 2022.
2 .The Wall Street Journal, "China Retaliates Against U.S., Intensifying Trade War," February 4, 2025.

Immigration reform

Border security is a signature issue for Trump and is gathering support among Democratic lawmakers. Undocumented workers in the U.S. exceed 9 million[3] as legal and undocumented immigrants have offset slowing labor-force growth. An 11.7 million person rise in foreign-born workers topped a loss of 8 million native-born workers in 2024.[4] Democrats generally favor legal paths for residence, though some now lean toward comprehensive immigration reform. The Laken Riley Act may be an indication of more bipartisan collaboration. Voters also expect Trump to fix an antiquated immigration system.

Using Trump's first-term record of 1.2 million deportations,[5] we developed three scenarios for weighing the potential breadth and magnitude of immigration reform. Under a *mild scenario,* convicted criminals would be deported. A *moderate scenario* would add undocumented foreign nationals based on federal deportation capacity (roughly 1 million per year) to lawbreakers. A less-likely *heavy scenario* would expand extraditions to maximum capacity (exceeding 3 million annually).

Just as with tariff policy, large-scale deportations carry economic costs. Reducing foreign-born laborers through deportations could disrupt sectors with sizable undocumented immigrant workforces — construction (13.7%), agriculture (12.7%), hospitality (7.1%), and general services (6.5%).[6] Many of these sectors have unfilled job openings, which would be exacerbated by shrinking the labor pool,[7] aggravating wage and price inflation.[8] And, again here, legal roadblocks to pursue an aggressive immigration policy include immigration-court backlogs, lack of Immigration and Customs Enforcement (ICE) agents, blue-state resistance, lack of cooperation from other countries, and legal challenges.[9] Although we see few legal hurdles to deporting convicts, extraditing undocumented immigrants who entered the U.S. within the past four years will likely pose legal challenges.

What it means for investors

Based on the flurry of President Trump's executive actions, we expect immigration and trade initiatives to precede tax and regulatory changes. Although tariffs and immigration restrictions pose inflation risk, the economic impact will depend on the scope and timing of implementation. In our view, any growth impediments should be offset by tax-cut extensions and deregulation coupled with U.S. economic resilience.

China's trade surplus reached a record $992 billion in 2024 as Chinese companies hastened to export goods ahead of a revised U.S. trade policy.

Source: Bloomberg, January 13, 2025

68% of Americans believe the Trump administration will control illegal immigration, an 8-point increase over 2016.

Source: Gallup, January 2, 2025

3. Pew Research Center, "What We Know About Unauthorized Immigrants Living in the U.S.," July 22, 2024.
4. U.S. Labor Department.
5. The Wall Street Journal, November 11, 2024.
6. American Immigration Council, 2024.
7. Ned Davis, May, 2024.
8. See Wells Fargo Investment Institute Alert 2.3.25 for detailed investment implications.
9. The Wall Street Journal, January 1, 2025.

Tax cuts and deregulation

Douglas Beath
Global Investment Strategist

Tax policy

The 2017 TCJA is set to expire at the end of this year, which will trigger a tax increase for 62% of filers according to the Tax Foundation. Beyond the extension of the TCJA, President Trump has proposed a further reduction in the corporate-tax rate from 21% to 15% for companies that make their products in the U.S. Additional tax-cut proposals floated by Trump during the election campaign include increasing the deduction limit on state and local taxes along with tax exemptions on Social Security benefits and overtime pay and tips and restoring full expensing of equipment and research and development (R&D) investment.

For most of the TCJA provisions up for extension, an extension would simply leave existing policies in place and on the surface would not be economically stimulative.[10] However, a 2024 National Federation of Independent Business (NFIB) survey suggests that small-business confidence would plunge if the TCJA is not extended. Thus, the elimination of an "uncertainty factor" regarding the TCJA would likely be a benefit to the economy.

Extending all expiring individual and estate-tax cuts within the TCJA, along with business-tax changes that congressional leaders favor, would reduce projected government revenue by $4 trillion over a decade, according to the congressional Joint Committee on Taxation. That would come atop $20 trillion in new deficits projected under current laws. The aforementioned additional tax-cut proposals should provide further stimulus that would benefit the U.S. economy over the long-term but are estimated to cost $3 trillion. President Trump expects that tariff revenue will offset lost revenue from additional tax-cut proposals, and, indeed, the Tax Foundation estimates that an aggressive scenario imposing hefty tariffs on China along with lesser-but-universal tariffs on all imports would increase federal-tax revenues by $3.8 trillion over 10 years.

Although we expect the TCJA extension in 2025, any additional proposed tax changes seem more probable in 2026. Congress must raise the debt ceiling to fund the TCJA with negotiations possibly running into the "X date" when the U.S. Treasury projects it will run out of cash sometime between June and August of this year. The legislative process could also be encumbered by slim majorities and intraparty differences.

Deregulation

Two key areas for deregulation include the financial and energy sectors.

Financials

In the aftermath of the global financial crisis, financial companies have experienced a surge of regulations, and bank executives are optimistic that Trump will reduce capital cushions and consumer protections and ease scrutiny of consolidation in the industry.

Small banks will be key as they have significant power to push regulatory relief. However, Republicans hold thin majorities in both the Senate and the House and are unlikely to find any Democratic support for dramatic changes.

These deregulation efforts will likely spur bank lending and boost the economy. We also expect mergers and acquisitions (M&A) to increase in the coming years with many regional banks selling at all-time highs and banks looking to achieve greater scale.

10. However, we note that the original TCJA that allowed for expensing R&D expenses already has converted to a more gradual amortization. Restoring the original provision to expense these costs should help stimulate more business capital spending.

Conversely, a temporary 10% cap on credit-card interest rates, which Trump proposed during his campaign, is a potential tail risk for banks, in our view. Deregulation initiatives are also more vulnerable to legal challenges — which can mean additional delays following last year's reversal of the so-called "Chevron deference" Supreme Court ruling, undercutting agencies' ability to unilaterally mandate regulatory changes. Finally, there are logistical lags in the corporate response to deregulations passed by Congress in allocating capital; spending it on plant, equipment, and R&D; and in fully integrating the added investment in production, so investor returns may need time to reflect the positive benefits of deregulation.

Energy

During President Trump's first full week in office, he declared a "national energy emergency" and signed a series of executive orders that encourages more oil and gas production but that disincentivizes electric vehicles. Still, while crude oil prices remain range bound, we expect restrained oil and gas production growth. Secondly, if a new 10% tariff on Canadian oil imports comes out of suspension and into force, we would expect refiners to see their profit margins narrow and gasoline prices rise. Other potential sources of demand that could boost prices and returns would be a policy to refill the Strategic Petroleum Reserve, which is 300 million barrels short of its potential, or expanding sanctions on Russian and Iranian oil sales. The bottom line is that it is not yet clear if recent executive orders or potential future policies from the U.S. will impact energy prices going forward.

What it means for investors

Although the initial relative outperformance of U.S. small-cap stocks postelection has faded, the equal-weighted S&P 500 Index is outpacing the market-cap weighted version year-to-date and U.S. large-cap value stocks are outperforming growth, indicating to us that the U.S. equity market is broadening in anticipation of expanding growth.

The significant outperformance of the Financial sector versus the S&P 500 — both since election day and year-to-date — combined with the KBW Bank Index (this index covers large national and regional banks) handily exceeding both, suggest that investors believe potential deregulation polices from the new administration will have a positive impact — particularly in the M&A space.

In the meantime, master limited partnerships (MLPs) have performed in line with bank stocks since the election (+14% to date according to the Alerian MLP Index and KBW Bank Index). This is an indication that MLPs potentially stand to benefit from deregulation of the domestic energy industry based on increasing natural-gas supply and demand and higher export volumes — particularly as Europe seeks to diversify its energy sources away from Russia while Trump is demanding the European Union buy more energy from the U.S. to avoid tariffs. However, the natural-gas sector will face time-consuming logistical issues as it takes several years to build storage and liquefaction facilities before extrapolating additional supply.

We continue to have most favorable and favorable ratings on the Energy and Financials sectors, respectively.

Although tax cuts and deregulation will likely happen in 2025 and early 2026, markets have already started to respond:

- **NFIB Small Business Optimism Index has soared.**
- **Equal-weighted S&P 500 Index is outperforming the market-cap weighted version and U.S. large-cap value stocks are outpacing growth, indicating to us that the U.S. equity market is broadening in anticipation of expanding growth.**
- **Financial and Energy stocks have outperformed, particularly small banks and the midstream energy sector.**

The big picture

Jennifer Timmerman
Investment Strategy Analyst

Placing President Trump's policy pillars into our outlook

While some policy aspects have already been unveiled in the opening weeks of the new administration, many details remain uncharted or subject to reversal. The good news is that we view President Trump's four policy pillars as only one set of factors in our overall outlook, overshadowed by other drivers of economic and investment performance in the coming year.

A wave of policy changes set on a firm economic foundation

Our view is that the flurry of policy changes — some positive for capital markets, others negative, and all carrying at least some uncertainty about timing and degree — are set against a solid U.S. economic backdrop. In 2025, we expect above-average economic growth and slightly higher year-end inflation to support equities and other risk assets. Our view is that the economy will be propelled by ample liquidity[11] and supported by still-respectable job growth, wage gains outpacing inflation, and increases in upper-income household wealth tied to the recent rally in stocks and other financial assets. In our base case, these economic strengths, along with growth-supportive deregulation and looming tax cuts, will outweigh the threat to growth and inflation from tariffs and immigration restrictions.

Stocks should tolerate modestly higher inflation

We believe the stock market can tolerate modestly higher inflation due to a resilient consumer and because of companies' discipline around cost controls. Our outlook for solid economic growth and firmer inflation in 2025 leaves us with a year-end target range of 4.50% – 5.00% for the 10-year U.S. Treasury yield — only slightly above recent levels. We think long-term interest rates in this range can limit the pressure on housing and other credit-sensitive sectors of the economy. In our view, modestly higher longer-term interest rates will be insufficient to impede further equity-market gains, supported by our expectation for earnings growth as the primary driver of stock prices, and allow the S&P 500 Index to accommodate current valuations. Further, we believe continued economic strength will foster widening stock-market breadth to include more cyclical (or economically sensitive) sectors as growth becomes more balanced between resilient services and lagging manufacturing due to tax cuts, reshoring, and consumer spending.

Weighing the impact of all policy pillars

We believe that threats to economic growth from tariff increases and the effect of tighter immigration controls on labor supply will be overshadowed by deregulation and tax policy for at least two reasons. First, as we discussed above, we expect tariffs to target the main trading partners of the U.S. along with deportations that focus on undocumented immigrants who are incarcerated. Universal tariffs are possible, but the Trump administration likely wants to avoid their high costs to the U.S. economy in slower growth and higher inflation. Second, our view is that tax cuts and deregulation initiatives can boost investment and raise business and labor productivity by improving the return on capital. On balance, we believe these factors support a positive

11. By this we mean cash available for investing and spending.

environment for equities and provide fixed-income investors opportunities to lock in higher long-term yields than have been available in years.

Putting policies into perspective

To reiterate a key point, noisy headlines will no doubt be the norm rather than the exception this year and we prefer to look through policy twists and turns to economic policy's final destination. Supportive economic measures, on balance, combined with the economy's strong underlying growth, inflation, and interest-rate fundamentals will ultimately drive market performance. But we do expect the ride to be bumpy as new tariffs and immigration controls are announced and enacted — a noticeably different backdrop for investors after the subdued volatility of the recent past.

Investment implications

Our portfolio guidance looks through initial policy announcements from the new administration and continues to focus on expected policy supports and more fundamental drivers of growth, inflation, and interest rates because of the economy's ongoing strengths:

- We favor U.S. over international assets and, within that, higher-quality and more-liquid U.S. large cap stocks. Large caps' underlying strengths should outweigh potential currency losses on multinationals' overseas earnings tied to U.S. dollar strength. Our preference is that portfolios hold full allocations to small- and mid-cap equities.

- We prefer to position for a rotation into more economically sensitive equity sectors. Our favored sectors include Energy, Financials, Industrials, and Communication Services.

- In fixed income, we favor reallocating from cash and money market funds into intermediate (three to seven years) and longer maturities to lock in rising yields.

- Tariffs on Canada, Mexico, and China may lift the prices of industrial metals, such as copper, aluminum, and zinc. We still favor commodities, both for potential return and as hedges for investors most sensitive to rising inflation.

We believe strong underlying fundamentals will ultimately drive market performance as investors look through a changing policy landscape in focusing on the economy's strengths.

We think more cyclical equity sectors will be able to participate in the stock rally as economic growth becomes more balanced between resilient services and lagging manufacturing due to tax cuts, reshoring, and consumer spending.

Risk considerations

Forecasts are not guaranteed and based on certain assumptions and on views of market and economic conditions which are subject to change.

Equity securities are subject to market risk which means their value may fluctuate in response to general economic and market conditions and the perception of individual issuers. There is no guarantee that value stocks will increase in value or that their intrinsic values will eventually be recognized by the overall market. The value type of investing tends to shift in and out of favor.

The prices of small and mid-cap company stocks are generally more volatile than large company stocks. They often involve higher risks because smaller companies may lack the management expertise, financial resources, product diversification and competitive strengths to endure adverse economic conditions.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. **Communication services** companies are vulnerable to their products and services becoming outdated because of technological advancement and the innovation of competitors. Companies in the communication services sector may also be affected by rapid technology changes; pricing competition, large equipment upgrades, substantial capital requirements and government regulation and approval of products and services. In addition, companies within the industry may invest heavily in research and development which is not guaranteed to lead to successful implementation of the proposed product. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Investing in the **Financial** services companies will subject an investment to adverse economic or regulatory occurrences affecting the sector. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance.

Investments in fixed-income securities are subject to interest-rate, credit/default, liquidity, inflation, and other risks. Bond prices fluctuate inversely to changes in interest rates. Therefore, a general rise in interest rates can result in the decline in the bond's price. Credit risk is the risk that an issuer will default on payments of interest and principal. This risk is higher when investing in high-yield bonds, also known as junk bonds, which have lower ratings and are subject to greater volatility. If sold prior to maturity, fixed-income securities are subject to market risk. All fixed-income investments may be worth less than their original cost upon redemption or maturity.

U.S. government securities are backed by the full faith and credit of the federal government as to payment of principal and interest. Unlike U.S. government securities, agency securities carry the implicit guarantee of the U.S. government but are not direct obligations. Payment of principal and interest is solely the obligation of the issuer. If sold prior to maturity, both types of debt securities are subject to market risk. Although Treasuries are considered free from credit risk, they are subject to other types of risks. These risks include interest rate risk, which may cause the underlying value of the bond to fluctuate.

Investment in Master Limited Partnerships (MLPs) involves certain risks which differ from an investment in the securities of a corporation. MLPs may be sensitive to price changes in oil, natural gas, etc., regulatory risk, and rising interest rates. A change in the current tax law regarding MLPs could result in the MLP being treated as a corporation for federal income tax purposes which would reduce the amount of cash flows distributed by the MLP. Other risks include the volatility associated with the use of leverage; volatility of the commodities markets; market risks; supply and demand; natural and man-made catastrophes; competition; liquidity; market price discount from Net Asset Value and other material risks.

Exposure to the commodities markets may subject an investment to greater share price volatility than an investment in traditional equity or debt securities. Investments in commodities may be affected by changes in overall market movements, commodity index volatility, changes in interest rates or factors affecting a particular industry or commodity. Products that invest in commodities may employ more complex strategies which may expose investors to additional risks.

Definitions

Alerian MLP Index is a composite of the 50 most prominent energy Master Limited Partnerships (MLPs) that provides investors with an unbiased, comprehensive benchmark for this emerging asset class. The index, which is calculated using a float-adjusted, capitalization-weighted methodology, is disseminated real-time on a price-return basis and on a total-return basis.

KBW Bank Index serves as the benchmark for the banking sector and consists of the stocks of 24 banking companies.

NFIB Small Business Optimism Index is the small business optimism index is compiled from a survey that is conducted each month by the National Federation of Independent Business (NFIB) of its members. The index is a composite of ten seasonally adjusted components based on questions on the following: plans to increase employment, plans to make capital outlays, plans to increase inventories, expect economy to improve, expect real sales higher, current inventory, current job opening, expected credit conditions, now a good time to expand, and earnings trend.

S&P 500 Index is a market capitalization-weighted index composed of 500 widely held common stocks that is generally considered representative of the US stock market.

S&P 500 Equal Weight Index is the equal-weight version of the widely-used S&P 500. The index includes the same constituents as the capitalization weighted S&P 500, but each company in the S&P 500 EWI is allocated a fixed weight - or 0.2% of the index total at each quarterly rebalance.

An index is unmanaged and not available for direct investment.

General disclosures

Global Investment Strategy (GIS) is a division of Wells Fargo Investment Institute, Inc. (WFII). WFII is a registered investment adviser and wholly owned subsidiary of Wells Fargo Bank, N.A., a bank affiliate of Wells Fargo & Company.

The information in this report was prepared by Global Investment Strategy. Opinions represent GIS' opinion as of the date of this report and are for general information purposes only and are not intended to predict or guarantee the future performance of any individual security, market sector, or the markets generally. GIS does not undertake to advise you of any change in its opinions or the information contained in this report. Wells Fargo & Company affiliates may issue reports or have opinions that are inconsistent with, and reach different conclusions from, this report.

The information contained herein constitutes general information and is not directed to, designed for, or individually tailored to, any particular investor or potential investor. This report is not intended to be a client-specific suitability or best interest analysis or recommendation, an offer to participate in any investment, or a recommendation to buy, hold, or sell securities. Do not use this report as the sole basis for investment decisions. Do not select an asset class or investment product based on performance alone. Consider all relevant information, including your existing portfolio, investment objectives, risk tolerance, liquidity needs, and investment time horizon.

Wells Fargo Advisors is registered with the U.S. Securities and Exchange Commission and the Financial Industry Regulatory Authority but is not licensed or registered with any financial services regulatory authority outside of the U.S. Non-U.S. residents who maintain U.S.-based financial services account(s) with Wells Fargo Advisors may not be afforded certain protections conferred by legislation and regulations in their country of residence in respect of any investments, investment transactions, or communications made with Wells Fargo Advisors.

Wells Fargo Advisors is a trade name used by Wells Fargo Clearing Services, LLC and Wells Fargo Advisors Financial Network, LLC, Members SIPC, separate registered broker-dealers and non-bank affiliates of Wells Fargo & Company.

PM-08142026-7642166.1.1