The Year of the U.S. Election
Implications for Investors to Consider

At a glance:

- Economic conditions may play a role in predicting the outcome of U.S. presidential elections, but they do not generally have a meaningful impact for long-term market performance

- Key policy areas that will most significantly have a pronounced economic impact will be taxes and trade

- A divided government or a sweep in Congress will likely determine the extent of policy change in the coming years

In the final weeks leading up to the 2024 U.S. Presidential Election in November, there is heightened anticipation (and slight anxiety) around the outcome of this important leadership challenge. It should be noted at the outset that while elections may provoke short-term volatility and uncertainty, they historically do not have a long-term impact on market performance. However, awareness of the potential implications of proposed policies that may affect the U.S. economic outlook, may be insightful for this year's contentious political race. This outlook will define the country's near-term prospects and its global impact as the largest economy in the world.

Economics and the Odds

The decision by President Biden to leave the race reinvigorated not just the Democratic party but the overall presidential race across the nation. The latest polls (at the time of writing) have shown that Harris has made substantial gains against Donald Trump's lead across key battleground states on the wave of electoral enthusiasm, particularly among young, Black and Hispanic voters. In a statistical dead heat, the odds of victory for either candidate are still very much at a coin toss, but it may be useful to look at past experience.

Analysis of data from the last 100 years, in which there have been 25 presidential elections (since 1924) and 17 of those included a sitting president, economic conditions have played a major role in determining the outcome. History has shown us that the probability of an incumbent winning has been greater in the absence of a recession, and where economic conditions were favourable, as perceived by the general electorate. Given the current growth data in the U.S. and performance of the S&P 500 Index so far this year, odds may favour the continuation of a Democratic president. Furthermore, the average annual return of the S&P 500 Index was 12.1% in the one-year period prior to election day when the incumbent won, compared to 1.1% when the incumbent was defeated.[1] Based solely on this hypothesis and on market performance this year, the odds may lean in favour of a continuation of a Democratic president.

It is important to note that even as volatility increases amid policy announcements and poll results, the economic reality that drives markets is based on data. The unexpected result of the 2016 election led to widespread volatility and temporary losses, however these declines were short-lived, and investors who stayed the course were rewarded.

Divided for Better

Policy drives legislation, and legislation ultimately impacts the economy. There are a range of potential policy outcomes that depend not just on the leadership ticket, but also on the structure of congress. A majority vote in both chambers of Congress (the House of Representatives and Senate) for the elected presidential party, would enable the advance of an agenda, and determine the likelihood of implementation and timing.

Balance of Power

President
- Cannot pass legislation
- Executive control over foreign policy, war, trade, enhancing war

President can veto bills

House of representatives:
- Makes and passes laws
- Budgetary matters generally originate here

New laws must pass the House and Senate

U.S. Senate
- Makes and passes laws
- Approves appointees and ratifies treaties

> **Advancing the President's agenda is higher with control over Congress (House and Senate)**
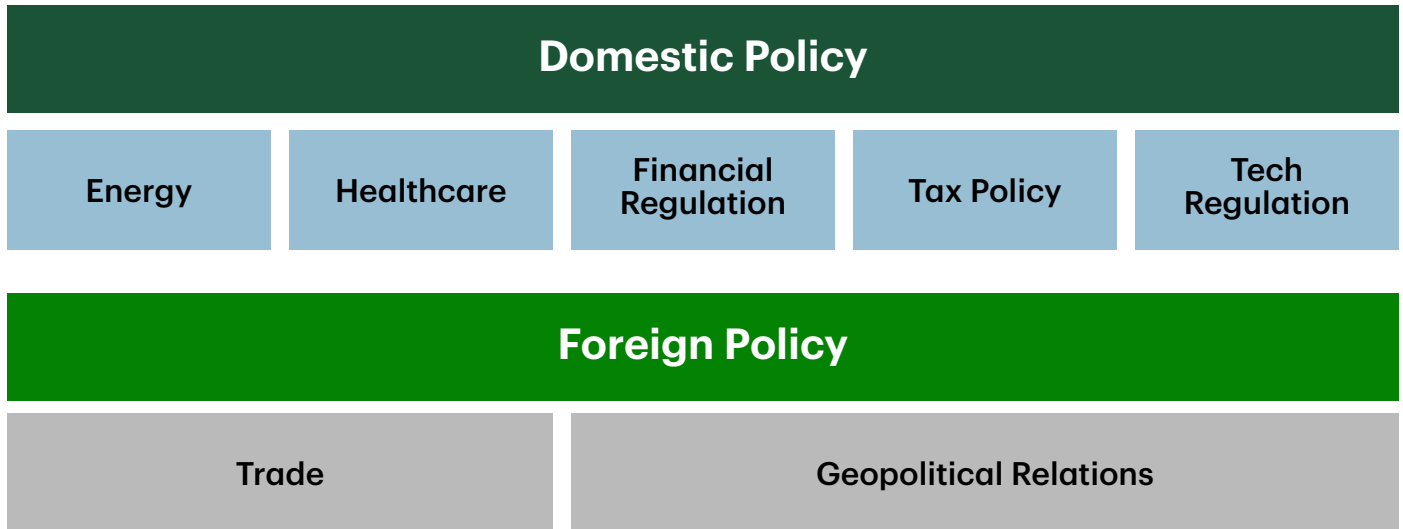
A Harris victory would likely result in a continuation of the status-quo, with perhaps more moderate adjustments on stance compared to the Biden administration. A Trump presidency would likely result in an isolationist America, a first stance that could be more extreme than his first term as president, without the previous cohort of controlled advisors.

The difference between a clean-sweep election and divided government could also be stark. More stimulative fiscal policies produced by a one-party rule could produce faster near-term growth but with higher inflation, bloated deficits and fewer U.S.

Federal Reserve ("the Fed") rate cuts than under a divided government. This could have a material impact on longer-term growth.

Regardless of who the victor may be, a clean-sweep in the 2024 election still looks unlikely, and Wall Street has real concerns about what one-party rule by either the Democrats or Republicans might mean for the U.S. economy and stock market. History shows us that a divided government tends to produce stronger stock market returns than one-party control, perhaps due to the lower possibility of major changes in regulation and a more moderate stance in government.

What's at Stake

Domestic Policy				
Energy	Healthcare	Financial Regulation	Tax Policy	Tech Regulation

Foreign Policy	
Trade	Geopolitical Relations

The following outlines some of the key areas of policy and their potential implications:

Policy	Donald Trump	Harris
Tax	• A Trump victory would likely lead to a push to extend all cuts	• Democrats will likely extend some, but not all cuts • Tax on share buybacks for corporations
Trade	• Trump has proposed at least 10% universal tariffs • 60% tariffs on China & de-coupling	• Harris will likely continue an "America First" policy in domestic manufacturing and remain vigilant on anti-competitive practices from China
Regulation	• Trump has favoured de-regulation especially for financial services and energy	• Democrats have generally favoured regulation across a range of sectors
Misc.	• Trump wants to significantly reduce immigration and deport illegal immigrants • Potentially repeal some green spending	• Status quo; perhaps more CHIPS and Science Act of 2022 funding and infrastructure investment • "Build back better" initiatives and the "Care" economy/social spending for the low and middle class

The most obvious, and arguably most important difference between the presidential candidates, is tax policy. Trump plans to cut the corporate income tax rate to as low as 15%, while Harris wants to raise it much higher. That alone could mean a double-digit percentage-point swing in S&P 500 Index earnings. Additionally, there have been various capital markets tax proposals from the Harris camp, including a tax on stock buybacks. Whether or not these proposals come into reality is still remote at this stage.

Trump's first two years in office with a GOP Congress produced a strong 29% advance for the S&P 500 Index, fueled by passage of the Tax Cuts and Jobs Act, which cut the statutory corporate tax rate to 21% from 35% and reduced individual income tax rates. A second Trump term could follow a similar playbook. Trump has said he wants to repeal the Inflation Reduction Act and its $400 billion in subsidies for battery manufacturing, electric vehicles, wind turbines and solar energy. Yet 18 House GOP lawmakers went on record in August opposing such a move. That means there's no obvious funding for Trump's new tax cuts, much less to renew his old ones. Beyond preserving existing tax policy, Trump

proposes to eliminate taxes on Social Security benefits at a cost of $1.2 trillion. Lowering the corporate tax rate to 15% would cost approximately $600 billion.

On the Democratic side, Harris has been attempting to appeal to moderates, with a partial break from Biden on taxing capital gains. Biden has backed an effective top rate of 44.6% versus the current 23.8%. Harris drew the line at 33%. That would include a 28% capital gains tax rate, up from the current 20%, and she proposes raising the top marginal income-tax rate to 39.6%. A key finding from a Penn Wharton budget analysis in September showed that a $1.2 trillion in corporate tax hikes might hurt GDP by about 1.3% up to 2034 compared to current policies, amid less investment in productive capital. It also sees wider deficits due to $2.3 trillion in tax benefits for moderate-income families.[2] Some estimates suggest that the effective corporate tax rate could jump from around 12% to above 19%. That would put the U.S. near the top among market-based Organization for Economic Co-operation and Development ("OECD") countries, with important implications on employment and growth.

[2] Penn Wharton University of Pennsylvania Budget Model Analysis, 2024.

From a general standpoint, it is clear that equity markets would be buoyed by lower taxes and lighter regulation, as prescribed by a second Trump administration. However, once Trump's more Wall Street-friendly policies are partially offset by concerns about the costs and inflation impacts of higher tariffs and trade wars, the net impact may only be slightly positive. Combined with possible trade tensions and deportations of unauthorized immigrants, Trump's policies may end up being an outright drag on GDP.

The coming fiscal cliff amplifies the high stakes of the 2024 election. History suggests that a divided government is more likely to exercise fiscal discipline. Further, even when Democrats presided over Congress, Biden was unable to raise the 21% corporate tax rate even to 22%, much less to 28%. Most of the 2017 Trump tax cuts are set to expire at the end of 2025. They would cost about $4 trillion to extend over the next decade, according to the Committee for a Responsible Federal Budget. Unless revenue from new tariffs helps shrink the

fiscal gap, the tax cut extension could balloon the already lofty budget deficit beyond 7% of GDP. That could risk a bond-market backlash, pushing up the 10-year Treasury yield and hitting stock prices along with demand for new mortgages and car loans. A contractionary fiscal policy might give the Fed even more reason to bring down rates to secure an economic soft landing. An analysis by the University of Pennsylvania's Wharton School budget analysis center finds that Trump's plans would add $4.1 trillion to the 10-year primary budget deficit.[2] That figure excludes both additional debt-service costs, which would widen deficits, and revenue from tariffs, which could stem the red ink.

On the trade front, Trump's plan to impose at least a 10% tariff on all imports and up to 60% on Chinese goods may raise additional revenue to the government, but at a cost of higher inflation and a continuation of major disruption to supply chains and business models for U.S. companies that began in Trump's first term.

Economy

Don't Bet on the Outcome

Overall, there are plenty of wild cards and a host of other probabilities that could sway the outcome of this election. We've already witnessed a series of unanticipated events since the beginning of this year, leading up to the nomination of the two candidates, and the November election is still weeks away.

For investors, a prudent plan and a long-term balanced allocation across asset classes and geographies, with a focus on evolving economic data, and how this data could shape market performance, is more important than betting on political odds and campaign rhetoric. In addition, policy itself is only part of the overall investment

mosaic. Company fundamentals, idiosyncratic business models, and the growth/inflation trajectory are likely to matter much more in terms of long-term performance, than individual elections.

As investment managers making tactical and strategic allocations all the time, we continue to analyze real-time data and events as they unfold, and are always preparing for inevitable tail-risk events that could jeopardize the base case scenario. Political elections and other exogenous developments may be a source of distraction, but for long-term investors, such events may lead to important opportunities if considered from the right perspective. ◼

[2] Penn Wharton University of Pennsylvania Budget Model Analysis, 2024.

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