2024 election and the markets

Insights

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Key takeaways

- Overall, we foresee minimal medium- to long-term impact on financial market performance based on potential upcoming election outcomes.
- Economic and inflation trends have demonstrated a stronger and more consistent relationship with market returns than election results.
- Significant policy changes require one party to control two parts of the government, though the capital market impact will most likely take place at the sector level, not necessarily at the broad market level.

2024 election – an unprecedented setup

On Tuesday, November 5, 2024, Americans will vote in a national election that will determine control of Congress and the White House. The election will shape the course of domestic and foreign policy until 2026's Congressional midterm elections. With the 2024 election nearly a year away, the political dynamics will remain fluid with the two major parties still to elect their respective presidential and Congressional nominees and flesh out their major policy agenda proposals.

President Joe Biden currently leads three other candidates with more than 70% of the expected vote for the Democratic nomination, according to RealClear Politics.[1] Meanwhile, former President Donald Trump leads his nearest Republican challenger, Florida governor Ron DeSantis, by 61.3% to 13.8%.[2] Adding to the charged political environment, former President Trump is facing four separate indictments, two for allegedly violating state laws in New York and Georgia, and two for alleged federal infractions in Florida and Washington, D.C. Donald Trump is the first former president in U.S. history to be charged with either federal or state crimes, and New York, Florida, and Washington, D.C., have set trial dates in 2024 prior to the election, while Georgia prosecutors have proposed an August 2024 trial date. Further complicating the election scenarios, Robert F. Kennedy, Jr., President Biden's former challenger, dropped his bid for the Democratic nomination and announced his candidacy as an Independent on October 9, 2023.

In a hypothetical head-to-head election rematch, former President Trump holds a slight advantage over President Biden, 47.1% to 45.2%, according to Real Clear Politics.[3] Prediction[4] markets provide a slightly differentiated read on the election than polls, because participants in prediction markets may account for polling limitations when making their bets. One such market, PredictIt, indicates a slight edge to former President Trump, 40% to 36%.[5] With 12 months' lead time prior to next year's election and four unprecedented indictments to navigate, national polling results and prediction market prediction odds will undoubtedly be dynamic as the major parties work through their nomination processes (and courts work through their legal processes).

To win the White House a candidate does not need to win the national vote; rather, they must receive at least 270 electoral votes from the U.S. Electoral College. Voters in roughly eight swing states or battleground states will have an outsized influence in deciding the election, and voting history in these states has moved back and forth between the two national parties since 2012. Swing states include Arizona, Florida, Georgia, Iowa, Michigan, Ohio, Pennsylvania and Wisconsin. In the 2016 election, former President Donald Trump won all eight swing states in defeating Democratic candidate former Senator Hillary Clinton, while in 2020 President Biden won five of the eight (Arizona, Georgia, Michigan, Pennsylvania and Wisconsin).

Overall, we foresee minimal medium- to long-term broad financial market performance impact based on the election outcomes. We base that judgement on observing historical market performance following presidential elections. Our proprietary work shows economic growth and inflation trends have a stronger, statistically significant relationship with forward market returns than election results, suggesting the forward path for the economy and the outcome of the Federal Reserve's (Fed) effort to tame inflation through its rate hiking campaign is more consequential to investors than the eventual constellation of White House, Senate, and House of Representatives political control.

Historical election outcome scenarios and market performance

We begin our historical statistical analysis in 1948, at the beginning of the post-World War II economy. We identify six major election outcomes (Republican control, Democratic control, and various divided outcomes) and observed average equity market performance as measured by the S&P 500 Index, a widely recognized measure representing large, publicly traded U.S. stocks across 11 economic sectors. To reduce statistical noise from monthly market volatility, we used average three-month returns following each election outcome and compared those returns with the average three-month return during the full analysis history. We then calculated the statistical significance of the relationship between political control and market performance using a calculation called t-statistic, or a t-test. A t-test determines whether one group of variables (in this case the political composition of the White House and Congress) has a measurable effect on another variable (in this case, average three-month S&P 500 returns during the control period). Finally, our analysis covers control periods (computing returns when the parties take control of the levers of government) rather than starting from election dates, though a statistical analysis using election dates results in a similar output and conclusion. See chart below.

While investors often view a Republican or Democratic "sweep" (one party outcome) as an election outcome with the highest likelihood of causing a significant market impact, our analysis suggests no statistically significant relationship exists historically between sweep outcomes and market

HISTORICAL ELECTION OUTCOMES ANALYSIS

Scenario	White House control	Congress control	Outcome	Average 3-month S&P 500 return during period	Average 3-month return relative to all periods	Statistically significant (>95%)?
1	Democrat	Democrat	One Party (D)	2.20%	+0.02%	No
2	Democrat	Republican	Divided	3.85%	+1.67%	Yes
3	Democrat	Split	Divided	3.93%	+1.75%	Yes
4	Republican	Democrat	Divided	1.19%	-0.99%	Yes
5	Republican	Republican	One Party (R)	2.67%	+0.49%	No
6	Republican	Split	Divided	1.62%	-0.67%	No
			All One Party (D or R)	2.33%	+0.15%	No
			All Divided	2.08%	-0.10%	No

Source: U.S. Bank Asset Management Group, November 2023.

performance during single party control of both the White House and Congress. Rather, our analysis finds only three divided government outcomes demonstrate a statistically significant relationship with market performance, with Democrat control of the White House and either full Republican control of Congress or split control of the Senate and House corresponding to positive absolute returns in excess of long-term average returns, while Republican control of the White House and full Democrat control of Congress correspond to positive absolute returns modestly below long-term average.

Historical economic regimes and market performance

Our proprietary analysis suggests that economic and inflation trends have a stronger and more consistent relationship with market returns than election outcomes. In general, rising growth and falling inflation are associated with returns above long-term averages, while falling growth and rising inflation correspond to positive but below average market returns. See chart below.

The consistency in strong statistical significance evidenced across growth and inflation regimes especially the combinations of rising growth/falling inflation (a disinflationary growth scenario) and falling growth/rising inflation (a stagflationary scenario), suggest investors should focus on underlying economic conditions rather than 2024 election results regarding potential forward capital market outcomes.

Key policy issues

While we do not expect the election to produce a meaningful medium- to long-term market impact, we must respect a potentially significant impact on individual sectors and industries. Further, should a mechanical issue emerge that leads to a hung or uncertain election outcome, we would expect riskier asset classes to decline until clarity emerges.

Finally, a sweep election is one scenario where we would anticipate a larger-than-normal short-term market impact if market participants anticipate major policy changes. Control of the U.S. Senate is key to bringing about significant changes in policy regarding taxes, spending, and regulation though the impact will most likely take place at the sector level, not necessarily at the index level as we demonstrated in our earlier analysis. The following are some of the policy issues with high importance to market segments we will follow throughout the nomination process:

- Individual and corporate tax policies, including state and local income tax (SALT) deductions
- Spending priorities, such as energy, infrastructure and defense
- Healthcare
- Regulation
- Immigration policy
- China (trade and Taiwan)
- Geopolitical conflicts (Russia/Ukraine, Israel/Hamas)

ECONOMIC AND INFLATION TRENDS

Economic regime	Average 3-month S&P 500 return during period	Average 3-month return relative to all periods	Statistically significant (>95%)?
Rising growth	2.99%	+0.81%	Yes
Falling growth	1.54%	-0.64%	Yes
Rising inflation	1.36%	-0.82%	Yes
Falling inflation	2.70%	+0.52%	Yes
Rising growth/falling inflation	3.52%	+1.34%	Yes
Falling growth/rising inflation	0.49%	-1.70%	Yes

Source: U.S. Bank Asset Management Group, November 2023.

Current investment considerations

With the 2024 national elections still 12 months away, economic growth, interest rates and inflationary pressures remain the dominant factors shaping the current capital market landscape. Consumer spending remains resilient, thanks to a healthy domestic labor market, stimulus savings, ongoing business capital expenditures and pockets of global economic strength. However, inflation is still above central bank target levels, and the Federal Reserve and other major central banks have increased interest rates to thwart inflationary pressures. We use a visual of central banks acting as the personal trainer to their respective economies, continuously elevating the treadmill ramp height in the form of successive interest rate increases. As those ramps remain elevated or potentially move higher, the runner — the economy — will likely fatigue, and the extent of the runner's slowdown may lead to more challenging conditions for diversified portfolios than what we have seen in 2023.

Relating current growth and inflation trends to the analysis we presented earlier, we currently emphasize a more balanced forward outlook for diversified portfolios, not wanting to get overly bearish due to still-strong consumer fundamentals but also respecting higher interest rates' impact on the economic runner's pace. A slowing economic growth pace has historically corresponded to more challenging forward riskier asset price returns, while higher bond yields, which move in the opposite direction of bond prices, offer investors the chance to collect income as they await the consumer's forward path.

Conclusion

Over the coming months, the national election Presidential and Congressional scenarios will evolve and come into clearer focus. The unprecedented indictments of the Republicans' leading Presidential candidate, former President Trump, adds significant uncertainty to the nomination process and events leading up to the November 5, 2024, national elections will follow an equally unprecedented path. We continue to monitor events as this uncertain path unfolds with a keen eye toward policy platforms and sector considerations once party nominees emerge. Meanwhile, we remind investors that when it comes to the forward path for capital markets and diversified portfolios, economic growth and inflation regimes have provided a clearer and stronger signal than election outcomes and we will keep you apprised of any changes to our balanced forward outlook.

 See important disclosures on page 5.

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[1] RealClearPolitics - Election 2024 - 2024 Democratic Presidential Nomination as of November 29, 2023.

[2] RealClearPolitics - Election 2024 - 2024 Republican Presidential Nomination as of November 29, 2023.

[3] RealClearPolitics - Election 2024 - General Election: Trump vs. Biden as of November 29, 2023.

[4] In a prediction market, participants bet on future events (such as elections) by purchasing contracts that pay out based on eventual outcomes. Contract prices for various potential outcomes represent a collective prediction by individual participating in the market.

[5] 2024 Presidential Election Predictions & Odds | Who will be the next president? (predictit.org) as of November 29, 2023.