



Global Investment Office | March 21, 2024

US Policy Pulse

2024 General Election Series

The 2024 general election series consists of monthly reports examining the relationship between financial markets, the economy and electoral outcomes. Please note this series will be published in addition to our flagship *US Policy Pulse* reports.

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New in This Edition

- President Joe Biden and former President Donald Trump are the presumptive Democratic and Republican presidential nominees following their Super Tuesday primary wins. Former South Carolina governor Nikki Haley, the last remaining GOP candidate, has dropped out of the race.
- Congress has agreed to a tentative appropriations deal that finalizes the fiscal year 2024 budget ahead of the April 30 sequestration deadline. Congress is also focused on passing supplemental foreign aid funding and advancing a tax bill.
- Two Democrats and an independent who caucuses with the Democrats have announced their retirements. Since two of those seats are in battleground states, we see the potential to flip control to the Republicans, while redistricting in the House of Representatives may also lead to a change of control to the Democrats.
- President Biden's disapproval rating remains historically high despite strong economic growth, while Trump currently leads polling in nearly all swing states.
- Consumer sentiment has declined for a second straight month and remains below the election-year average, which by historical standards, indicates a Republican presidential victory.
- Our analysis of industries that may benefit from a Democratic or Republican win indicates that the stock market may be positioning for a GOP victory.

The 2024 General Election

The outcome of the 2024 general election, which is less than eight months away, will have significant investor implications. For example, the winner of the presidency will play an important role in developing tax and trade policy, addressing budget deficits and the debt ceiling, and navigating geopolitical unrest. Given the highly consequential nature of this election, we leverage financial market and economic data to guide investors and identify risks and opportunities as they develop. While this report focuses on current performance, we encourage investors to refer to our [History of General Election Performance Part 1](#) and [Part 2](#) reports for our comprehensive and historical view on elections.

What's New in Policy

President Joe Biden and former president Donald Trump have now each secured enough delegates from the primaries to become their party’s presumptive nominee, setting up the first US presidential election rematch since 1956. In the meantime, as of this writing, Congress has agreed to a tentative appropriations deal that will fund the government for the remainder of fiscal year 2024 and avoid the April 30 sequestration deadline, which would have led to a 1% across-the-board cut in discretionary spending. Also on the table is a national security supplemental funding bill for aid to Ukraine, Israel and Taiwan, which is being held up due to an impasse on immigration policy. With sequestration likely avoided, defense spending will continue to be prioritized, given escalating geopolitical tensions. The recent passage of the National Defense Authorization Act, which authorizes a 3.2% increase in defense spending, supports this and may help catalyze an upside surprise for defense sector performance, which has come under pressure due to budget uncertainty.

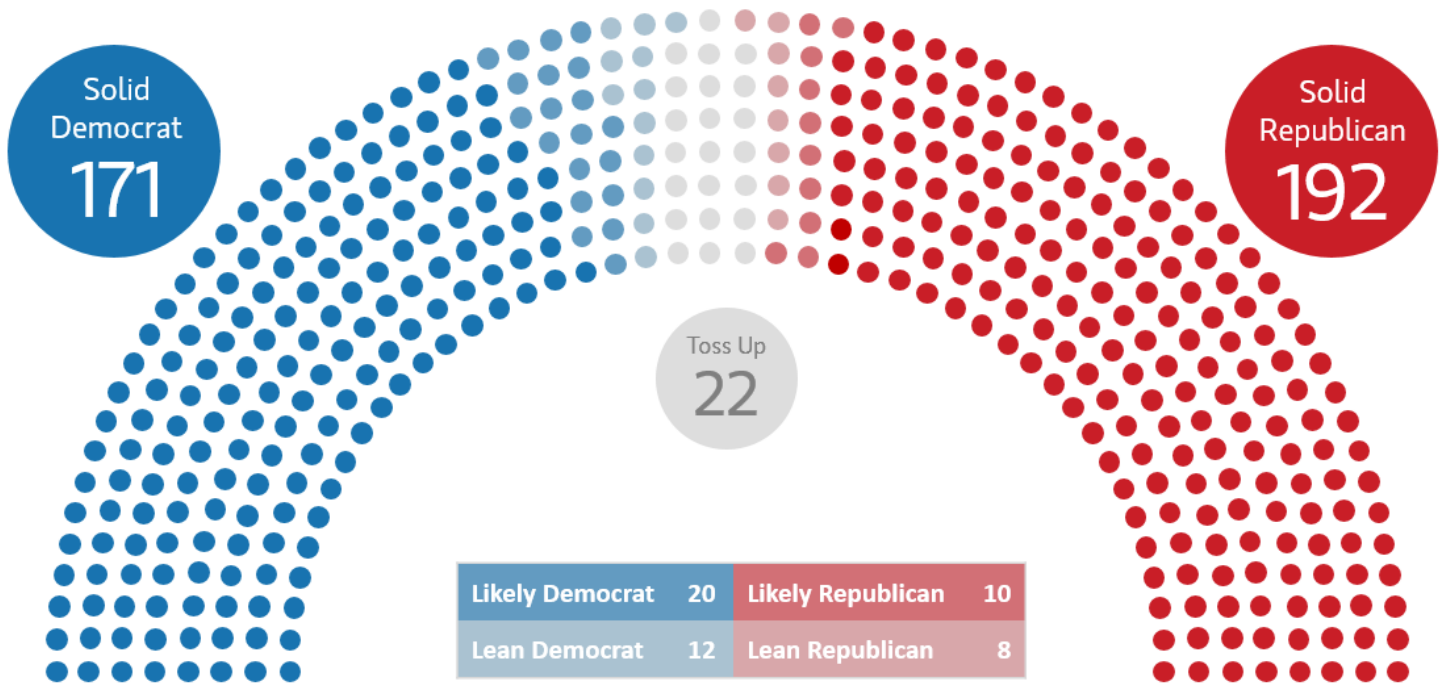
Congress is also considering a tax bill that would expand the child tax credit and restore three major business tax credits in the 2017 Tax Cuts and Jobs Act that have expired: full bonus depreciation, more generous expensing for research and development, and increased interest expense deductions.

The House of Representatives

Republicans currently maintain a narrow 218-213 majority over Democrats in the House of Representatives, with three GOP and one Democratic seat vacant. However, the balance of power is subject to change, as every two years all 435 House seats are up for reelection. The ultimate composition of the chamber is dependent on several factors, including candidate electability, shifts in voting trends due to congressional redistricting and the combination of retirements and legislators seeking other public offices. As of this writing, 43 House members (20 Republicans and 23 Democrats) are leaving their seats either due to retirements or in pursuit of other offices. We expect more departures to be announced ahead of states filing deadlines.

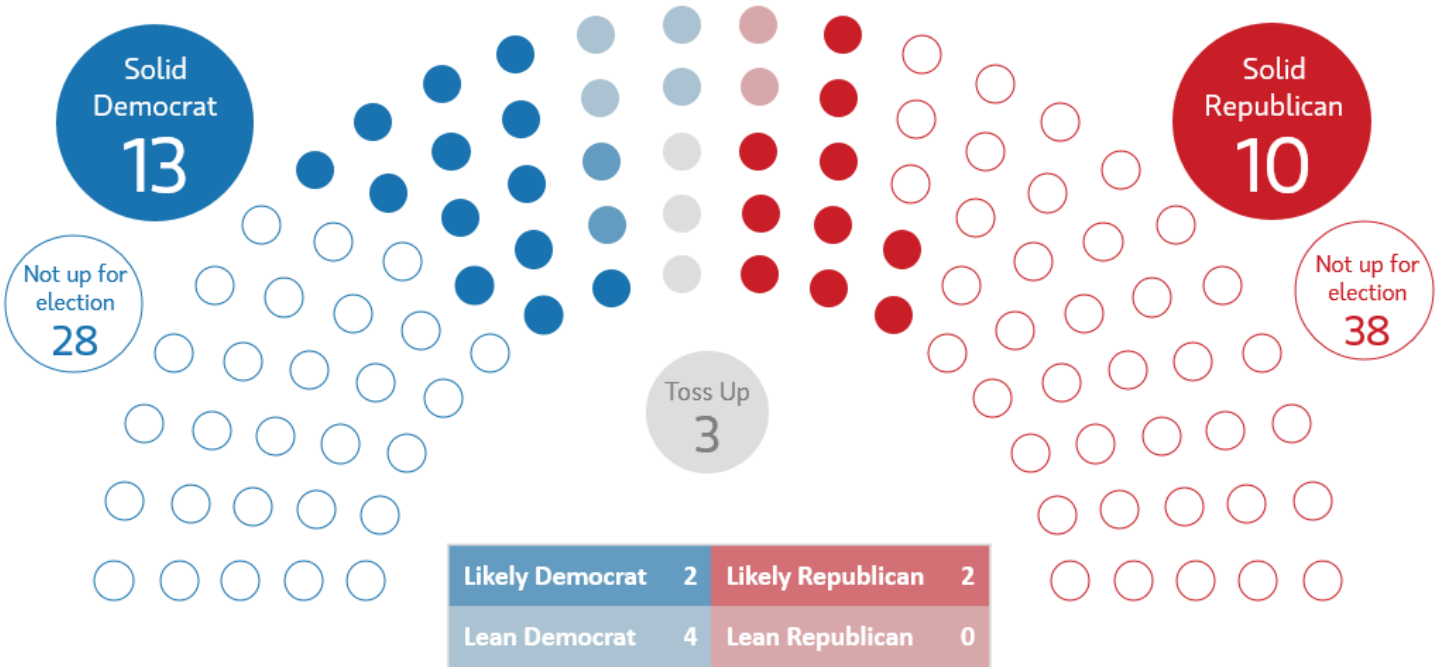
While both parties see opportunity in certain races, we anticipate the House is likely to fall under Democratic control, primarily due to advantages from recent congressional redistricting. Furthermore, the Cook Political Report (CPR) projects that 171 seats are solidly Democrat—not considered competitive—while 32 seats are likely or lean Democrat. It projects 192 solidly Republican races, with 18 likely or lean Republican races (see Exhibit 1). Importantly, CPR also considers 22 races “toss ups,” adding considerable competition to the fight to control the House.

Exhibit 1: House Race Competitiveness



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Exhibit 2: Senate Race Competitiveness



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

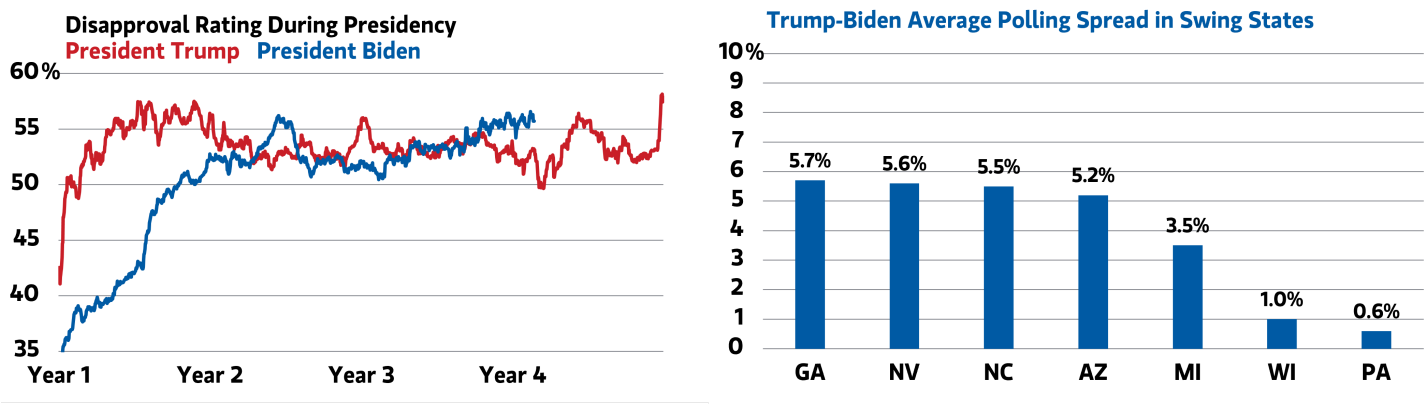
The Senate

In the Senate, Republicans maintain 49 seats, while Democrats and independents who caucus with them give Democrats a slim 51-49 majority. Unlike the House, where all seats are up for election every two years, only one-third of seats are up every two years in the Senate. Of those seats up this year, CPR rates 13 solid Democrat, 10 solid Republican, six likely or lean Democrat and two likely or lean Republican. Three seats are considered "toss ups" (see Exhibit 2). We believe this breakdown puts the Democratic majority in the Senate at risk: the retirement of Sen. Joe Manchin (D-WV) opens a seat in a state where former President Trump won 69% of the vote in 2020. The retirement of Sen. Kyrsten Sinema (I-AZ) opens another seat in a state which Biden won by a narrow 10,000 votes in 2020. Lastly, the retirement of Michigan Democrat Debbie Stabenow sets up a potential flip in another swing state.

The Presidency

President Biden is struggling with a historically high disapproval rating of 56%, exceeding former President Trump's 53% early in his fourth year in office (see Exhibit 3, left). Concerns remain among voters about the president's age and health, as well as his handling of other issues such as the economy. Despite falling inflation, many voters still view high costs of living as their top concern, while wars in Ukraine and the Middle East as well as immigration concerns, further pressure his favorability. Although the Republican nominee is not formally chosen until August, former President Trump has accumulated enough primary delegates to become the presumptive nominee, while Nikki Haley, his sole challenger, has since dropped out of the race. Furthermore, according to RealClearPolitics polling averages, Trump currently leads Biden in all seven swing states, each of which were decided by less than three percentage points in 2020 (see Exhibit 3, right). As the longest US presidential election campaign kicks off, we expect both candidates to focus their rhetoric on attacking the other's platforms and policies, while painting starkly different pictures of America, especially from an economic and foreign policy perspective.

Exhibit 3: President Biden Remains Highly Unpopular Among Voters As Trump Leads in Swing States

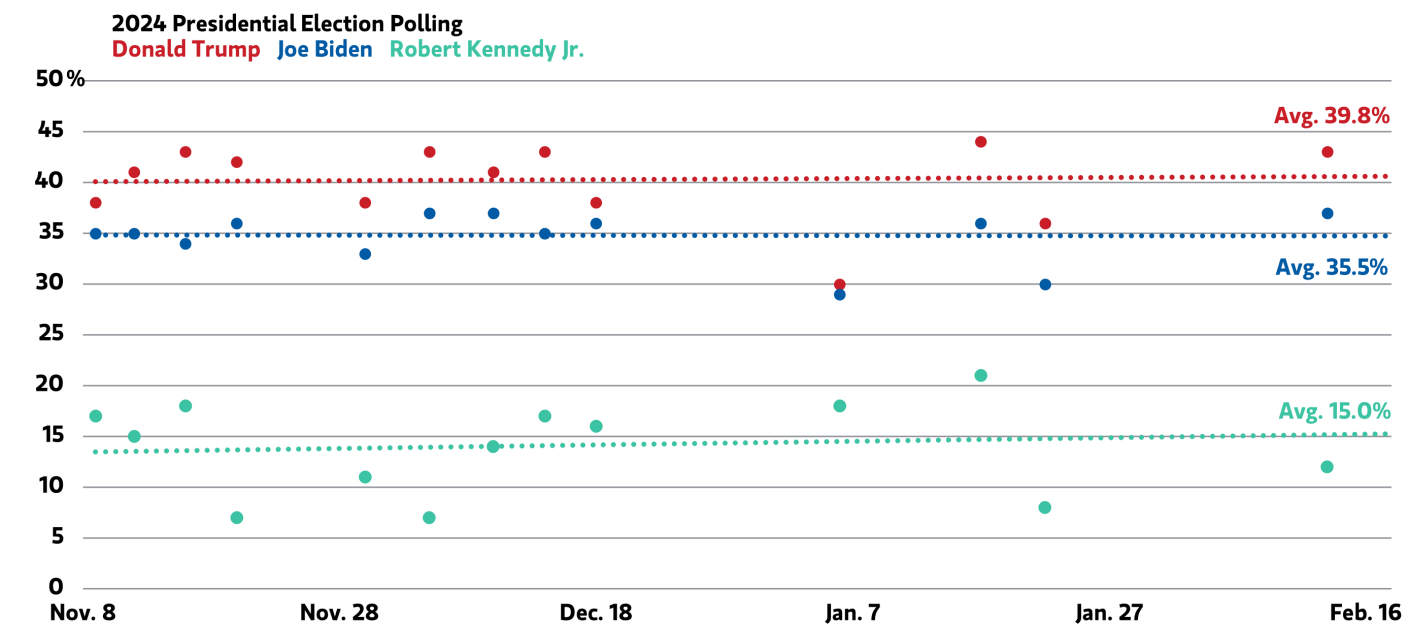


Source: FiveThirtyEight, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Polling for Trump, Biden and Robert Kennedy Jr., the leading independent, shows notable disparities as well. According to RealClearPolitics, Trump leads President Biden 39.8% to 35.3%, while Robert Kennedy Jr. polls at 15.8% (see Exhibit 4). While winning the presidency outright may be difficult, the historically high disapproval of the two major party candidates provides an opening and casts a spotlight on a

challenger who offers an alternative to the established parties. Kennedy's polling is important to watch in 2024, as third-party candidates often divert votes away from major-party candidates. As the election progresses, both Trump and Biden will not only seek to retain their votes against Kennedy, but will also need to pull voters away from Kennedy as long as his polling numbers remain high.

Exhibit 4: Third Party Candidates Could Impact Major Party Candidate Polling in the Near Term



Source: RealClearPolitics, Morgan Stanley Wealth Management Global Investment Office as of Feb. 22, 2024

Macroeconomics, Markets and the Election

Macroeconomic Indicators

Perhaps the most important indicator of a sitting president's reelection chances is voter sentiment about the economy. While not the singular determinant, presidential outcomes are correlated with GDP performance in the months prior to an election. According to the Center for the Study of Democratic Institutions, a 5% increase in GDP results in a corresponding 6% gain in incumbent vote share. However, in recent months we have seen the connection between candidate favorability and GDP diverge. While GDP increased at an annual rate of 3.3% in the fourth quarter of 2023, Biden's approval rating dropped by more than 2% since October.

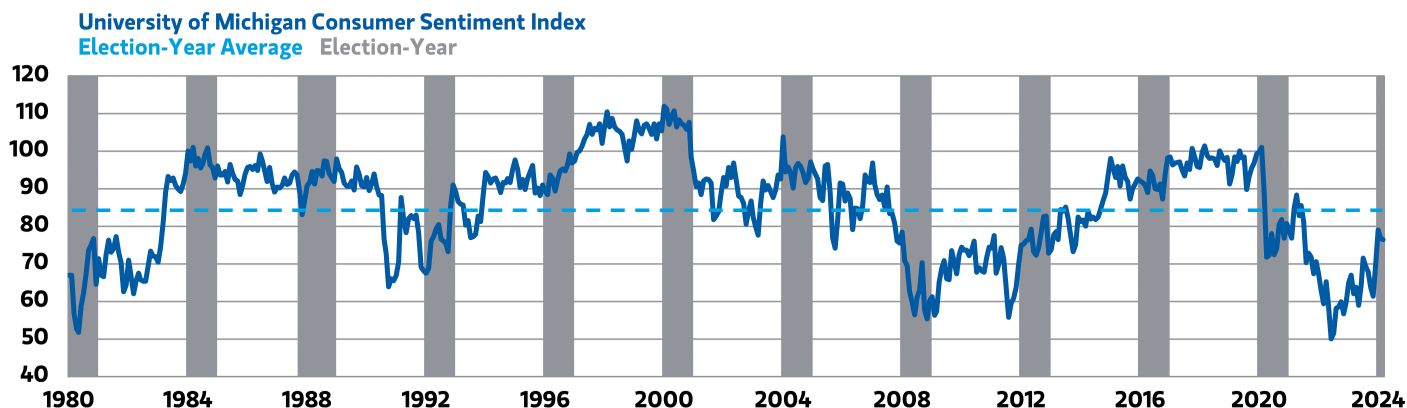
The disconnect between GDP and support for President Biden may be explained by voters' perceived wealth, which is often connected to inflation and the "economic pinch". This is supported by Morgan Stanley & Co. Research's latest AlphaWise survey, which shows inflation and the economy to be the top concern for 63% of consumers in 2024. Notably, average gasoline prices, important to many voters, are up 6% year-to-date and a significant 44% since Biden took office. While inflation and inflation expectations are falling since

their mid-2022 peak, wage growth is slowing and unemployment is on an uptrend. As such, much of Biden's reelection chances hinge on the state of the economy in 2024 and the amount of drag on consumer confidence.

The University of Michigan Consumer Sentiment Index (MCSI), a proxy for consumer confidence, fell for a second consecutive month to 76.5 in March from 76.9 in February and 79.0 in January. Sentiment is still below its historical election year average of 85.0, indicating that voters remain hesitant about the economic outlook amid election uncertainty (see Exhibit 5). In fact, consumer sentiment was only this low entering an election year four times, two of which resulted in losses for the incumbent.

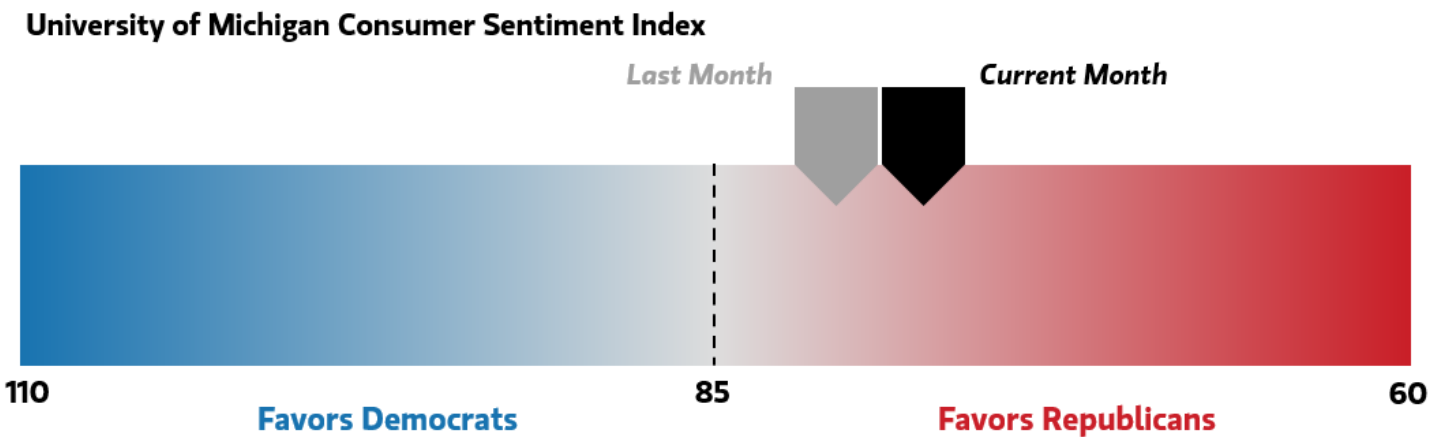
We will be tracking the MCSI monthly data and its correlation with electoral results. In fact, the index reports a positive correlation of 0.5 with incumbent presidential wins and losses, with the index at 92, on average, when the incumbent party wins and at 80, on average, when the incumbent party loses. The MCSI has fallen for two consecutive months and continue to point to a Republican party win (see Exhibit 6). We emphasize that the MCSI is one of many indicators of election results and we encourage investors to consider economic conditions holistically through notable macroeconomic, policy and market changes as we near election day.

Exhibit 5: Consumer Sentiment Has Fallen From Last Month and Remains Below Election-Year Average



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Exhibit 6: Consumer Sentiment Still Favors Republicans



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

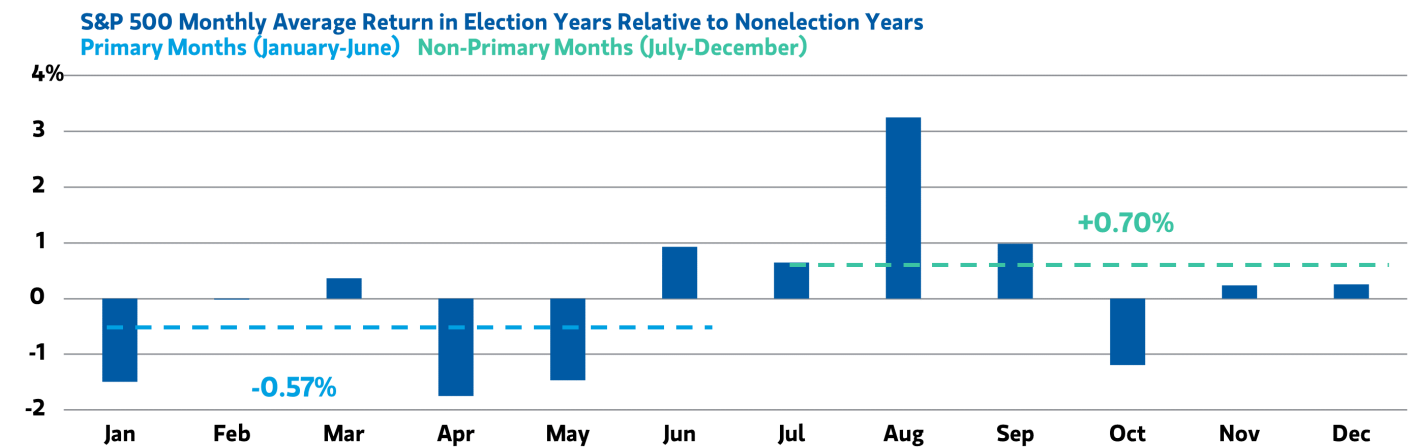
Market Indicators

As investors begin to position their equity portfolios ahead of the election, an analysis of market performance during presidential election years is imperative. Overall, we find that on average, the S&P 500 rises during election years regardless of which party wins control. The market also shows positive average monthly returns in election years relative to nonelection years. However, nonprimary months show higher average returns of 0.70% relative to nonelection years, as confirmation of party nominees somewhat increases certainty during the final months of the campaign (see Exhibit 7).

When analyzing market performance by sector, patterns emerge that may serve as opportunities for investors leading

up to and out of elections, as political outcomes and policy platforms can have an impact on an industry's regulation and profitability. For example, if investors anticipate a Republican win, Utilities, Energy, Financials and Industrials may track the strong historical performance those sectors have had in election years when Republicans won. Conversely, Information Technology and Consumer Discretionary performed best when a Democrat was the eventual winner (11.1% and 9.4%, respectively), though most sectors historically struggled in the first quarter of the election year (see Exhibit 8). We believe that opportunities in certain sectors and industries may arise for investors as Election Day approaches.

Exhibit 7: Returns Are Generally Positive, Relative to Nonelection Years, in Months Prior to General Election



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Exhibit 8: Sector Returns By Democrat and Republican Election-Year Wins

Republican Win Average Performance in Election Year							Democratic Win Average Performance in Election Year						
	Full Year	Q1	Q2	Q3	Q4	YTD		Full Year	Q1	Q2	Q3	Q4	YTD
S&P 500	2.8%	1.4%	0.1%	-0.1%	1.3%	8.6%	S&P 500	3.2%	-3.3%	3.7%	2.0%	0.0%	8.6%
Information Technology	-8.9%	4.4%	-3.3%	-3.8%	-6.4%	12.0%	Information Technology	11.1%	0.7%	6.5%	2.4%	-1.0%	12.0%
Health Care	10.5%	-2.3%	10.4%	-1.9%	3.7%	7.0%	Health Care	0.6%	-5.3%	2.2%	2.8%	0.3%	7.0%
Energy	21.9%	3.2%	6.7%	6.7%	3.8%	10.0%	Energy	-10.3%	-12.1%	10.6%	-5.8%	1.0%	10.0%
Consumer Discretionary	-1.4%	-0.6%	-3.5%	-1.4%	3.5%	2.7%	Consumer Discretionary	9.4%	0.5%	5.0%	4.2%	-0.7%	2.7%
Consumer Staples	7.7%	-2.5%	5.7%	-2.5%	8.5%	6.1%	Consumer Staples	4.7%	-2.6%	2.4%	5.3%	-0.4%	6.1%
Communication Services	-2.0%	5.8%	-3.4%	-4.1%	-2.8%	14.2%	Communication Services	2.0%	-8.7%	7.2%	-0.8%	4.4%	14.2%
Utilities	27.8%	8.3%	2.8%	10.3%	4.5%	0.7%	Utilities	-7.4%	-7.9%	4.5%	-3.0%	-0.9%	0.7%
Real Estate	10.9%	5.6%	-0.4%	0.9%	4.8%	-3.1%	Real Estate	-11.3%	-2.9%	3.1%	0.8%	-12.0%	-3.1%
Materials	2.4%	-4.0%	-3.4%	-0.7%	11.2%	5.9%	Materials	0.8%	-0.4%	4.1%	-1.1%	-1.7%	5.9%
Financials	17.3%	0.2%	-1.6%	9.0%	9.8%	9.1%	Financials	6.1%	-3.6%	-1.9%	3.8%	3.3%	9.1%
Industrials	12.2%	0.5%	2.5%	3.9%	5.1%	7.9%	Industrials	1.9%	-2.8%	0.7%	2.3%	1.3%	7.9%

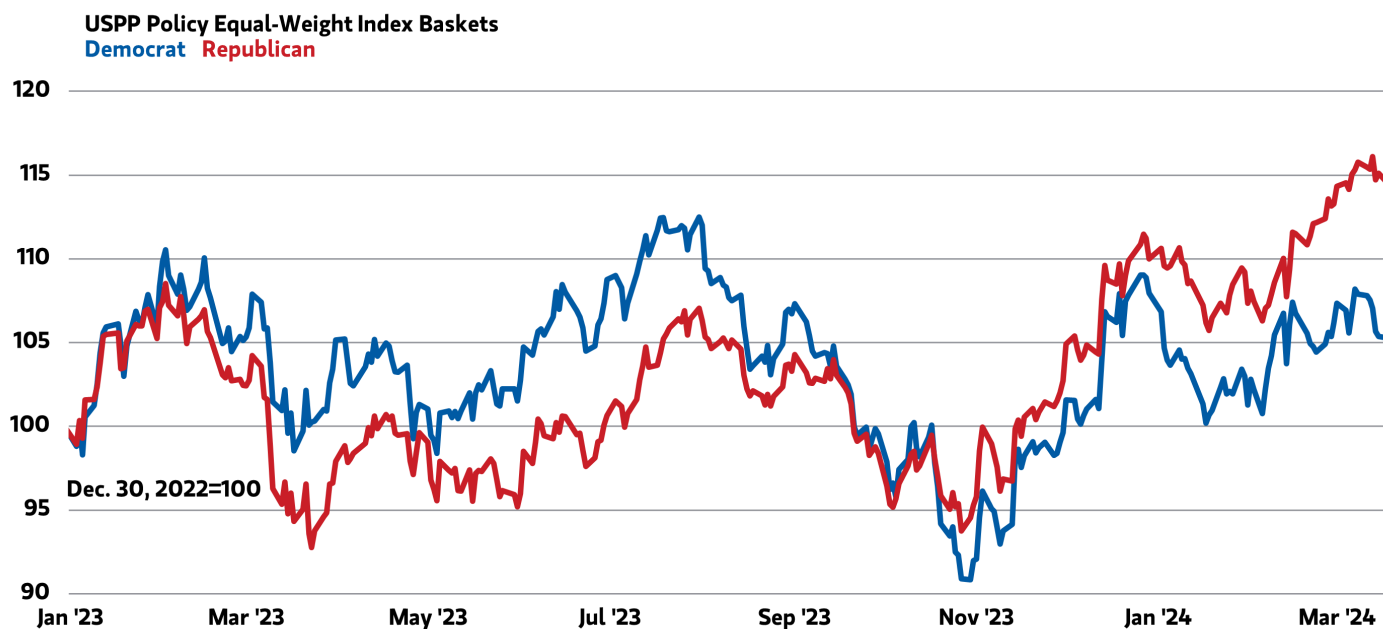
Note: Percentages indicate sector performance for each election-year quarter or other period, ending on Dec. 31 of that election year.

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

In further analyzing election-related market performance, we developed two political party equal-weight baskets, each tracking 12 sector and industry exchange-traded funds (ETFs) positioned to benefit from either a Democrat or Republican victory. For example, sectors and industries that we expect to benefit from Democratic policymaking include clean energy, including electric vehicles (EVs); managed care; infrastructure; defense; and technology, including cybersecurity and

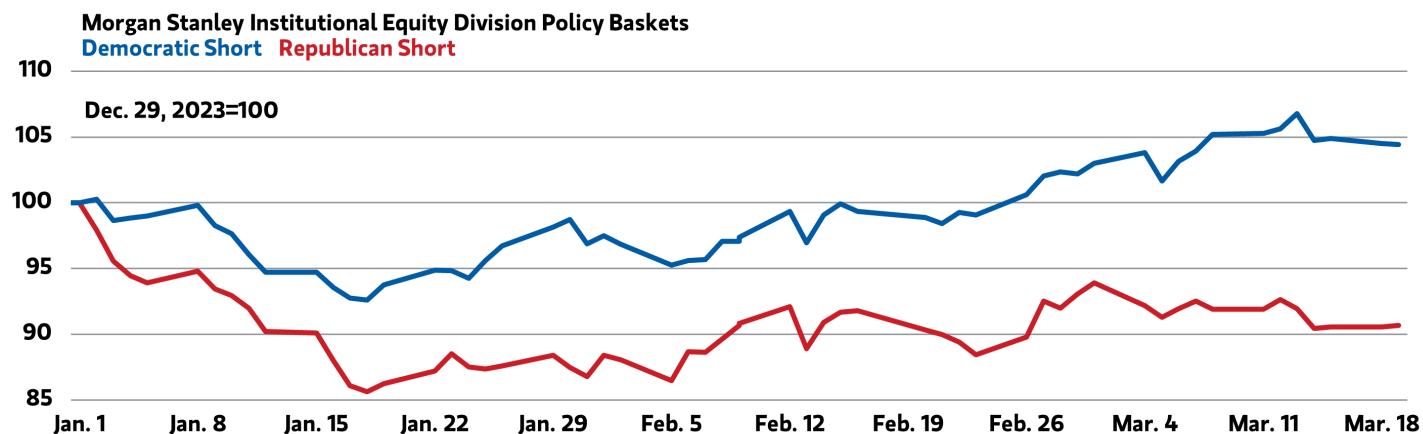
semiconductors. Areas that may benefit most from a Republican win include traditional energy, master limited partnerships, utilities, materials, real estate, block-chain technology, banks, pharma and biotechnology. The Republican basket has recently extended its outperformance of the Democratic basket to 9% since Dec. 30, 2022, potentially indicating market positioning for a Republican win (see Exhibit 9). In 2024, the Republican basket leads by about 5% so far.

Exhibit 9: Republican Equal-Weight Basket Has Outperformed the Democratic Basket



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Exhibit 10: Investors May Be Avoiding Stocks Vulnerable to a Trump Win



Source: Bloomberg, Morgan Stanley Institutional Equity Division, Morgan Stanley Wealth Management Global Investment Office as of March 19, 2024

Analyzing election market performance from a different angle, we leveraged two baskets of stocks from Morgan Stanley's Institutional Equity Division: a Democratic short basket, which contains stocks that may be disadvantaged should a Democrat win the White House, and a Republican short basket containing stocks that may perform poorly from a Republican win (see Exhibit 10). The Republican short basket, which has extended its year-to-date relative underperformance to 13.75%, indicates that investors could already be hedging against a Trump victory by selling stocks that would be affected. In other words, the market may be bracing for a change to the status quo, which may provide negative downside to companies with exposure to higher tariffs, less support for EVs or potential repeal of parts of the Inflation Reduction Act.

Investment Conclusion

A highly consequential and uncertain election is just months away, with implications for the future of federal debts and deficits, tax and trade policy, national security, health care and more. At this early stage, both parties have their presumptive nominees, setting up the first presidential election rematch since 1956 and one of the longest presidential campaigns in history. In the meantime, Congress has been focused on the fiscal year 2024 budget, which is now tentatively resolved, negotiating a national security supplemental funding bill and passing a significant tax bill that would expand the child tax credit and restore expired TCJA business tax breaks.

Consumer sentiment data has recently deteriorated and remains below average for an election year, which continues to suggest a Republican winning the White House. Analyzing market returns in election years, we find that opportunities may emerge in energy, utilities, financials and industrials if investors anticipate a Republican win, and in information technology and consumer discretionary if investors expect a Democratic win. Finally, when assessing performance of the USPP Policy Equal-Weight Index Baskets and the Morgan Stanley Institutional Equity Division Policy Baskets, we see the stock market positioning for a GOP win.

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Index Definitions

For index, indicator and survey definitions referenced in this report please visit the following:

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Glossary

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