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Key Implications of Trump 2.0 for Private Equity

While the policies and implications of Trump 2.0 are difficult to predict, we remain optimistic about private equity's ability to navigate change in a dynamic environment and potentially deliver attractive risk-adjusted returns.

The Importance of Being Nimble

Donald Trump's victory in the U.S. presidential election has stirred significant response in markets. While pre-election polls projected razor-thin margins, Trump solidly won the election (including the popular vote), and the Republicans gained firm control of the Senate and are set to maintain their majority in the House. The speed of the outcome was surprising, with the lack of uncertainty catalyzing rallies in risk assets (particularly U.S. small cap equities and the financial sector) and further increases in U.S. Treasury rates due to inflation concerns.

The Republican sweep may increase the likelihood that President-elect Trump will be able to implement many aspects of his agenda. So what are some of the potential implications of Trump 2.0 for private equity?

Mr. Trump is inheriting an economy that, by most metrics, is performing well: The U.S. boasts the strongest growth among the G7 nations;[1] its equity markets are thriving; unemployment is low; and interest rates are on a downward trajectory. Moving forward, we believe key areas worth watching include taxes, deregulation and antitrust policy, tariffs and trade, and inflation.

Since the policies and implications of Trump 2.0 remain difficult to predict, the range of potential outcomes is wide. Not only is it difficult to predict which policy initiatives a new president will actually implement, but also the effect such policies could have on private equity in a complex economy. We do believe, however, that the nimbleness of private equity managers and private-equity-backed companies provides significant advantages in navigating a dynamic policy environment.

[1] Source: OECD, past year real GDP growth by the end of Q2 2024.

Taxes: Potential Rate Reductions May Not Significantly Affect Private Equity

- *Personal tax rates.* Trump and Republicans have indicated that further cuts in personal tax rates will be enacted. We note that, despite the proposal to eliminate taxes on tips and social security benefits, rate reductions are more likely to eliminate a headwind by extending the TCJA cuts that expire at the end of 2025 rather than introducing material *new* tax cuts. Even if such rate cuts are implemented, they are likely to have little direct impact on private equity, in our view.
- *Corporate tax rates.* President-elect Trump has made statements about the desire to reduce corporate tax rates yet has provided few specifics. We expect corporate tax reductions to be limited. We also would not expect any such reductions in corporate tax rates to materially affect private equity, as many private-equity-backed companies are not significant corporate taxpayers.

Deregulation and Antitrust: Looser Policy Could Reignite Animal Spirits

- Trump has highlighted his intent to prioritize deregulation, which has potential to spur "animal spirits" among U.S. corporations (including small businesses) and drive increases in capital spending. Deregulation can be particularly beneficial for small and midsized businesses, which make up the largest segment of the private equity asset class. If successful, we believe deregulation could be a meaningful tailwind for private equity.
- In recent years, the Biden administration has shown an increased aggressiveness in the field of antitrust, challenging more activities than had been the case under many other recent administrations. Republicans have historically had a narrower view of antitrust, though these policy views have been evolving in recent years. While President-elect Trump has not made his views on this topic clear, we believe his appointments to the FTC and the Antitrust Division of the Justice Department could be a meaningful indicator.
- A continuation of stricter antitrust enforcement could have a chilling effect on M&A by large companies, particularly in sensitive industries such as technology. On the one hand, this might limit the exit opportunities for existing private-equity-backed companies by restricting large corporates as potential buyers, particularly for large and mega-cap private equity managers; however, it could also create interesting new buying opportunities for private equity managers facing fewer competitive bids from strategic buyers.
- If a Trump administration were to pursue a more traditional approach to antitrust, this could lead to a more favorable M&A environment, particularly for the exits of larger private-equity-backed companies.

Tariffs and Trade: Higher Tariffs Would Likely Weigh Less on Private Equity Than on the Broader Economy

- During the campaign, President-elect Trump spoke of his support for tariffs. He stated his desire to implement headline tariff rates of 20% across the board, and of 60% or more for imports from China. While the U.S. president has broad authority to implement tariff increases, it is yet unclear if these tariff increases will be implemented, and if they are, how quickly and how uniformly. Some of President-elect Trump's policy advisors have stated that the aim of these policies is to renegotiate better trade deals for the U.S., rather than full imposition of the tariffs themselves.
- The consensus view among economists is that higher tariffs would be inflationary, but to what degree depends on the extent and speed with which they were implemented. It should be noted that the U.S. economy is more self-sufficient than many other developed countries: U.S. imports equal approximately 15% of its GDP, roughly half that of the United Kingdom and one third that of Germany.
- Private equity as an asset class is overweight intellectual property and service-based sectors relative to the economy as a whole. Tariffs, by their nature, are taxes on the importation of goods. While certain private-equity-backed businesses could be directly affected by tariff increases, our proprietary analysis of private equity portfolios suggests that the typical diversified portfolio is likely less exposed to tariff risk than the broader economy.

Inflation: Private-Equity-Backed Companies Have Shown Ability to Protect Their Margins When Costs Rise

- There are concerns that some of President-elect Trump's proposed policies—including tax cuts (if deficit increasing), tariff increases and workforce reduction through lower immigration—could be inflationary. We believe this outcome is far from certain as many of the most inflationary aspects of those policies could be avoided and/or overwhelmed by other macroeconomic and market forces.
- If inflation did reappear, what would it mean for private equity? Fortunately, we have insights based on how private equity managers and private-equity-backed companies responded after the COVID pandemic. By and large, private equity dealt with COVID-induced inflation successfully: Portfolio companies were generally successful in addressing supply chain issues and protecting their margins while continuing to generate higher revenue and EBITDA.

Conclusion

While the policies and implications of Trump 2.0 are difficult to predict, we remain optimistic about private equity's ability to adapt to changing rules and market conditions, capitalize on opportunities and move aggressively to mitigate risk. We expect this to continue to be the case as the U.S. transitions to a new administration.

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Market Conditions: Private equity strategies are based, in part, upon the premise that investments will be available for purchase by at prices considered favorable. To the extent that current market conditions change or change more quickly anticipated investment opportunities may cease to be available. There can be no assurance or guarantee that investment objectives will be achieved, that the past, targeted or estimated results be achieved or that investors will receive any return on their investments. Performance may be volatile. An investment should only be considered by persons who can afford a loss of their entire investment.

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Default or Excuse: If an Investor defaults on or is excused from its obligation to contribute capital to a private equity fund, other Investors may be required to make additional contributions to replace such shortfall. In addition, an Investor may experience significant economic consequences should it fail to make required capital contributions.

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