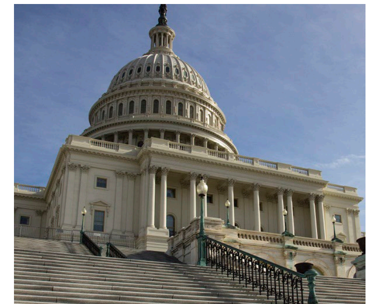
Special Report



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Campaign 2024: Political issues with staying power

Key takeaways

- This is the first in a series of reports to help guide investors as the 2024 elections approach.
- Today's highly polarized and closely divided Congress is unusual across the past century and makes predicting the makeup of the next Congress more difficult than usual.

What it may mean for investors

- With the elections nearly a year away, we prefer to focus on key campaign issues that have bipartisan support. These include increased infrastructure spending and reshoring, likely benefiting two of our favored equity sectors generally: Industrials and Materials.

Leadership changes in both chambers of Congress have become more frequent since 2000, making it difficult to predict election outcomes nearly a year in advance. Tighter congressional majorities reflect a more evenly balanced electorate. Party control lasting 15 years in both the House and the Senate was not uncommon during the first half of the 20th century, rising to a 26-year stretch in the Senate and a 40-year stretch in the House beginning in the mid-1950s. Tenures have shortened since then with neither party controlling the Senate or the House for more than 8 years since 2007. Narrow majorities have added to the uncertainty of anticipating election outcomes. House and Senate average majorities narrowed from 68 and 10 seats in the 1980s and 1990s to 35 and 6, respectively, in the past 24 years. That includes current majorities of 9 seats in the House and just 1 in the Senate.

That makes the debate over economic and social policy issues more fluid in the run up to next November's elections. Investors are facing shifting priorities among voters at the start of campaign '24 from social issues, seemingly favoring the Democrats earlier this year, to the economy, working against them in recent polls. And the large polling errors during the last two presidential races only add to the uncertainty over investment implications this time around.

This election cycle also brings an uncommon combination of challenges for voters and investors. Outsized deficits and the budget's structural weaknesses should limit the usual election-year stimulus spending. Geopolitical tensions complicate the budget picture and are forcing voters and investors to consider the extra dimension of

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foreign affairs. Meanwhile, our outlook notes tight credit conditions, high and rising long-term interest rates, and a slowing economy that is likely to contract early in the year before a moderate recovery by year-end.

Avoid generalizing the market's past election-year performance

Table 1 shows the S&P 500 recorded positive returns in 20 of 24 U.S. presidential election years going back to 1928, but we believe some caution is in order. The S&P 500 retraced election-year gains the following year in 8 of those 20 instances — a notable 40% of the time. And in 6 of those 8 instances, the S&P 500's two-year (election-post election) returns fell below its long-term 10% annual average (see Table 1). This supports our view that even identifiable market patterns during an election year can be a misleading guide to longer-term investment strategy. As indicated in the table, S&P 500 returns around election years are widely dispersed around a long-term average, reinforcing our view that long-term investors are best served by avoiding portfolio decisions based on generalizations about the market's past election-year performance. Furthermore, we anticipate elevated market volatility around a turn into a deeper economic slowdown and subsequent pivot to recovery — even if there were no elections scheduled in 2024. A budgetary impasse in Washington and global geopolitical events will likely add to that turbulence.

Table 1. Election years: An imperfect guide to long-term investment strategy

Year	S&P 500 Index annual total return: Election year	S&P 500 Index annual total return: One year later	S&P 500 Index annual total return: Two-year compound annual average
1928	**43.6%**	**-8.4%**	**14.7%**
1932	-8.2%	54.0%	18.9%
1936	**33.9%**	**-35.0%**	**-6.7%**
1940	-9.8%	-11.6%	-10.7%
1944	19.8%	36.4%	27.8%
1948	5.5%	18.8%	11.9%
1952	**18.4%**	**-1.0%**	**8.3%**
1956	**6.6%**	**-10.8%**	**-2.5%**
1960	0.5%	26.9%	12.9%
1964	16.5%	12.5%	14.4%
1968	**11.1%**	**-8.5%**	**0.8%**
1972	**19.0%**	**-14.7%**	**0.8%**
1976	**23.8%**	**-7.2%**	**7.2%**
1980	**32.4%**	**-4.9%**	**12.2%**
1984	6.3%	32.2%	18.5%
1988	16.8%	31.7%	24.0%
1992	7.6%	10.1%	8.8%
1996	23.0%	33.4%	28.1%
2000	-9.1%	-11.9%	-10.5%
2004	10.9%	4.9%	7.9%
2008	-37.0%	26.5%	-10.7%
2012	16.0%	32.4%	23.9%
2016	12.0%	21.8%	16.8%
2020	18.4%	28.7%	23.4%
Average	**11.6%**	**10.7%**	**10.0%**

Sources: Wells Fargo Investment Institute, Ibbotson Associates, and Bloomberg data, as of October 26, 2023. *Bold data represents instances where the S&P 500 Index gained in an election year but declined in the subsequent year. **Past performance is no guarantee of future results.**

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Focus on the issues, rather than polls and campaign rhetoric

Instead, we believe investors are better-served by focusing on the key, market-oriented issues that ultimately shape investment strategy even as these issues evolve over the course of the campaign. A polarized government cuts across an array of core election issues shaping what we believe will be the heart of the 2024 election campaign. Summarized below are issues we see having the greatest impact on investment strategy in 2024 and beyond. Subsequent reports will examine party differences over these and any other emerging issues in greater detail.

1. Tax policy

- *Republicans* broadly favor maintaining the 2017 Tax Cuts and Jobs Act, expiring at the end of 2025, offset by discretionary spending cuts. However, they are divided over the extent of defense versus nondefense cuts in outlays.

- *Democrats* favor higher corporate and personal taxes, particularly for upper-income families. However, the party's moderate and progressive wings are divided over upper-income tax surcharges, childcare tax credits, and deductions on business income.

- *Of bipartisan interest:* The 2017 tax cuts are showing every sign of becoming a contentious issue in 2024. Early talk of a bipartisan, pre-election compromise on tax policy is centered, instead, around an expanded child tax credit in exchange for extending corporate tax breaks. Hope also springs eternal among Democrats and Republicans from high-tax states for elimination of a Trump-era cap on state and local tax deductions as part of any future tax compromise.

- *Investment implications:* Higher corporate and personal taxes proposed by Democrats and Republican spending-cut proposals would make the budget less stimulative for economic growth. More specifically, higher tax rates likely would enhance after-tax income on municipal versus taxable debt securities, bolstering our favorable rating on municipals. Higher corporate tax rates likely would affect less capital-intensive tech and services industries. Traditional manufacturing and other capital-intensive firms would be cushioned by more sizable depreciation allowances. Compromise legislation enhancing corporate tax breaks would add to corporate after-tax earnings, supporting stock valuations generally across the board.

2. Defense spending and foreign policy

- *Republicans* generally favor inflation-adjusted increases in defense spending as an effective foreign-policy tool, though differences have emerged between party moderates and the party's more conservative wing over the size of the increases and their distribution. Likewise, we would expect moderates to take a more cautionary view of tariffs than conservatives in controlling trade deficits.

- *Democrats* tend to seek a greater share of non-defense spending in discretionary federal outlays. They also favor a greater role for industrial policy, in which the government attempts to shape the economy with a range of incentives, including subsidies, tax incentives, infrastructure development, protective regulations, along with research and development funding. Progressive Democrats tend to favor a greater tilt toward nondefense spending and a more activist government industrial policy role than moderates within the party.

- *Of bipartisan interest:* Both parties tend to favor tougher investment and trade restrictions on China as a way to protect U.S. technology companies and improve U.S. competitiveness in bilateral trade.

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- *Investment implications:* Global tensions provide a more sanguine outlook for defense that supports our favorable view of capital goods and the broader Industrials sector. Technology and other businesses selling into China, along with retail firms relying on lower-cost Chinese exports to the U.S. market would be among some of the most exposed to added trade restrictions on the country. At least some of the economic sting from tougher regulations on China would be offset by reshoring incentives and other subsidies under Democratic industrial policies that tend to support high-tech and renewable-energy development. Republican-supported tariffs would likely benefit traditional manufacturing, much of which resides in our favored Industrials sector.

3. Energy and climate change

- *Republicans* generally favor fossil fuel development to ease energy-cost pressures through more enhanced permitting reform and a rollback of at least some of the clean-energy provisions in the Inflation Reduction Act (IRA).

- *Democrats* generally support emissions controls and renewable-energy project funding embodied in IRA incentives.

- *Of bipartisan interest:* While there is nothing concrete on the table yet, one area of compromise could be a rollback of new royalties and fees stymying oil and gas production in return for more liberal leasing of federal land for solar and wind projects. Disbursements also are ramping up from $280 billion in investments for local semiconductor research and output under the companion CHIPS and Science Act legislation passed in 2022.[1]

- *Investment implications:* Climate change has been a focused political issue for Democrats and we expect their continued support for capital investments aimed at renewable-energy generation and emissions reduction. This would likely benefit diversified companies focused on advancing large clean-energy projects (generally found in our favored Industrials and Materials sectors along with the Energy sector — which we currently rate as neutral). Republican support for easier permitting of oil and gas drilling and infrastructure would be favorable for energy stocks as well as an oil industry already benefiting from tight oil-market supply globally.

4. Fiscal policy

- *Republican* conservatives have been more aggressive than the party's moderate wing in pressing for discretionary-spending cuts to control outsized deficits, replacement of the Affordable Care Act (ACA), tightened rules on Medicare eligibility, and fewer drug-pricing restrictions.

- *Democrats* favor redistributive upper-income tax increases to fund discretionary-spending growth, ACA retention, and drug-pricing reforms to control cost increases with party progressives advocating a more aggressive approach toward government-sponsored health insurance and pricing support.

- *Of bipartisan interest:* Bipartisan efforts at debt-ceiling reform could be resurrected in legislation similar to the Responsible Budgeting Act introduced at the end of 2021. Reform of trust funds financing Social

1. "The CHIPS and Science Act: Here's What's in It," McKinsey & Co., October 4, 2022.

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Security and other entitlements could be revived in revamped Trust Act legislation that Senators Romney and Manchin proposed over two years ago.[2]

- *Investment implications:* Defense, health care, and other industries exposed to discretionary government spending (like infrastructure and renewable energy) are vulnerable to periodic attempts to contain outsized deficits. We believe exposure of pharmaceutical companies to drug-pricing controls will increase with expanded Medicare negotiating authority for new and existing drugs in 2024. Fiscal policy differences between parties would affect our favored Health Care sector unevenly. Parts of the managed-care industry could be hurt by Republican proposals to tighten Medicare eligibility rules, in our view, but could benefit from Democratic plans to safeguard retention rules under the ACA. Republican proposals to lift most drug-pricing restrictions would potentially favor pharmaceutical firms, while Democratic plans to maintain and tighten controls would potentially hurt the industry.

5. Immigration

- *Republicans* are focused more on funding for stronger border security.

- *Democrats* favor legal paths for residence by immigrants, though some are taking a harder stance as increased demand stresses state resources.

- *Of bipartisan interest:* The bipartisan reform effort is most visible in the proposed Dignity Act of 2023, aiming to, among other things, improve border security, enhance and speed screening provisions, expand pathways for skilled immigrant workers, and create an uncapped, temporary visa program for farmworkers.

- *Investment implications:* Increased labor supply from immigration has the potential to ease pressure on wage inflation from an aging U.S. workforce and slower labor-force growth. It would likely have its greatest impact on construction, hospitality, agriculture, and less-skilled manufacturing, in our view. We believe lower-end retailing would likely be another beneficiary from both increased demand for essential goods and the potential added labor supply for retailing.

6. Infrastructure investment

- *Republicans* favor joint public-private partnerships and funding for traditional infrastructure (including roads, ports, water, and energy).

- *Democrats* have pushed for a more government-oriented role in infrastructure planning and development, using a broader definition of such investment to include renewable energy, national security, and rural internet access. Budget pressures make a rollback of selected IRA provisions Democrats support more likely under a GOP-controlled government.

- *Of bipartisan interest:* Infrastructure investment enjoys bipartisan support through direct investment spending and from reshoring. We do not expect new legislative initiatives on infrastructure. However, it is worth remembering that disbursements under the bipartisan infrastructure bill (including $550 billion in

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2. "Explaining the TRUST Act: Just the FAQs," Committee for a Responsible Federal Budget, April 15, 2021.

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new spending and $650 billion in existing programs) have entered the middle innings of ramped-up spending on traditional and nontraditional projects during 2022 – 2026.[3]

- *Investment implications:* We anticipate that the main beneficiaries of added infrastructure spending will continue to be our favored Industrials and Materials sectors and, increasingly, the Information Technology sector (which we rate as neutral).

What we favor doing now

Many investors want to position their portfolios to the greatest advantage as the 2024 elections approach. We appreciate the growing urgency as Tuesday, November 5, 2024 comes into view, but we also acknowledge that each party still faces considerable work to persuade voters. The primaries and multiple debates are upcoming and should provide much more clarity, but only over time. While the issues remain fluid, we strongly favor keeping investment plans focused on the economy for potential opportunities that we believe are likely to be clearer and more immediate.

We will supplement this report with additional guidance as the political party campaigns come into better focus and issues gain enough clarity for markets to begin to include in prices.

3. "Myths and Facts: Infrastructure Investment and Jobs Act," American Society of Civil Engineers, September 23, 2021.

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Risk considerations

Each asset class has its own risk and return characteristics. The level of risk associated with a particular investment or asset class generally correlates with the level of return the investment or asset class might achieve. **Stock markets**, especially foreign markets, are volatile. Stock values may fluctuate in response to general economic and market conditions, the prospects of individual companies, and industry sectors. **Bonds** are subject to market, interest-rate, price, credit/default, liquidity, inflation, and other risks. Prices tend to be inversely affected by changes in interest rates. **High-yield (junk) bonds** have lower credit ratings and are subject to greater risk of default and greater principal risk.

Sector investing can be more volatile than investments that are broadly diversified over numerous sectors of the economy and will increase a portfolio's vulnerability to any single economic, political, or regulatory development affecting the sector. This can result in greater price volatility. The **Energy** sector may be adversely affected by changes in worldwide energy prices, exploration, production spending, government regulation, and changes in exchange rates, depletion of natural resources, and risks that arise from extreme weather conditions. Some of the risks associated with investment in the **Health Care** sector include competition on branded products, sales erosion due to cheaper alternatives, research and development risk, government regulations and government approval of products anticipated to enter the market. There is increased risk investing in the **Industrials** sector. The industries within the sector can be significantly affected by general market and economic conditions, competition, technological innovation, legislation and government regulations, among other things, all of which can significantly affect a portfolio's performance. **Materials** industries can be significantly affected by the volatility of commodity prices, the exchange rate between foreign currency and the dollar, export/import concerns, worldwide competition, procurement and manufacturing and cost containment issues. Risks associated with the **Technology** sector include increased competition from domestic and international companies, unexpected changes in demand, regulatory actions, technical problems with key products, and the departure of key members of management. Technology and Internet-related stocks, especially smaller, less-seasoned companies, tend to be more volatile than the overall market.

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