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# AOR Update: Election Themes and Investment Implications

1 October 2024

## Key Takeaways

- ▶ The outcome of the presidential and congressional elections will determine government policy across four key areas that influence the economy and equity markets: taxes, regulation, trade and fiscal spending.
- ▶ We view a Trump win, likely coming in a sweep scenario, as net positive for equities as it preserves favourable corporate tax treatment and builds on tax elements that expired. A Harris win, likely coming with a divided Congress, would be mildly negative due to fewer provisions of expiring tax legislation getting extended due to political gridlock.
- ▶ While investors may react to every sound bite from the presidential candidates, creating elevated volatility through election day, the trajectory of the economy is the most important driver for equity markets over the long term. With the Fed cutting rates, that trajectory should accelerate from here.

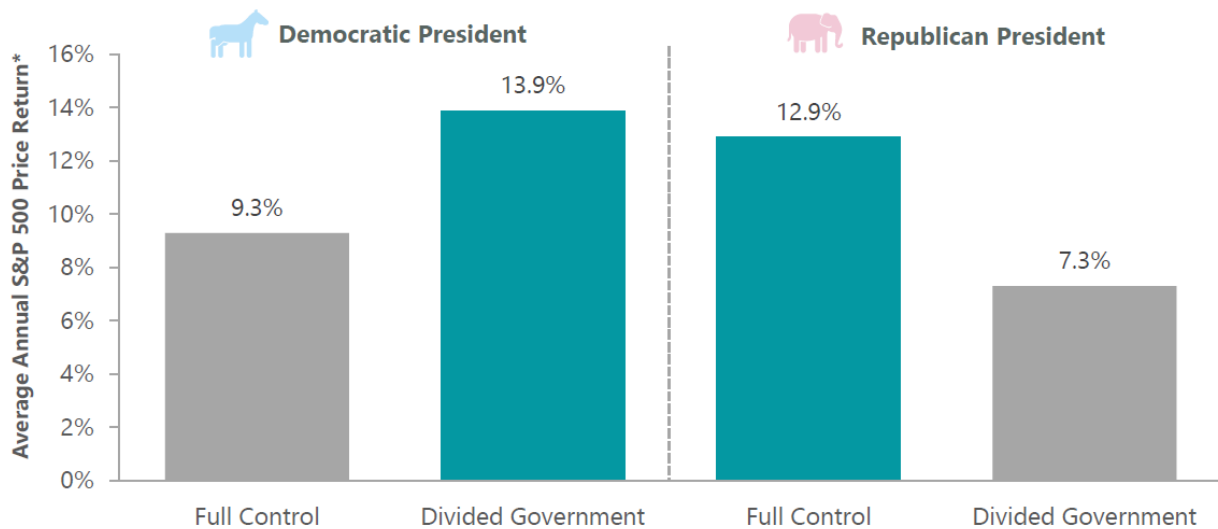
## Red or Blue Wave Would Spark Most Policy Change

With a month to go before election day, the presidential race remains tight with Kamala Harris maintaining a two percentage lead over Donald Trump in national polls. A lot can change in the final days on the campaign trail but based on the prediction markets, the two most likely outcomes are either a Republican sweep or a Harris presidency with a divided government. This is due to races for the Senate favouring the Republicans. Looking at the national map, for Harris to win with a Democratic sweep, the party would have to win all the states up for grabs except Texas and Florida. This will be difficult, especially in Montana, a state Trump won by 16 percentage points in 2020.

Different presidential and congressional configurations will dictate how much legislation can be passed and ultimately how much an effect politics will have on equity markets and the economy. A sweep scenario can lead to drastic changes in tax and spending policies, such as the Republican sweep in 2016 that paved the way for Trump's Tax Cuts and Jobs Act (TCJA). Similarly, much legislation was passed after the Democratic sweep in 2020 elections. With a divided government, regulation and trade policy will come into play, because those are the areas where the president can act unilaterally.

While investors may be reacting to every sound bite and policy announcement from both candidates, leading to increased volatility, the trajectory of the economy is the most important driver for markets over the long term. However, there are four key areas that will be most impacted by election results: tax, regulatory, trade and fiscal policy.

Exhibit 1: Likely Political Outcomes Favourable for Equities



\*Note: 1945-Present, excluding 2001-2 due to mid-year changes in party control of the Senate. Source: Macrobond.

## Taxes

The new president will face a unique tax situation coming up early in their term because major elements of the TCJA, the Trump tax cuts, are sunseting in 2025. If nothing is done, almost every taxpayer will see a higher average tax rate. This should act as an incentive from both sides of the aisle to negotiate and extend some of these expiring provisions. The TCJA had a material impact on equities in late 2017 and early 2018. Forward earnings for large and small cap stocks increased by 10% to 12%, respectively, during that timeframe. So it's important that a meaningful portion of this legislation remains intact.

Kamala Harris recently released tax proposals to dramatically increase the tax rates on corporations and high-income households while leaving most Americans taxes unchanged, promising to protect households making under \$400,000 from higher taxes. Her tax goals are unlikely to become reality, however, unless the Democrats retain control of the Senate and flip the House of Representatives.

Meanwhile Donald Trump would likely prioritise extension of the TCJA, including reinstating individual provisions that expired, including business depreciation allowances such as immediate expensing for equipment, property and research and development. He has advocated to reduce the corporate tax rate even further from 21% at present.

A Republican sweep would be the most market friendly outcome from a tax perspective, building on some of the elements that expired, including individual provisions and full expensing of R&D, which would benefit capex-heavy areas of the market like technology, industrials and manufacturing.

## Regulation

From a regulatory standpoint, Harris is focused on prescription drugs, more affordable housing, a higher minimum wage, lower grocery costs and a supportive stance toward clean energy. She has also talked about accelerating Medicare negotiations on more drugs and cracking down on pharmacy benefit managers, creating more risk in health care.

Trump significantly dialled back regulation in his first term. Most of the former president's efforts on the deregulation front will likely be focused on labour, education, the environment and health care, with a

slowdown in the transition to EVs. Energy production and fracking in particular should increase. A potential negative, at least from a labour market perspective, is more stringent immigration policies, which could hurt labour-intensive companies.

It's worth noting, however, that the expected election outcomes due to regulation are usually very different from what ends up occurring. The consensus thought energy would thrive under the Trump administration, yet it was one of the worst-performing sectors in his four years. Under Obama, health care was expected to be a tough sector, but it performed well on a relative basis. So, it's important not to read too much into higher regulation and what the impacts will be for these sectors.

## Trade

Harris is expected to mostly maintain the status quo on trade policy from the Biden administration. Changes are expected to be more surgical compared to the broad brush approach Trump has discussed. Harris would likely remain firm on China to protect industries like solar and semiconductors.

From a Trump perspective, we expect a repeat of what we saw under his first term. He is proposing two types of tariffs: a 10% across the board tariff on all imported goods and increases on Chinese tariffs to 60%. According to a Tax Foundation analysis, a 10% tariff and retaliation from U.S. trading partners would be expected to contract the economy by 1%. From a trade perspective, equities would face more headwinds under Trump while a Harris win would continue the status quo.

## Fiscal Spending

The most bipartisan view right now is that government spending will keep growing. Neither candidate wants to rein in spending. Deficits are forecast to be in the 6%–7% of GDP range for the foreseeable future and potentially even higher in a sweep scenario where more legislation gets passed. Harris would prioritise spending on health care, housing, childcare, clean energy and infrastructure.

Trump is expected to keep spending focused on defence and infrastructure. The fiscal thrust from a Republican administration will come in the form of tax cuts, while the Democrats will likely lead with more spending. We expect such policies to boost the economy in either scenario.

Impacts of a Trump Victory

## Impacts of a Trump Victory

In aggregate, we view a second Trump presidency under a sweep scenario as net positive for equities. The expectation is for a more favourable corporate tax regime and less of a regulatory burden, both of which should boost corporate profits. Conversely, there is the potential for increased tariffs and retaliation from U.S. trade partners. A gridlock scenario where the House is under Democratic control would be mildly negative as fewer provisions of expiring tax legislation would get extended due to gridlock.

We view U.S. stocks as best placed under Trump, with banks and capital markets, as well as the oil and gas complex, well positioned due to lighter regulation. Aerospace and defence is also likely going to benefit as well as biopharmaceuticals. Areas that could see pressure are restaurants and leisure, due to the less availability of labour, as well as EVs, autos and clean energy producers. From a regional standpoint, China would be hurt by tariffs while other import-driven nations like Vietnam, Mexico, India and Italy would stand to benefit.

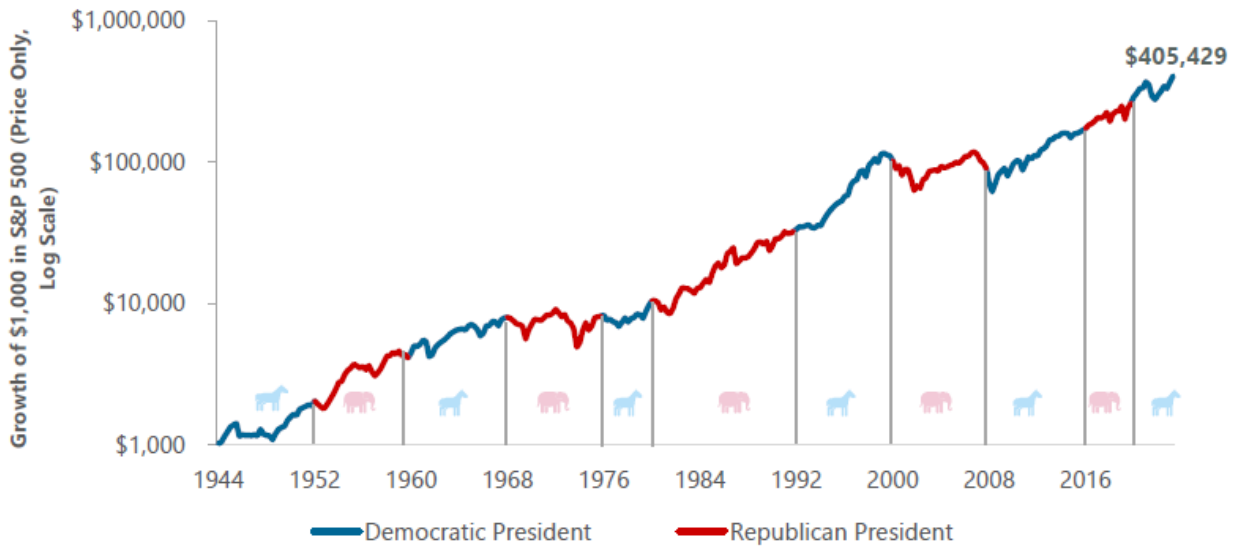
## Impacts of a Harris Victory

We see a Harris win as mildly negative to equities should she preside over a divided Congress. It will be more of a headwind to the markets should we see a Democratic sweep as she will then be able to implement higher taxes on corporations and high-income individuals, as well as push a more ambitious

regulatory agenda. However, tax credits for low-income individuals would provide an offset, creating an economic boost to this segment of the economy.

Tighter regulation could weigh on biopharmaceuticals, banks, capital markets, energy as well as mega cap technology. But again, we caution against basing investment or portfolio positioning solely on the regulatory environment. Areas to be bullish about under Harris would be consumer discretionary, specifically restaurants and leisure, home building and building products.

Exhibit 2: Don't Mix Politics and Investing



Data as of 30 June 2024. Sources: FactSet, S&P.

It's easy to categorise each candidate as bullish or bearish for stocks and the economy, but markets have gone up regardless of the party in control. Economic momentum will be a bigger driver of equities. That said, we are expecting elevated volatility heading into election day. Historically, the VIX picks up dramatically in September and October as election uncertainty boils over. Regardless of who wins, markets generally experience a relief rally. This catalyst, combined with the support of a Fed rate cutting cycle, should reaccelerate economic momentum in 2025, which we believe will ultimately drive equities higher.

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