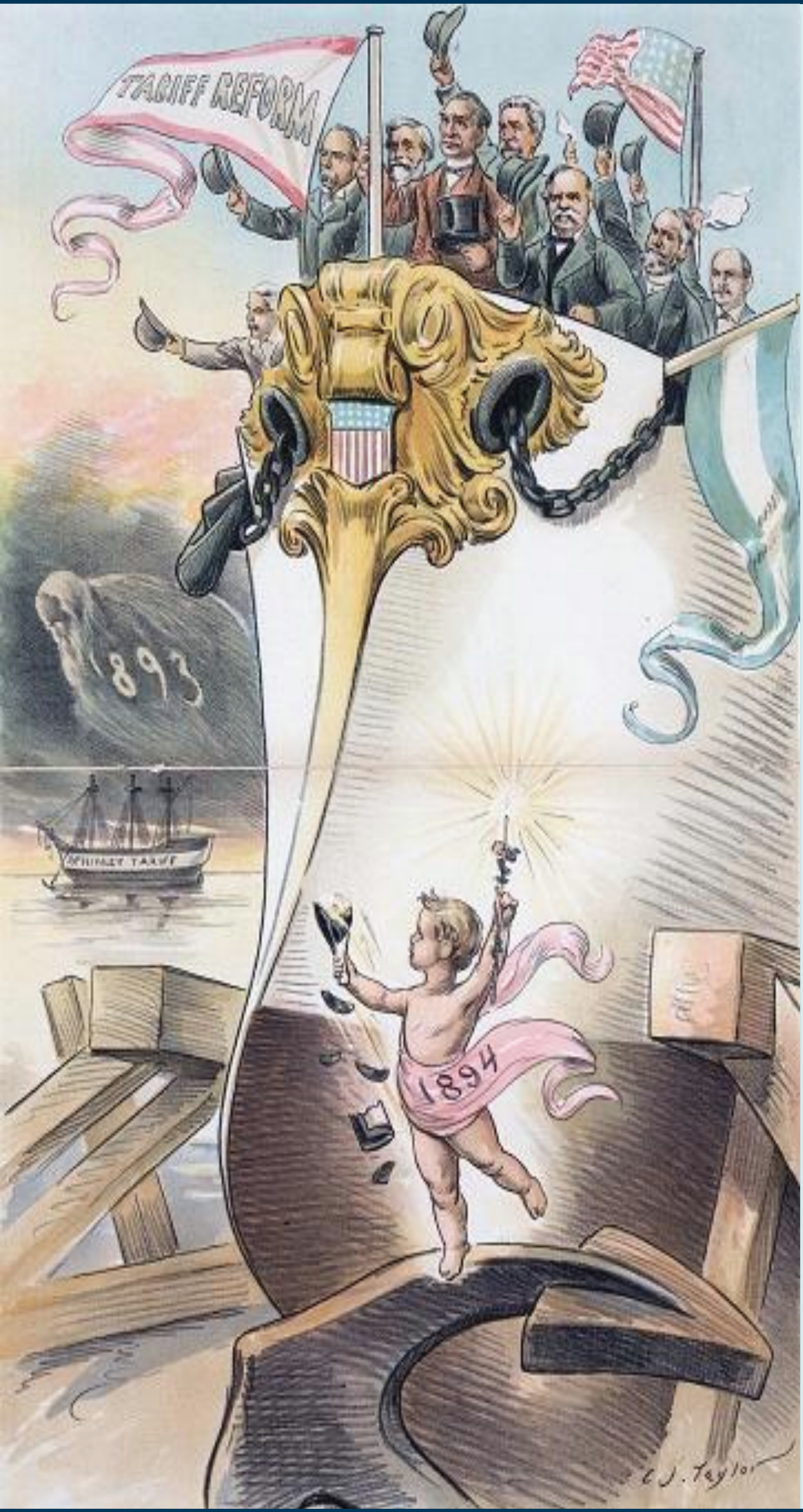

After the Interregnum: What Is the Best Second Term Trump Trade?

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After the Interregnum: What Is the Best Second Term Trump Trade?

By Neal J. Wilson

Executive Summary:

- A look back at the second administration of the last president to win non-consecutive terms, Grover Cleveland, provides a valuable lesson of history regarding the imposition of tariffs. Whether, and to what extent, President-elect Donald Trump applies such tariffs is perhaps the greatest unknown of his upcoming presidency.
- EJF Capital's ("EJF") view is that tariffs, however Trump and his administration pursue them, will have a more disparate impact on those financial institutions with large exposures to international loans and deposits (money centers and large banks) than on those that are primarily domestically focused (small banks, i.e. those with less than $100 billion in assets).
- Beyond the more unpredictable imposition of tariffs, EJF believes that there are six policies that we can anticipate the Trump administration pursuing during his second term: (1) a continuation of the low corporate taxes established in his first term; (2) a push for deregulation beyond those achieved in his first term; (3) increased M&A across industries, with the exception of the technology sector; (4) extension of the fiscally stimulative Opportunity Zone program; (5) support for regulating and supporting cryptocurrencies, resulting in the additional commercial embrace of blockchain technology and the use of stablecoins; and (6) more restrictive immigration policies.
- In its almost twenty-year history, EJF has never felt more confident about the direction of travel for small U.S. banks given the deregulatory and interest rate environments, predictably low corporate tax rates and fiscal stimulus policies that the second Trump administration will bring. Although the application of tariffs are as yet unknown, we feel that within the financial sector, small banks will reside in the protective cove of the domestic economy. EJF strongly believes that as small bank loan growth and M&A heats up, there will be no better "Trump Trade" than owning small bank equities and debt.

Grover Cleveland and Donald Trump

With his 2024 election to a non-consecutive second term after losing in 2020, Donald Trump accomplished what only one other person has before him. That other person, Grover Cleveland, won election to the White House in 1884 and 1892. This aside, the historic parallels between Trump and Cleveland are remarkably few. Before running for president, Cleveland was primarily a career politician, serving as the Sheriff of Erie County (NY), Mayor of Buffalo and Governor of New York. By contrast, Trump was a television personality and real estate developer and brander. When Cleveland lost to Benjamin Harrison in 1888 after his first term, Cleveland won the popular vote but lost the Electoral College vote. This means that Cleveland is the only

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president other than Franklin D. Roosevelt to win the popular vote for president three (consecutive) times. By contrast, the only time Trump won the popular vote was on his third try in 2024.[1]

Cleveland was popular, but he was not a populist; Trump has led what many consider a world-wide populist movement. In foreign affairs, Cleveland "moved with tact and delicacy" in diplomatically settling an Alaska/British Columbia boundary dispute with Canada. Cleveland was also considered a non-imperialist, killing an effort to build a canal through Nicaragua[2] (the Panama Canal was not completed until 1914) and passing on an opportunity to annex Hawaii. In all matters involving foreign policy -- including his recent pronouncements on Canada, the Panama Canal and Greenland -- Trump clearly does not move with tact or delicacy. On monetary policy, Cleveland promoted "sound money" and the gold standard; Trump has consistently cajoled the Federal Reserve and Chairman Jerome Powell to pursue "loose money" policies and lower interest rates. Cleveland was considered an enemy of labor and even sent federal troops to Chicago to stop the violence of the infamous railway Pullman Strike in 1894; Trump is the first Republican to intentionally seek (somewhat successfully) the support of organized labor. Although one could argue the two men did share one quality – a laudable aversion to government waste and abuse[3] – this is a notable exception.

So why is it worth discussing the Cleveland presidency when considering the impending second term of Trump? The answer is tariffs - the most important policy difference between the two presidents. Trump famously imposed them in his first term and threatens to do so more broadly in his second, while Cleveland ran for his second term on the issue of lifting the protective tariffs put in place during the interregnum Harrison administration.

Cleveland's first term was considered a financial success, especially after coming into office in 1884 at the time of a financial recession and contraction. The period 1886 to 1890 was indeed one of prosperity, with "healthy growth in trade and industry."[4] This growth meant increasing levels of imported goods and commodities by businesses and consequent tariff revenues to the federal Treasury. The Cleveland administration was even able to pay off the national debt that had accumulated since the Civil War.[5] During the interregnum administration that followed, Congress, with the backing of Harrison, then passed two significant pieces of legislation in 1890 that changed economic matters for the worse: the highly restrictive McKinley Tariff Act (which raised tariffs to an average of 48.7%[6] on all imported goods, the highest since The Tariff of

[1] After the fourth election and death of Roosevelt, the Constitution was amended in 1947 (Amendment XXII) to provide that a person may only be elected twice to the office of president, so Trump will not get a fourth try at winning the popular vote for a second time. https://constitution.findlaw.com/amendment22.html.
[2] Henry Graff, "Grover Cleveland: Foreign Affairs," University of Virginia Miller Center, https://millercenter.org/president/cleveland/foreign-affairs.
[3] William Bushong, "The Life and Presidency of Grover Cleveland," The White House Historical Association, https://www.whitehousehistory.org/the-life-and-presidency-of-grover-cleveland.
[4] W. Jett Lauck, "The Causes of the Panic of 1893", 23, (Houghton, Mifflin & Co.: 1907), https://babel.hathitrust.org/cgi/pt?id=uc2.ark:/13960/t3hx1hx46&seq=39.
[5] Id.
[6] Id., 14.

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Abominations in 1828), and the Sherman Act (also known as the Silver Purchase Act). The McKinley Tariffs significantly reduced imports and federal revenue and the Sherman Act allowed dollars to be redeemed from banks by not just gold but also silver. Three years later, and three months into Cleveland's second term, the Panic of 1893 ensued, resulting in the worst economic depression the country had experienced until that point in history. The protectionist McKinley Tariff cannot be considered the sole cause of the Panic of 1893 as Europe was in financial turmoil and the Sherman Act incented bank depositors to redeem their cash for silver, thereby spurring a bank run. However, historians believe that the McKinley Tariff was a significant contributing factor.[7] The lesson of history, according to most conventional economists, is that broadly applied protective tariffs are unwise. Whether, and to what extent, Trump applies such tariffs is perhaps the greatest unknown of his upcoming presidency.

Trump Administration 2.0

Before returning to the subject of tariffs, we should consider first what *is* safe to assume about Trump's second term. In EJF's opinion, one can anticipate at least six policy directional moves. The first is the continuation of low corporate taxes, which Trump has even suggested should be reduced further. The margin of Trump's victory almost ensures a permanent continuation of Trump's domestic corporate tax rate of 21% as enacted during his first term in the 2017 Tax Cuts and Jobs Act. The Trump campaign proposal is to reduce this rate to 15%. Second, we can anticipate a repeat of Trump's first term push for deregulation. In his first term, Trump required that for every new regulation proposed two must be revoked.[8] In his campaign, Trump vowed to increase that ratio to 10:1. President Trump will not need Congress to significantly impact, and reduce to a meaningful degree, the regulatory apparatus of the federal administrative state. Under the Congressional Review Act, Trump and the Republicans in Congress can immediately overturn more than 56 recently promulgated regulatory actions.[9] Third, and related, we can anticipate a wave of M&A broadly, except in the technology sector to which Trump and his allies have signaled a desire to apply continued scrutiny. Approval for M&A in industries under direct federal administrative oversight, like banks, do not need Congressional input. We would agree with Professor Rodney Lake of the George Washington University School of Business: "The Trump trade we are looking at is more M&A in the banking sector."[10] As we have written in a previous report to investors on November 8, 2024, "two of the last four years have seen the fewest bank M&A deals since the 1990s" and we are already seeing the anticipated

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[7] Id., 26-34.
[8] McCaskill & Nussbaum, "Trump Signs Executive Order Requiring That for Every One New Regulation, Two Must be Revoked," *Politico*, January 30, 2017, https://www.politico.com/story/2017/01/trump-signs-executive-order-requiring-that-for-every-one-new-regulation-two-must-be-revoked-234365.
[9] Suzanne P. Clark, "Let the Trump Deregulation Begin", *Wall Street Journal*, November 11, 2024, https://www.wsj.com/opinion/let-the-trump-deregulation-begin-us-chamber-of-commerce-second-term-economic-growth-73f24387.
[10] Craig Mellow, "Can Trump Fulfill Promise on Banking Deregulation?", *Global Finance*, December 26, 2024, https://gfmag.com/economics-policy-regulation/trump-banking-financial-cryptocurrency-deregulation/.

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rebound in deal activity after the election as small and regional bank share prices – the currency for M&A transactions – have risen throughout 2024. Fourth, we have strong reason to believe that the Trump administration will extend the Opportunity Zone program that it launched in its first term. By some estimates, the program that provides tax-relief in exchange for investing in real estate development projects and business prompted, since 2018, more than $40 billion in investment in opportunity zones and the creation of at least 192,000 new residential units and thousands of temporary and permanent jobs.[11] Fifth, we can expect newfound support for regulating and supporting cryptocurrencies, which EJF believes will most significantly result in the additional commercial embrace of blockchain technology and the use of stablecoins. Finally, we can anticipate more restrictive immigration policies, perhaps Trump's signature policy initiative.

Some, or all, of these six policy directions have the potential to spur growth and fan inflationary pressures in the economy. While the reduction in immigration may increase the cost of labor, America's impressive growth trajectory can be continued, or even enhanced, by predictably lower taxes, deregulation and investment in real estate development. This viewpoint has been expressed in the market in the form of increased yields in the 10-year U.S. Treasury bond as well as a steepening yield curve. The yield on the 10-year has moved over 90 basis points since September 16, 2024 in the lead up to Trump's election.

EJF believes that one subset of companies in America that will clearly benefit from Trump's six likely policy shifts and a steepening yield curve is smaller banks, i.e. those with less than $100 billion in assets. A steepening yield curve is very positive for bank fundamentals due to a combination of lower deposit costs (short end), as well as fixed asset repricing given the medium duration of most small and mid-size loan portfolios. Valuations of bank equities are highly correlated with margin improvement. While higher interest rates may increase the probability of credit deterioration, we believe that the combination of fiscal stimulus, healthy economic growth and fewer regulatory hurdles should more than offset this risk. It is also worth looking back to Trump's first term to see how small banks performed. Between 2016 and 2020, small banks grew at 10.6% annualized versus large banks at 2.5%. Today, small banks are growing at 3.3% versus large banks at 0.7% annualized. Therefore, we believe that the potential for a tripling of small bank loan growth may lead to much higher earnings expectations for the sector, a catalyst for higher bank share prices and strengthening bank issued credit.

The Trump Tariffs – EJF Takeaways

Which brings us back to tariffs. History tells us that broadly applied tariffs increase the costs of goods for both consumers and producers and therefore can be inflationary in the short term and economically damaging in the long term. Unlike Cleveland, Trump does not want to undo

[11] Georgiev & Hecker, "Understanding the Opportunity Zone Program," National Multifamily Housing Council, Dec. 10, 2024, https://www.nmhc.org/news/research-corner/2024/understanding-the-opportunity-zone-program/.

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any tariffs that the interregnum Biden administration kept in place from Trump's first term. However, one must assume that Trump's threats of even broader application of tariffs cannot be achieved legislatively like the ill-considered McKinley Tariff. There appears to be a Republican consensus around higher tariffs on China, but it is less clear that there is a movement of support for broad based tariffs. Tariff implementation may also not be permissible under the rules of budget reconciliation, which Republicans would likely have to use given their slim majorities in both houses of Congress.[12] But clear executive authority does exist to ramp up tariffs on imports from China and some products from Europe. Trump can also seek new authority through the regulatory process to levy tariffs on other countries, although that takes time.

EJF's view is that tariffs, however Trump and his administration pursue them, will have a disparate impact in the financial sector, with a more negative impact on money center, large banks. Although small banks will not be immune to the tariff policies of Trump, particularly as they relate to loans made to American companies with ties to Canada and Mexico, small banks are substantially more domestically focused. U.S. banks under $100 billion of assets have less than 0.5% of loans outside of the U.S. and source less than 0.2% of deposits from outside of the country. By contrast, the largest banks, over $700 billion of assets, are much more exposed to international loans and deposits, with over 17.5% of loans and over 12.5% of deposits originating outside of the U.S.[13]

Conclusion

After the interregnum of the Biden administration, we enter an era of Trump 2.0 that portends risk in the form of an unknown Trump tariff policy that history shows can result in short-term inflation and long-term economic damage. Nonetheless, EJF believes that Trump's tariff policy will not uniformly affect financial institutions and that small and community banks, in particular, will largely operate outside the policy's area of maximum impact. In its almost twenty-year history, EJF has never felt more confident about the direction of travel for small U.S. banks given the deregulatory and interest rate environments, predictably low corporate tax rates and fiscal stimulus policies that the second Trump administration will bring. Although the application of tariffs are as yet unknown, within the financial sector, we feel that small banks will reside in the protective cove of the domestic economy. EJF strongly believes as small bank loan growth and M&A heats up, there will be no better "Trump Trade" than owning small bank equities and debt.

[12] See Michael Zezas, Morgan Stanley & Co. 2025 Outlook, December 8, 2024, in which Zezas argues for "Fast announcement, slow implementation" in terms of tariffs in the upcoming Trump administration.
[13] S&P Capital IQ Pro as of September 30, 2024.

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