

# This Time Will Be Different

## *Investing in the fog of the 2024 election season*

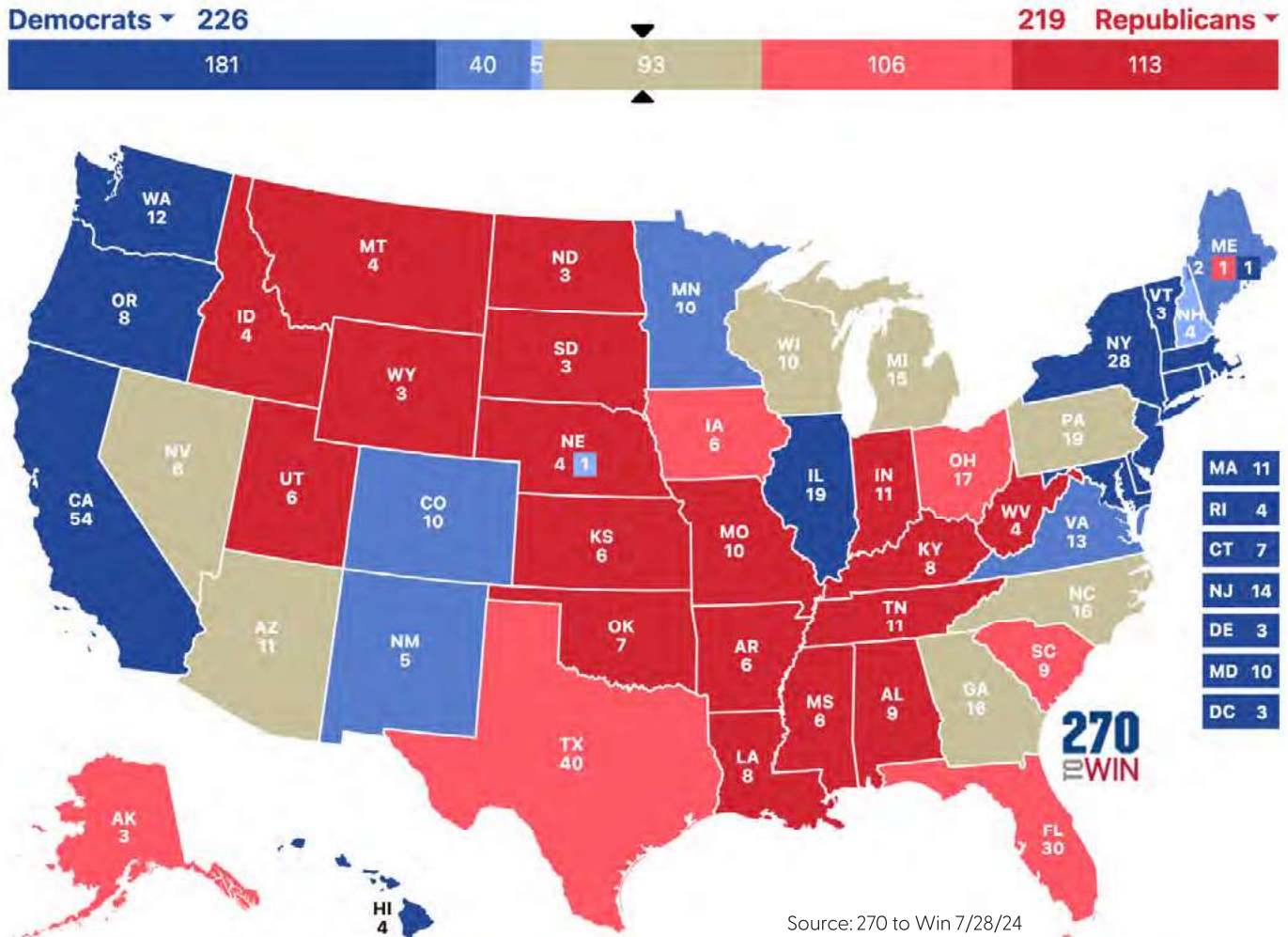
How many times have we all done it? We get up in the morning, start the car, head out to work, the grocery store, or take kids to school and we recognize it immediately...dense fog...an eerie mist...like pea soup. It's hard to see nearby traffic. What do we do? We turn on our lights. We drive slower. We focus our attention. Importantly, we take less risk. The same goes for investing. When you have less visibility, prudence demands that you take less risk. When driving, you may resign yourself to being late to work or late to school, given the lack of visibility, but you get there. When impaired visibility demands heightened risk management in investing, you may have to assume lesser returns to preserve your nest-egg – until you reach your goals – but you get there.

Normally, U.S. presidential elections come and go with a lot of fanfare, but not a lot of substance for investors. Plenty of brainpower is focused on analyzing election outcomes, but in the end, the variance in go-forward investment results are not solely driven by the political decision. While the 2024 U.S. post-election investment outcome could be a repeat of election years past, it is not a stretch to say that this time may indeed be at least a little bit different. Simply put, visibility into how this election season will play out has been meaningfully impaired this time around.

- **Political Uncertainty:** The 2024 U.S. presidential election is marked by significant uncertainty, exacerbated by recent events and the growing division of policy positions between Democrats and Republicans. Be prepared for potential ongoing changes to the election landscape amidst so many known and unknown factors.
- **Election Dynamics:** Swing states will once again likely decide the election outcome. Former President Trump has again received the Republican nomination, while President Biden has bowed out of the race, leaving Vice President Kamala Harris as the Democratic nominee.
- **Congressional Outlook:** The 2024 election season includes all 435 House seats and 34 Senate seats. Outcomes are expected to be very closely contested and are far from certain with the political landscape in so much flux.
- **Investment Implications:** The election is expected to increase market volatility, with historical correlations suggesting potential stock market fluctuations tied to uncertainty and election outcomes. The bond market may offer stability amid policy uncertainty, while differing candidate policies could create specific investment opportunities across areas such as trade, energy, and fiscal policy.



2024 U.S. presidential election - projected electoral college voting map



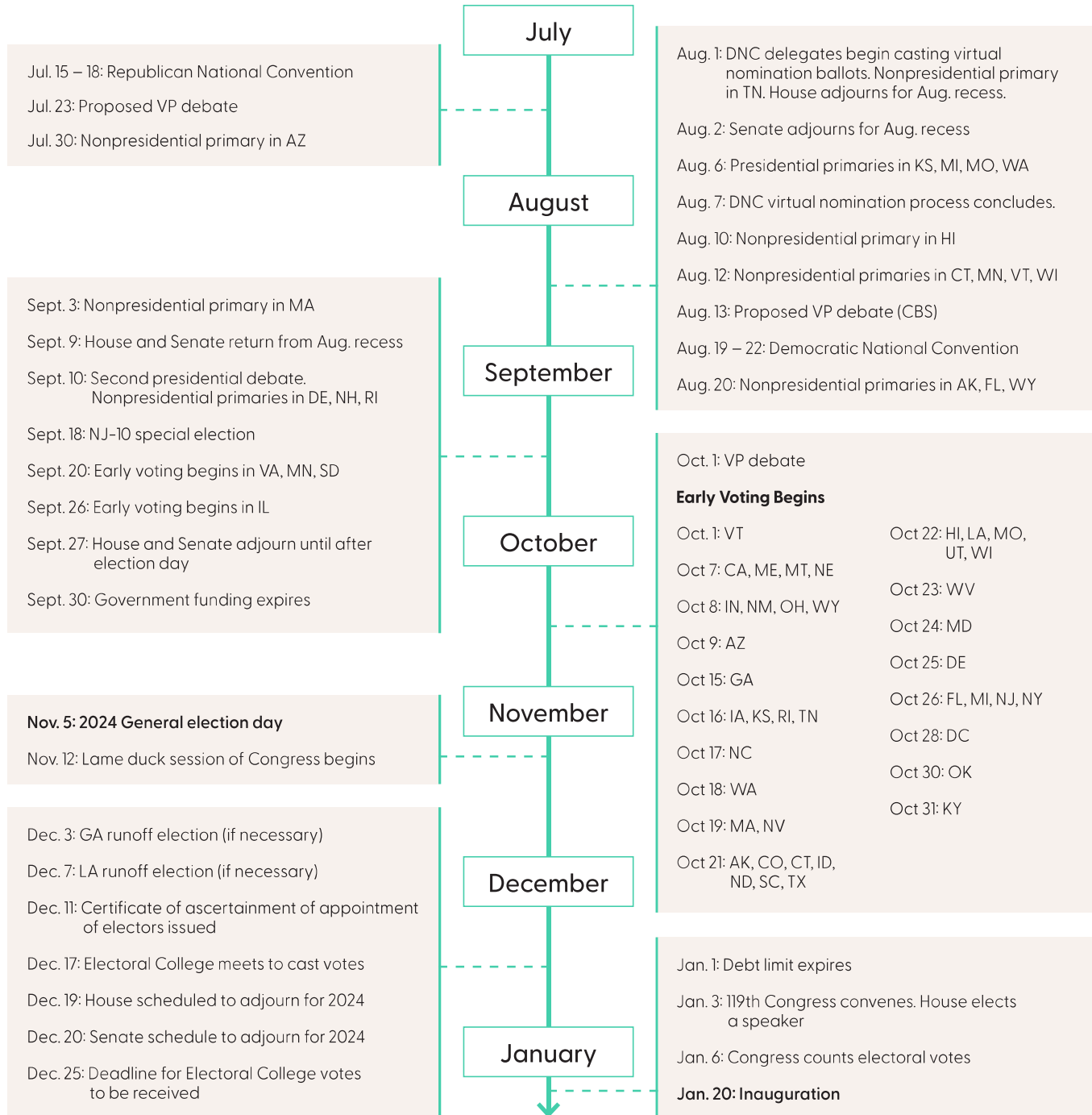
How could 2024 be different? First, this is clearly not a standard election season, as evidenced by the attempted assassination attempt of former President Trump on July 13 and President Biden stepping down as the Democratic nominee with less than four months until election day. As such, investors may seek to reduce their reliance on election playbooks of years past. The likely bifurcated policy outcomes, based on election results up and down the ticket, certainly adds a higher degree of uncertainty this go-round. Today, the divergence in policy between Democrat and Republican is much more pronounced than in years past, making policy and investment outcomes much more uncertain.

### The basics

With President Biden stepping out of the race, Vice President Kamala Harris secured the democratic nomination for president. Her campaign strategy is focused on the economy, social justice, reproductive choice, climate change, student loan debt, and consumer protection.

Trump's campaign has been focused on the economy, border security, inflation, reducing the impact of special interests in Washington, energy independence, an "America-first" foreign policy, and more tariff-driven trade policy.

## 2024 U.S. presidential election timeline of events



Source: LPL Research, LPL Government Relations Team

While the U.S. presidential election is rightfully getting the most attention this election season, there are also 34 Senate seats and all 435 House seats up for grabs. Getting the majority in both congressional chambers is likely to be a tough road for either party, especially as prediction market odds have begun to tightened since Biden stepped out of the race.

## Investment implications

Historically, the stock market has been a surprisingly accurate and unbiased election forecaster. Since 1928, if the S&P 500 was positive in the three months leading up to an election, the incumbent party remained in control of the White House 80% of the time (12 of 15 elections). Conversely, a declining market in the same period usually signaled a loss for the incumbent in eight of the last nine elections. Overall, market trends have predicted 20 out of the last 24 elections. All that said – the unpredictability of this election season suggests we should be cautious about relying solely on these historical patterns.

## Stocks have an impressive track record of predicting elections

S&P 500 Index returns three months before the presidential election

Election day	President	S&P 500 return	Incumbent party	Was the stock market right?
11/6/1928	Herbert Hoover (Rep)	13.6%	Won	Yes
11/8/1932	Franklin Roosevelt (Dem)	-2.6%	Lost	Yes
11/3/1936	Franklin Roosevelt (Dem)	7.9%	Won	Yes
11/5/1940	Franklin Roosevelt (Dem)	9.7%	Won	Yes
11/7/1944	Franklin Roosevelt (Dem)	2.3%	Won	Yes
11/2/1948	Harry Truman (Dem)	5.4%	Won	Yes
11/4/1952	Dwight D. Eisenhower (Rep)	-3.3%	Lost	Yes
11/6/1956	Dwight D. Eisenhower (Rep)	-3.2%	Won	No
11/8/1960	John F. Kennedy (Dem)	-1.3%	Lost	Yes
11/3/1964	Lyndon Johnson (Dem)	3.9%	Won	Yes
11/5/1968	Richard Nixon (Rep)	6.0%	Lost	No
11/7/1972	Richard Nixon (Rep)	3.0%	Won	Yes
11/2/1976	Jimmy Carter (Dem)	-1.0%	Lost	Yes
11/4/1980	Ronald Reagan (Rep)	6.9%	Lost	No
11/6/1984	Ronald Reagan (Rep)	3.6%	Won	Yes
11/8/1988	George H.W. Bush (Rep)	2.8%	Won	Yes
11/3/1992	Bill Clinton (Dem)	-0.4%	Lost	Yes
11/5/1996	Bill Clinton (Dem)	6.7%	Won	Yes
11/7/2000	George W. Bush (Rep)	-3.4%	Lost	Yes
11/2/2004	George W. Bush (Rep)	2.8%	Won	Yes
11/4/2008	Barack Obama (Dem)	-24.8%	Lost	Yes
11/6/2012	Barack Obama (Dem)	1.9%	Won	Yes
11/8/2016	Donald Trump (Rep)	-2.3%	Lost	Yes
11/3/2020	Joe Biden (Dem)	2.3%	Lost	No

Number of years with accurate signal: 20

Total years 24

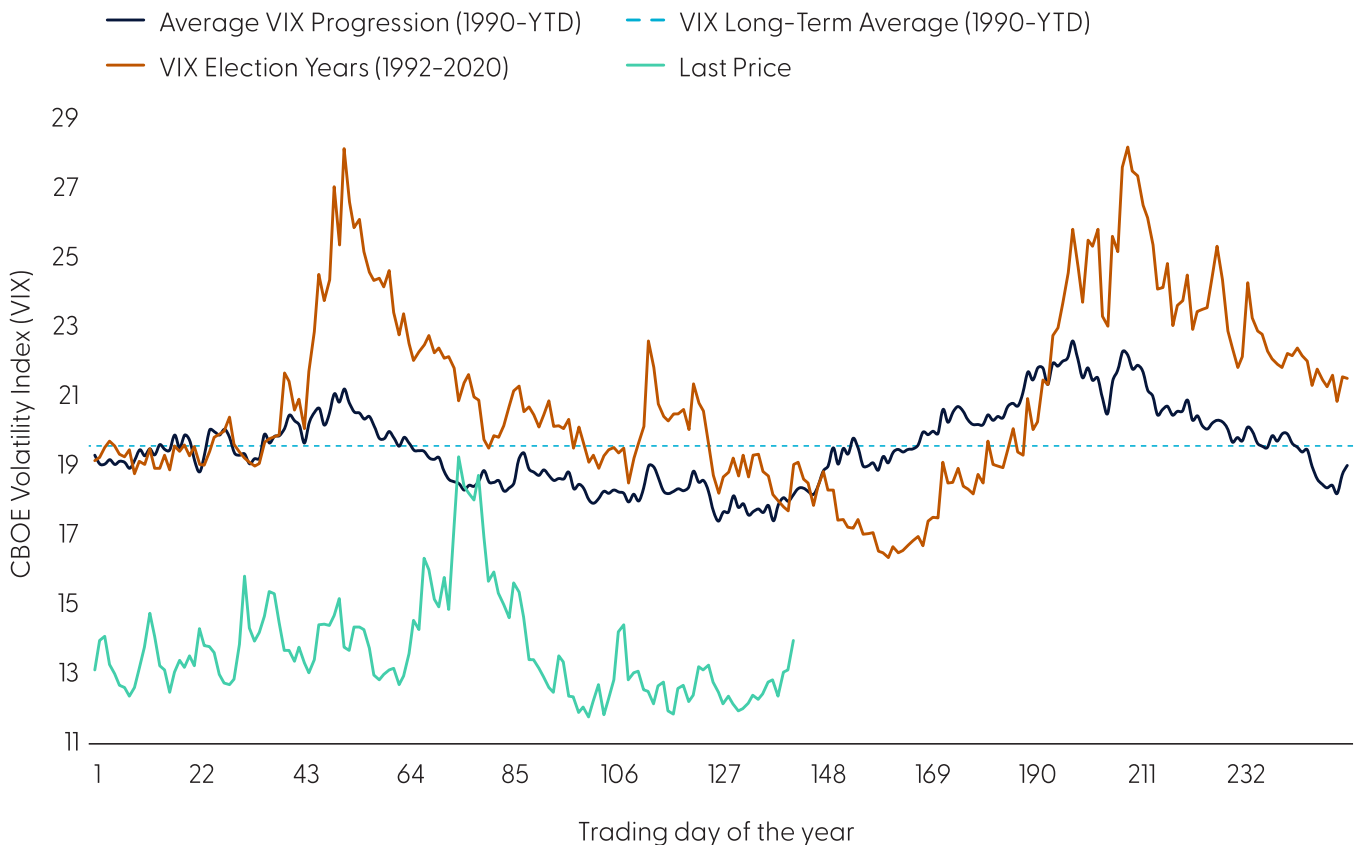
Source: LPL Research, FactSet 08/31/2024

All indexes are unmanaged and cannot be invested into directly. Past performance is no guarantee of future results. The modern design of the S&P 500 Index was first launched in 1957. Performance before then incorporates the performance of its predecessor index, the S&P 90.

## Election year seasonality points to a pickup in volatility

In **Midyear Outlook 2024**, we expressed our belief that volatility would likely increase in the second half, potentially around policy uncertainty related to the upcoming presidential election, geopolitical threats, or an expected reacceleration in inflation. History shows election years tend to be more volatile for stocks, particularly during the August – October time period as illustrated below. Analysis of annual election-year returns also reveals that the S&P 500 has generated an average price return of 7.3% (excluding dividends) during all election years since 1952. However, when election years are positive, as they tend to be 83% of the time, the average price return jumps to 12.2%. So, while a strong stock market during an election year is quite common, we would acknowledge that additional pullbacks are to be expected given strong year-to-date gains.

### Election year markets are historically more volatile



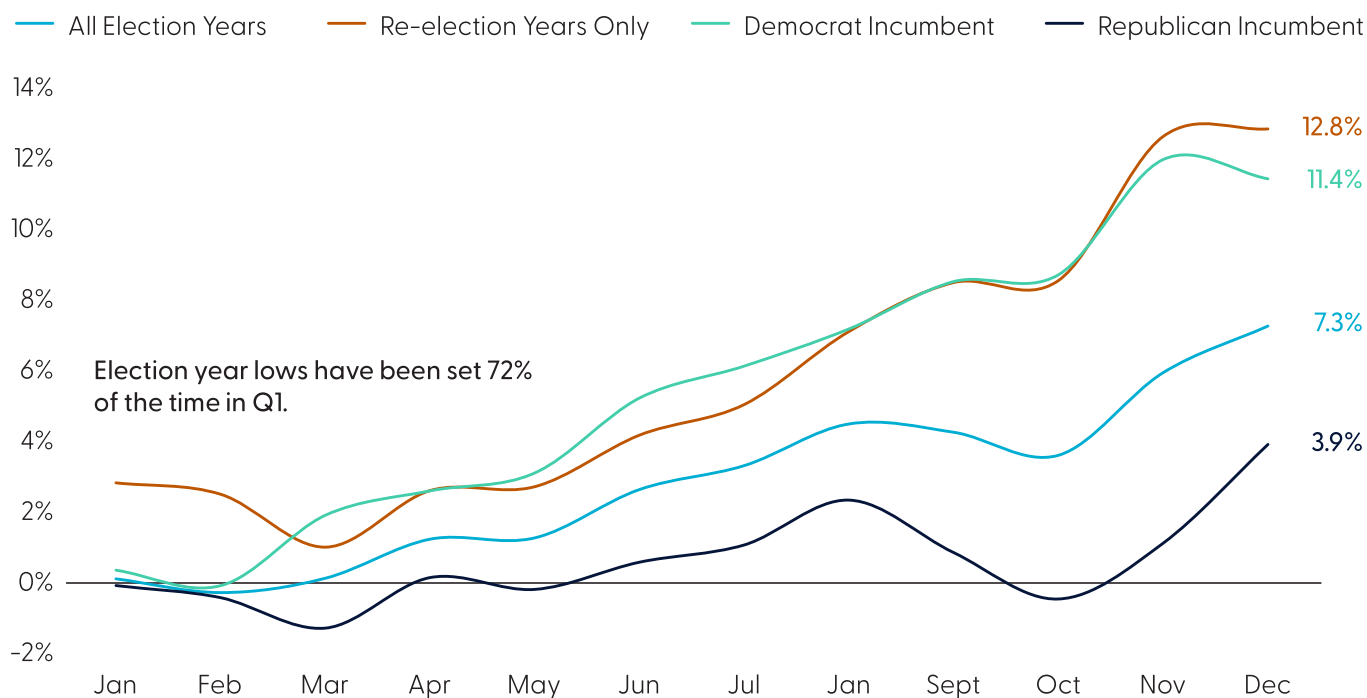
Source: LPL Research

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## Stocks tend to be positive in election years

Despite our belief that market volatility could pick up as we approach the election, stocks do tend to finish the year fairly strong when the election is over. So while we would suggest investors not get too aggressive with their portfolio allocations, given the potential volatility, elections have historically not been a cause to change investment strategies.

### S&P 500 election year progression (1952-2020)



Source: LPL Research

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## Bond market may offer better opportunities amid elevated policy uncertainty

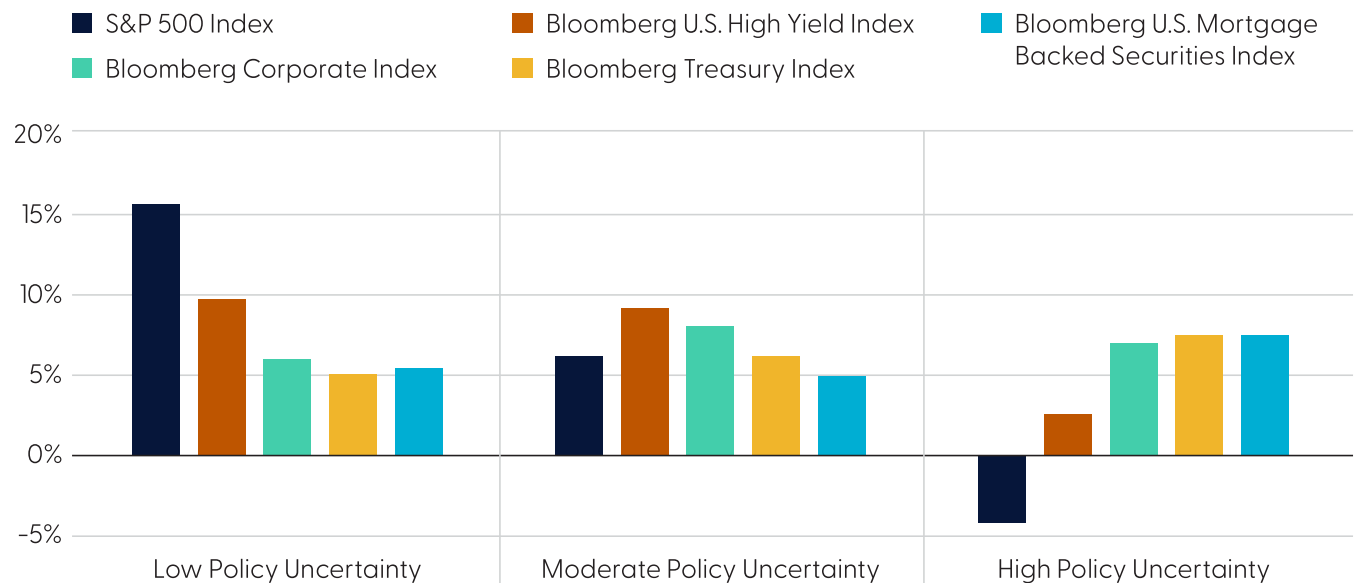
As noted above, increased stock market volatility is expected due to policy uncertainty ahead of Election Day. Although short-run market volatility is typically not good for stocks, it can be a benefit for the bond market.

A recent report from Guggenheim Investments examined the performance of various markets under varying economic policy uncertainty regimes. Per their work, since 1985, during U.S. presidential election years, the U.S. Economic Policy Uncertainty Index, which measures uncertainty related to economic policy based on media coverage, has averaged 17% higher relative to non-election periods. And the degree to which policy uncertainty prevails has had a meaningful impact on asset returns. The higher the economic policy uncertainty (and we expect to have material policy uncertainty as we approach this election), as illustrated in the chart below, the better high-quality bonds have performed.

While policy uncertainty may indeed be a reason to own bonds, we believe it is not the only reason. LPL Research believes the investment risk/reward trade-off between bonds and stocks does favor bonds at this juncture. Given that current starting yields in the bond market are attractive, and easier Federal Reserve policy could be a bond price tailwind, policy uncertainty could be the third leg of a bullish stool for bondholders.

## High-quality bonds have outperformed when policy uncertainty is high

### Economic policy uncertainty and asset class returns (since 1985)



Source: LPL Research, Guggenheim Investments, 07/18/24

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## Policy differentiation can be the source of investment opportunities

While near-term political shifts prove to be of little importance in driving long-term investment returns, differences in policy approaches between the two candidates can create some investment opportunities. Below we list some policy divergences that we believe may be important with regard to potential economic and market impacts, and we share some investment implications to think about in the coming months and beyond.

### 2024 election: Summary of key policy items

	Democrats	Republicans
Trade and investment	Continue CHIPS Act implementation, Ukraine aid, Russian sanctions and Indo Pacific Economic/Taiwan trade agreements.	A more U.S. centered framework. Use of tariffs to protect domestic manufacturers. Potentially enact a universal tariff.
China	Continue restricting flow of capital to China. Seek cooperation with China to reduce illicit drug production and AI risks.	Further curtail investment flows to China. Larger expansion of tariffs. Review all imports. Reduce reliance on Chinese goods. Stronger emphasis on protecting U.S. interests.
Immigration	Strengthen border security through an increase in personnel. Maintain current citizenship requirements.	Restrict immigration, re-establish “Migrant Protection Protocols” and resume building wall on Mexican border. Potentially change current citizenship requirements.
Climate	Further regulation of air pollutants. Continue building regulations around climate risk management, Toxic Substances Control Act evaluations.	Rescind many energy regulations. Leave Paris Climate Accord. Reverse bulk of Inflation Reduction Act. Reduce carbon capture utilization and storage funding. Repeal SEC ESG regulations. Rework climate change and efficiency standards for appliances.
Energy	Expand offshore wind program, oil & gas leasing restrictions, and emissions standards regulations. Continue with implementation Inflation Reduction Act.	Increase domestic drilling and speed up pipeline approvals. Remove EV and clean energy incentives. Increase size and scope of drilling auctions. Reorganize DOE. Explore use of liquefied natural gas exports as a potential foreign policy trade tool.
Tax	Increase IRS funding and audit capacity. Subsidize clean energy products. Enforce certain import tariffs. Align corporate income tax policy with OECD agreement. Expand Child Tax Credit and Affordable Care Act tax credits.	Keep Tax Cuts and Jobs Act (TCJA) and permanently re-enact individual tax cuts. Resolve small business pass-through deductions. Withdraw from international tax agreement and increase Sec. 232 and 301/201 tariffs. Enforce certain import tariffs.

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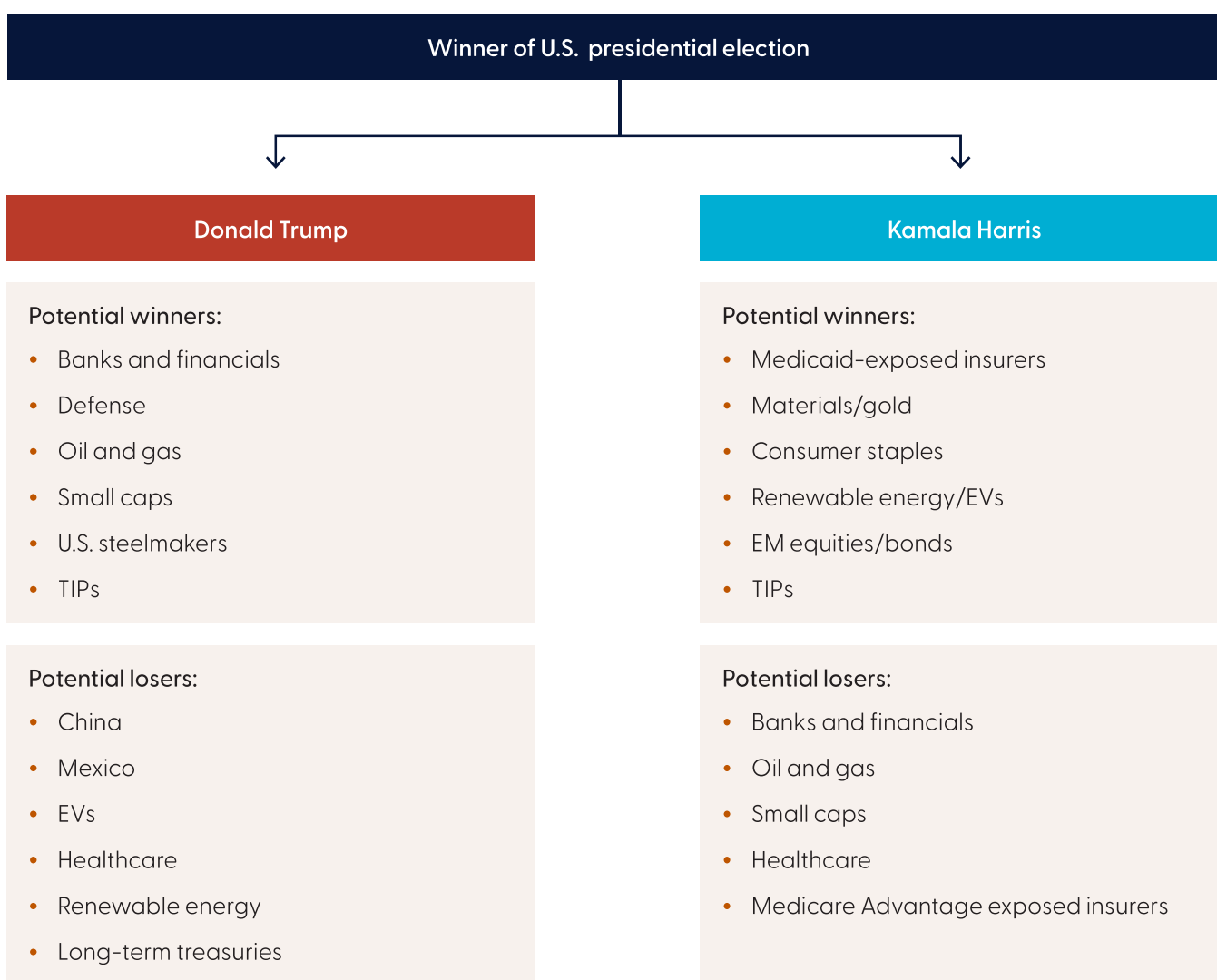
2024 election: Summary of key policy items

	Democrats	Republicans
<b>Fiscal policy</b>	Preserve current Social Security and Medicare benefit levels. Increase some individual and corporate alternative minimum tax rates. Close carried interest “loophole.” Maintain current spending levels on foreign aid, climate subsidies, and immigration. Promote affordable housing.	Potential reforms for Social Security and Medicare but led by Congress. Extend from TCJA corporate income tax rate, bonus depreciation, and immediate R&D expensing. Withdraw from OECD global tax agreement and implement countermeasures against countries who adopt it. Reduce foreign aid and climate subsidies.
<b>The Fed and FOMC</b>	More likely to reappoint Fed Chair Powell and push for heavier regulation. Less active public dialogue regarding Fed policy.	Less likely to reappoint Fed Chair Powell in 2025. More active public dialogue regarding Fed policy. Potential reform of FRB system.
<b>Regulation and deregulation</b>	Continue current regulatory agenda use with a focus on antitrust and merger scrutiny. Direct regulators to finalize proposed rules. Artificial intelligence regulation.	In conjunction with Congress, bring some regulatory agencies under presidential authority. Require Congress to approve major rule changes before they take effect. Reverse Biden Administration regulations and limit regulations overall.

Source: LPL Research, LPL Financial Government Relations

## U.S. presidential election: Potential winner and losers

As a result of some of the potential policy differences, we believe there could be likely market “winners and losers,” depending who stands as president in 2025. Note: The potential winners for each candidate highlighted below, would perhaps be more likely or more definitive should that candidate’s party also control the House and/or Senate. Of the potential winners below, we believe renewable energy/EVs and Medicaid-exposed insurers may be the most likely beneficiaries in a Harris administration, while U.S. steelmakers and oil & gas, could be the most likely beneficiaries in a Trump administration. On the downside, a Trump administration may be the most detrimental to China’s economy and its companies, while a Harris administration would perhaps weigh the most heavily on the traditional oil & gas segment.



Source: LPL Research, Evercore ISI, 7/30/2024

## Tax policy

While the potential winners and losers we mentioned are notable, the biggest election variable may be go-forward tax policy. Indeed, the 2017 TCJA expires in 2025, making tax policy a big campaign issue this fall. Extending the tax cuts put in place by the TCJA would cost over \$4 trillion over 10 years (estimated by the Congressional Budget Office). Trump would like a full extension, with tariffs generating some revenue as an offset, while a Harris administration favors extending tax cuts only to those with incomes below a certain threshold, similar to President Biden's previous proposals. The extent of additional pay-fors to limit the deficit impact are uncertain and would depend on the makeup of Congress. While the tax policies for the two candidates are different, there are some key items to highlight that may have potential investment implications:

- If the Democrats fare well, there may be a push to raise corporate tax rates. A lower corporate rate benefits companies paying the highest tax rates, e.g., more domestic and smaller companies, because they could experience the biggest bump. Conversely, a higher rate would benefit those companies paying the lowest rates with more non-U.S. income because they would experience a smaller tax hit.
- Consumer spending may fare better under Republicans, who would be expected to deliver lower tax rates all across the income spectrum. A win by the Democrats and strong showing in Congress could prop up relative spending on food and other necessities (as opposed to discretionary spending) and be good for consumer staples companies.

Consumers and investors should become more familiar with the tax details below, as these variables could be subject to material change as a result of election outcomes. Please consult with your financial advisor and tax professional for more information.

## Tax policy provisions

### Permanent provisions

- Reduction in corporate tax rate from 35% to 21%
- Elimination of corporate alternative minimum tax
  - The Inflation Reduction Act (IRA) revised the minimum tax to 15% for companies with \$1B+ in income in 2022
- Expanded depreciation deductions



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The 2017 Tax Cuts and Jobs Act (TCJA) is currently set to expire in December 2025.

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### Expiring provisions (expiring December 2025)

#### Business

**New markets tax credit:** The credit permits individual and corporate investors to receive a credit against their federal income tax in exchange for investing in Community Development Entities. The credit totals 39% of the original investment amount and is claimed over a seven-year period.

**Employer credit for paid family and medical leave:** The credit is given to employers who provide paid family and medical leave to their employees, equal to a percentage of wages they pay to qualifying employees while on leave.

**Work opportunity credit:** The credit is given to employers that hire and pay certain individuals that are a member of one of 10 targeted groups. The credit is equal to 40% of up to \$6,000 of wages paid.

**Rate on modified taxable income and treatment of credits in the calculation of BEAT:** The computation of BEAT is reduced (but not below zero) by the excess, if any, of:

- Credits allowed under Chapter 1 against regular tax liability over the sum of the following credits (for taxable years beginning on or before December 31, 2025):
  - Credit allowed under IRC 38 for the taxable year that is allocable to the research credit under IRC 41(a)
  - The portion of the applicable IRC 38 credits not in excess of 80% of the lesser of the amount of those credits or the BEMTA (determine without regard to this rule)
  - Any credits allowed under IRC 33, IRC 37 and IRC 53
- The sum of the following credits (for taxable years after December 31, 2025) any credits allowed under IRC 33, IRC 37 and IRC 53

### Individual

**Modification of individual income tax rates:** The TCJA reduced statutory tax rates in nearly every income bracket, as well as shifted the income tax bracket thresholds.

**Increase in exemption amount and phaseout threshold of AMT:** The TCJA increased the alternative minimum tax exemption (AMT), as well as the income at which the exemption begins to phase out. Additionally, it repealed and scaled back several AMT preference items such as personal exemptions, state and local tax deductions (SALT), and deductions subject to 2% of adjusted gross income floor.

**Limitation on excess business losses of non-corporates:** The changes disallow excess business losses if the amount of the loss is in excess of \$250,000 (\$500,000 for a joint return), adjusted for inflation. The disallowed amount is carried forward as a net operating loss to the following tax year, eliminating the need for carryback provisions.

**Qualified business income deduction:** The deduction, also referred to as Section 199A, allows sole proprietors, partnerships, S corporations, and some trusts and estates to deduct up to 20% of their qualified business income plus 20% of qualified real estate investment trust (REIT) dividends. C corporations are not eligible for the deduction.

**Exclusion for certain employer payments of student loans:** The educational assistance program allows up to \$5,250 of tax-free wages to pay for employees' student loans. Payments on the principal and interest of an employee's qualified education loans are eligible, as well as payments made directly to the lender.

**Certain Child Tax Credit modifications:** The TCJA increased the maximum Child Tax Credit (CTC) to \$2,000 per child, lowered the Additional Child Tax Credit (ACTC) formula to begin phasing in at \$2,500 of earned income, capped the refundable portion of the CTC at \$1,400 per child (inflation adjusted), and increased the income levels at which the CTC begins to phase out.

**Suspension of deduction for personal exemptions:** The TCJA set the value of the federal personal exemption to \$0.

**Limitation on SALT deduction:** The TCJA capped the state and local property tax deduction at \$10,000 for all filers and eliminated deductions for state and local income and sales tax.

**Increase in estate and gift tax exemption:** The TCJA increased the lifetime estate and gift tax exemption from \$5.6 million to \$11.18 million for individuals (inflation adjusted).

**Increase in standard deduction:** The TCJA increased the standard deduction from \$6,500 to \$12,000 for individuals, and from \$13,000 to \$24,000 for joint filers.

**Suspension of miscellaneous itemized deduction:** The TCJA suspended the deduction of several miscellaneous deductions including unreimbursed job expenses, investment expenses, tax preparation fees, and hobby expenses.

**Tax exemption for student loan discharges on account of death or disability:** The TCJA allows student loan debt that was discharged due to death or disability to be exempt from gross income calculations.

**Exclusion from gross income of discharge of indebtedness on principal residence:** The TCJA allows qualified principal residence debt to be excluded from gross income calculations.

**Limitation on deduction for qualified residence interest, suspension of deduction for home equity interest:** The TCJA lowered the acquisition indebtedness limit on the qualified residence indebtedness deduction to \$750,000, and suspended the deduction for home-equity indebtedness.

Source: 2017 Tax Cuts and Jobs Act legislation

### Investing Summary: What to Do...

There is a large amount of data and history that suggests investors should avoid investment decisions based on election outcomes, some of which we've highlighted in this report. Still, some investors may be inclined to move their portfolios to be consistent with their projected presidential winner and the winners' and losers' outcomes we mentioned. Given the tightness of the presidential and congressional races and the amount of time before voters go to the polls, we would not recommend investors make such bets. However, we do suggest investors take this pre-election opportunity to prepare portfolios for higher-than-normal volatility that could come around this election season. Rather than focusing on predicting the winners, we believe protecting against likely volatility is the best investment advice one can give at this juncture, and keep a well balanced, diversified portfolio. We would reserve any other investment judgement until after the election results have been formally tabulated.

*LPL Research would like to thank LPL Financial's Government Relations team and specifically Mary Kate Clement for important insight and contributions to this report.*

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