MAINSTREET ADVISORS

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U.S. Election Commentary

With several weeks to go before Election Day, we have seen some major twists and turns across the political landscape. Despite the headlines, these developments have not yet had much of an impact on markets. As is usually the case, Federal Reserve policy, employment, consumer spending, and U.S. corporate profits have been the primary drivers of market sentiment and pricing. Of course this could change as October unfolds, especially given the tightly contested nature of the presidential contest and key congressional races. As of the second week in October, Democratic nominee Kamala Harris holds a narrow lead over Republican challenger Donald Trump in the race for the White House based on several polling aggregates including RealClearPolitics and prominent political betting platform PredictIt. Suburban districts in the swing states of Pennsylvania, Michigan, Wisconsin, North Carolina, Georgia, and Nevada are generally viewed as the key battlegrounds which will likely determine an electoral college victory. Republicans are projected to narrowly retain their majority in the House of Representatives and regain a majority in the Senate by a slim margin.

Looking Back

What does market history tell us about the potential path forward for investors based on the current political situation? Since the end of World War II, there have been five instances of a Democratic incumbent running for re-election: Harry S. Truman in 1948, Lyndon Johnson in 1964, Jimmy Carter in 1980, Bill Clinton in 1996 and Barack Obama in 2012. Although not technically an incumbent, we think it's reasonable to assume most voters view Harris as one considering she served as Vice President and did not go through the usual competitive primary process incumbents typically avoid. The S&P 500's average total return in those Democratic incumbent presidential election years (1948, 1964, 1980, 1996, 2012) was 18.4%, compared to its average of 12.3% for all years from 1948 through 2023. The index's average total return in the five years immediately following those election years (1949, 1965, 1981, 1997, and 2013) was 19.1%. Investors should not automatically extrapolate the past into the future based on a such a small sample size. Yet, history suggests the U.S. stock market can withstand (and perhaps even thrive) during a presidential election year and the first year of a new administration even amid such an uncertain political environment. As chart 1 depicts, the U.S. economy and stock market have generally performed well under both Democratic and Republican control of the executive branch, with several recession-driven exceptions in the 1970s and first decade of the 2000s.

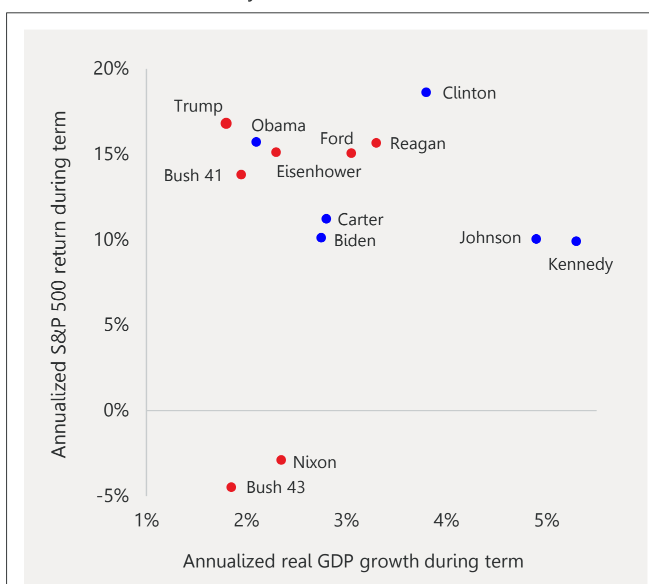
Looking back to market developments immediately following Donald Trump's surprise 2016 election victory could provide some useful context for investors thinking about how the next three months could unfold. In the final eight weeks of 2016, the yield on the 10-year U.S. Treasury yield climbed 80 basis points from 1.8% to 2.6% and the U.S. dollar index gained about 5%. The S&P 500 financials and energy sectors handily outperformed the broad index to close 2016, while the traditionally defensive groups including utilities and consumer staples lagged the overall market. These moves occurred as market participants began to price higher odds of a reflationary growth cycle given the incoming Trump administration's policy priorities that were most well-received by traditional GOP leaders in Congress, including tax cuts, reduced regulation, and infrastructure spending.

Moving Forward

This time around, the Trump-Vance ticket is prioritizing lower taxes, de-regulation for most industries, higher tariffs on goods imported to the U.S., and immigration restrictions. Tax policy is probably the most market-relevant subject on which there is a stark difference between the candidates. The Trump policy platform calls for most of the provisions of the 2017 Tax Cuts and Jobs Act to be extended and the corporate tax rate to be reduced from 21% to 15% for companies that produce goods in the U.S. In contrast, the Harris-Walz agenda targets an increase in the corporate tax rate from 21% to 28% (back to its pre-2017 level), a closure of the carried interest loophole favored by the private equity industry, and an increase in the tax rate on corporate share buybacks. All other things equal, higher corporate tax rates suppress profit margins, however; history suggests investors should probably avoid getting too negative about the prospects for higher corporate tax rates. As chart 2 depicts on the next page, the S&P 500 generated an average calendar year return of 12.91% in the five years in which the U.S. corporate tax rate was raised over the last 75 years (1950, 1951, 1952, 1968, 1993).

CHART 1

U.S. Stocks and Economy Performance: 1952-2024



Source: Bloomberg, Invesco. Returns shown are annualized. Past performance does not guarantee future results.

Even though the S&P 500 and Nasdaq may seem oblivious to the upcoming election, potential signs of changing policy winds have emerged at the industry level, one or two layers below the market's surface. For instance, the relative performance of stocks in various renewable energy and consumer finance industries have ebbed and flowed with the polling numbers of Harris given the regulatory priorities of her policy platform. On the other hand, stocks in the capital markets and managed healthcare industries, along with manufacturers that rely heavily on Chinese parts, have been among the most sensitive to Trump's polling numbers.

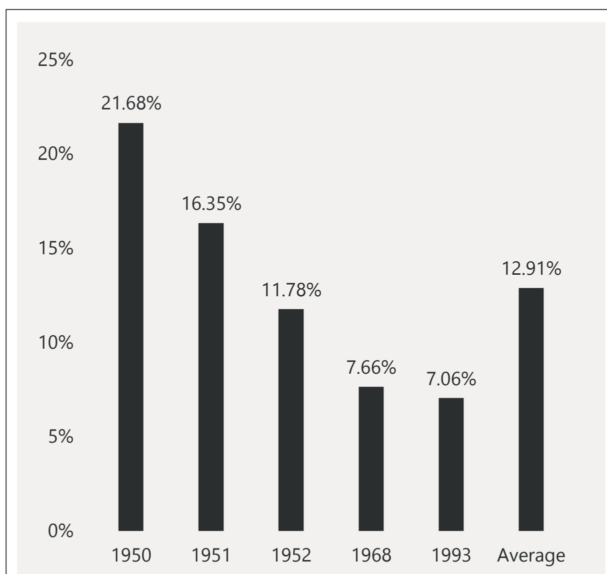
Policy Priorities

Turning to regulatory and industrial policy, a Trump-Vance victory would likely lead to significant rollbacks in federal spending directed at renewable energy-related industries contained in the Inflation Reduction Act of 2021. A prospective Trump White House also seems ready to put pressure on branded drug pricing, promote domestic energy production, relax capital restrictions on U.S. banks, and take a friendlier approach to most mergers and acquisitions that do not diminish domestic goods production than seen during the Biden administration. Based on recent messaging, the Trump policy platform could also include a universal baseline tariff of 10% on all imported goods and tariffs of more than 60% on some Chinese goods.

If elected, Kamala Harris will presumably pursue the traditional Democratic priorities of increased regulatory oversight on banks, oil and gas production, health insurers, and pharmacy benefits managers. Grocery store chains and homebuilders could also be subjected to increased political pressure to keep prices in check based on recent Democratic messaging. Harris is also widely expected to push for expanded federal subsidies for the domestic production of electric vehicles (EVs), solar panels, and offshore wind-power related industries. On trade policy, Harris has voiced a preference for maintaining the current tariff framework (mostly unchanged from the Trump administration), which includes targeted tariffs on certain strategically sensitive items like Chinese EVs and solar panels. It is worth noting that more uncertainty probably exists with Harris than with Trump on the substance of major economic policy areas, given the former's lack of a developed set of preferences during her time as a senator and as Vice President.

CHART 2

S&P 500 Returns in Years with Corporate Tax Rate Hikes



Source: Bloomberg, U.S. Department of Treasury. Returns shown are annualized. Past performance does not guarantee future results.

Potential differences in technology sector regulation between the candidates are more nuanced and will likely depend on appointments at the Federal Trade Commission (FTC) and the antitrust division of the Department of Justice (DOJ). If Harris wins and replaces the current antitrust leadership at the DOJ and FTC, it could benefit the likes of Amazon (AMZN), Alphabet (GOOGL), Apple (AAPL), Meta Platforms (META), and Microsoft (MSFT) – all of which are the subjects of pending antitrust investigations or cases. Perhaps due to her California roots, Harris is seen by some observers as less stridently opposed to the market dominance of so-called "Big Tech" than the antitrust heavyweights in the Biden administration, led by FTC Commissioner Lina Khan. Meanwhile, a Trump presidency could turn up the heat on GOOGL and META specifically, as both Trump and J.D. Vance have publicly denounced several of the largest technology platforms as biased against conservative views. Vance, in particular, has espoused clear and consistent antipathy toward "Big Tech." Trump and Vance's hostility to several dominant consumer technology firms notwithstanding, their preference for de-regulation in broad terms could prove beneficial to overall technology sector. As a former partner at Peter Thiel's Mithril capital and former venture capital industry participant, Vance's suspicion toward the biggest technology players seems to be matched by his zeal for small, independent startups.

Divided Government

Based on the overlap in the two candidates' platforms, industries that could benefit from policy under a Republican or Democratic administration include advanced manufacturing (with a focus on domestic production), biotechnology, utilities, aerospace, and defense. On the subject of defense spending, it's worth noting that most Democrats are much more supportive of providing military aid to Ukraine than Republicans. Meanwhile, many senior-level Democratic foreign policy officials are just as hawkish from a military deterrence perspective toward China's geostrategic objectives as prominent voices in the Trump-led GOP.

While the contest between Kamala Harris and Donald Trump will likely dominate the news cycle, competitive congressional races could be just as important as the main event. This is because the contests for House and Senate seats will determine 1) whether 2025 and 2026 are spent under a divided or unified government

and 2) the size and resilience of congressional majorities in a potential unified government. The stock market tends to prefer a dividend government because major legislation with significant economic impact is less likely when the White House and Congress are controlled by different parties. Importantly, a split government could also lead to a bit of unintended fiscal discipline as neither party's legislative and spending priorities are likely to be enacted. But split governments can also yield meaningful new laws and redirected spending. For instance, the Infrastructure and Jobs Act of November 2021 and Chips and Science Act of August 2022 authorized nearly $900 billion of new federal spending. The bills were largely negotiated between the Biden White House and the Republican majority in the Senate. Given the current policy platforms of the two candidates, legislation in 2025 or 2026 under a divided government that offers a satisfactory compromise to both sides could take the form of enhanced funding of domestic manufacturing paid for in part by increased tariffs on selected Chinese imports.

Sweep Outcomes

If the election results in a one-party sweep of the presidency and congress, there could be a higher probability of expanding fiscal deficits as the party in power would face less opposition to their preferred mix of spending and tax priorities. Given the current political environment, a unified Democratic government might not increase taxes by as much as is commonly believed to offset spending priorities. Meanwhile, a unified Republican government might not be willing or able to cut enough discretionary federal spending to meaningfully offset the tax cuts championed by the party. Both candidates have pledged to protect Social Security and Medicare entitlement spending and avoid unpopular reforms like increasing the retirement age. Even though we view a deficit-driven bout of market weakness as a low-probability event, investors will want to keep an eye on bond yields, market-based inflation measures, and perhaps even precious metal prices to gauge sentiment around this risk.

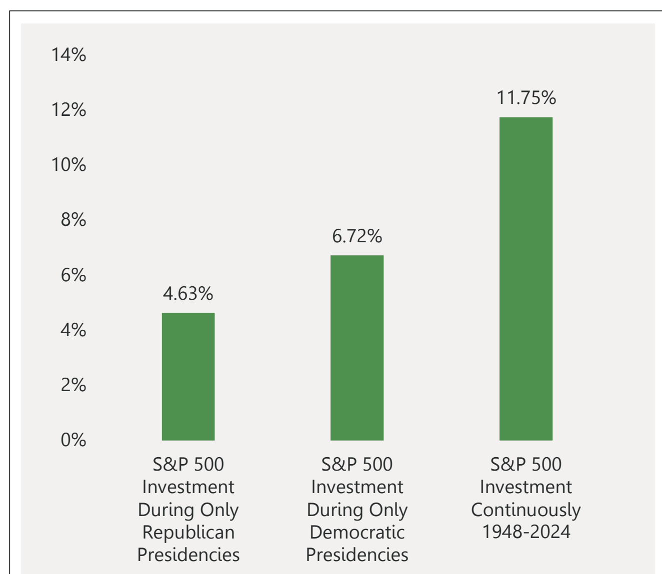
A prospective Trump administration's set of policy priorities under a unified GOP government could be better for the broad stock market than the bond market. In large part this is because the combination of policy directed at lower tax rates and a lighter regulatory touch would likely support corporate profit margins and stoke small business activity. A more hands-off regulatory agenda (as seen during the first Trump administration) would be amplified by a set of recent Supreme Court rulings that have significantly constrained the capacity of federal agencies to interpret legislation. A more predictable, lighter-touch regulatory environment could lead to improved business confidence and create the conditions for more mergers, acquisitions, and overall dealmaking activity. At the same time, an expansion of tariffs from current levels and tighter immigration controls could put some upward pressure on import prices and domestic wages. The anticipation of higher trajectories for both growth and inflation might cause investors to price a stronger trajectory for U.S. companies' earnings growth but also demand higher yields from fixed income securities. A Democratic sweep might lead to a bout of market volatility at least in the short run as investors recalibrate expectations for fiscal spending, tax policy and regulatory focus.

In the End

No matter what happens in November, making investment decisions based solely on which party controls the White House has historically led to suboptimal outcomes. As with most elections, there is a high probability of a split government and limited policy change. Historically, this has provided a supportive backdrop for risk assets absent a recession. There are some risks that come with an election sweep by either party, but those appear to be mostly found at the industry level and can be mitigated by portfolio diversification and the avoidance of market timing. According to Bloomberg data summarized in chart 3, holding the S&P 500 during only Republican presidencies since 1949 through the first three quarters of 2024 (1953-1960, 1969-1976, 1981-1992, 2001-2008, 2017-2020) produced a 4.63% annualized total return. Over the same period, an investment in the S&P 500 during only Democratic administrations (1949-1952, 1961-1968, 1977-1980, 1993-2000, 2009-2016, 2021-2024) yielded an annualized total return of 6.72%. Staying invested in the S&P 500 throughout this 76-year period produced a superior annualized return of 11.75%.

CHART 3

Staying Invested Has Been the Best Strategy



Source: Bloomberg. Returns shown are annualized. Past performance does not guarantee future results.

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