Morgan Stanley

WEALTH MANAGEMENT

INVESTMENT STRATEGY

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US Policy Pulse

A History of General Election Performance, Part 1

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This is the first part of a two-part report discussing economic and market implications of presidential versus nonpresidential election years. It also examines market performance in the first two years of Democratic and Republican administrations as well as in various presidential and congressional outcomes.

Key Insights:

- Over the long term, market performance is more closely correlated with the business cycle than political party control.
- Historically, real GDP growth tended to be stronger during presidential election years than in other years. When assessing by political party, economic growth and the S&P 500 Index was stronger, on average, under Democratic administrations.
- By sector, information technology, consumer discretionary and financials outperformed one year after a Democratic president took office. Materials, real estate and consumer discretionary outperformed one year after a Republican president took office.
- The US dollar exhibited higher volatility and tended to appreciate a year before and after elections.
- While political outcomes may contribute to industry regulation and profitability, fundamentals may be more influenced by the business and economic cycle.
- Investor fears around general election outcomes may often be misplaced due to individual policy bias. While we acknowledge the occurrence of delayed policy implementation and coincident data, “conventional wisdom” often does not align with market results regarding the combination of policy, business cycle and valuations.

The 2024 presidential election is less than a year away, and recent events are meaningfully impacting campaigns and client-investment strategies. US fiscal uncertainty, monetary policy and macroeconomic concerns are likely to shape much of the rhetoric on the campaign trail. Increased political polarization and new geopolitical tensions may also play key roles in influencing outcomes. The general election is all but certain to be dominated by familiar candidates with deeply entrenched reputations, presenting investors with opportunities and risks. That said, course-altering events are still possible and may influence market performance throughout the year. While the past does not predict the future, a review of

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election-year market behavior reveals several patterns that may help navigate recurring market cycles and plan investing strategies.

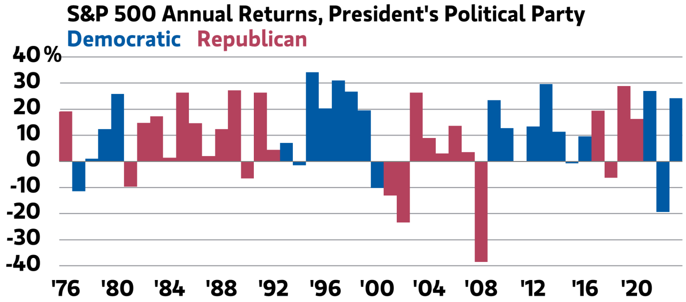
During the campaign season, markets may at times be driven by sentiment and deviate from fundamentals associated with candidate platforms. We believe investors can capitalize on schisms that open as markets tactically react to shifts in momentum and as contrary fundamental economic implications of policy platforms arise. For example, risk asset gains paralleling expectations for progressive policies may be misplaced. Markets may also believe a divided Congress raises the likelihood of the status quo, but does not account for uncertainties related to the populist and progressive platforms that seem to be gaining traction worldwide.

Furthermore, according to the RealClearPolitics polling average, former President Trump maintains a narrow two-point lead over President Biden. The polls will likely change as we approach Election Day, and investors should prepare for market responses to the results. In this report, we examine historical economic and market performance in presidential election years and the three years between presidential election years, with particular attention to various scenarios. These include Democratic and Republican sweeps, as well as Democratic and Republican presidential wins with split-partisan control of the House and Senate.

Macro Factors in Election Years

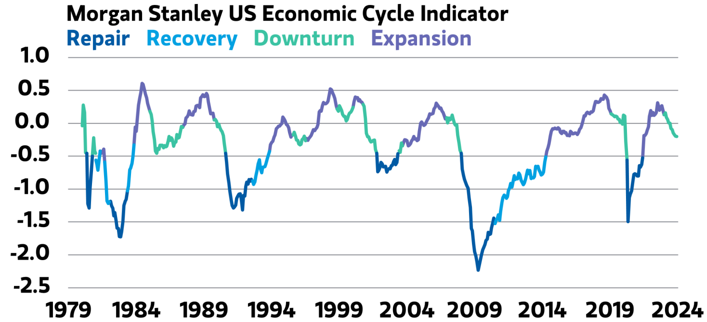
Market performance is more strongly correlated with the business cycle and does not solely depend on which political party holds the White House (see Exhibits 1 and 2). Furthermore, coincident economic and market data may present limitations based on the timing of the legislative calendar, geopolitical influences and outlier events. However, when analyzing historical data at the intersection of economics, markets and political cycles, we see distinct trends arise in presidential versus nonpresidential election years.

Exhibit 1: Market Returns Vary No Matter the Political Party in the White House



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Exhibit 2: Market Returns Are More Closely Associated With the Business and Economic Cycle

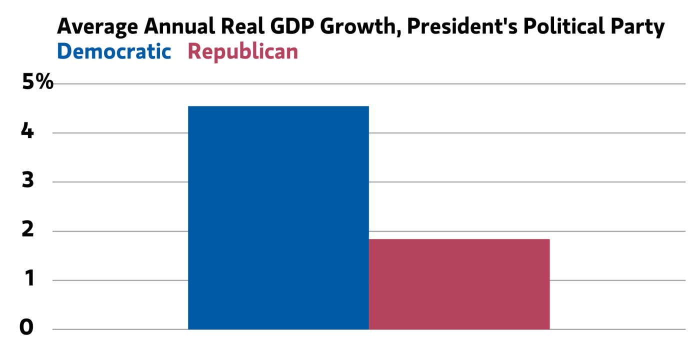


Source: Bloomberg, Datastream, Haver Analytics, Morgan Stanley & Co. Research, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

When assessing underlying economic indicators, average year-over-year real GDP growth in presidential election years since 1942 surpasses nonelection years by approximately 0.24%. 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. This relationship may support the economic upside experienced in election years relative to nonelection years and underscores the important role of the economy in campaign messaging.

Once a president is sworn in, investors closely monitor economic policies. Assessing the average annual real GDP growth of all years of a presidential term by political party beginning in 1928, we see that Democratic term real GDP growth outperforms Republican term real GDP growth by 2.7% (see Exhibit 3).

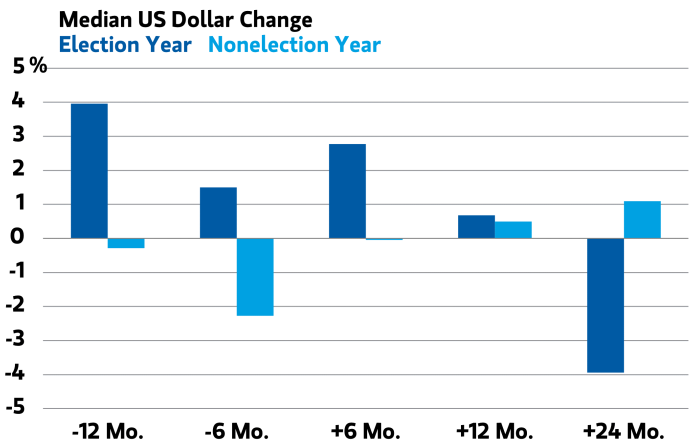
Exhibit 3: US Economy Has Grown at a Higher Rate Under Democratic Presidents



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Election-year differences can be seen when comparing the median performance of the US dollar to nonelection years. The value of the dollar in election years exhibits greater volatility and strength than in nonelection years. During the twelve months prior to the election year, the dollar rises by 3.96% and continues strengthening six months before and after the end of the election year, and even slightly one year after, as investors prepare for and monitor the actions of transitioning fiscal policy regimes (see Exhibit 4). By two years post-election, however, the dollar swings down by 3.94%, as perceived risks abate. In contrast, nonelection years see relatively flat and stable dollar movement, owing to less election-related uncertainty.

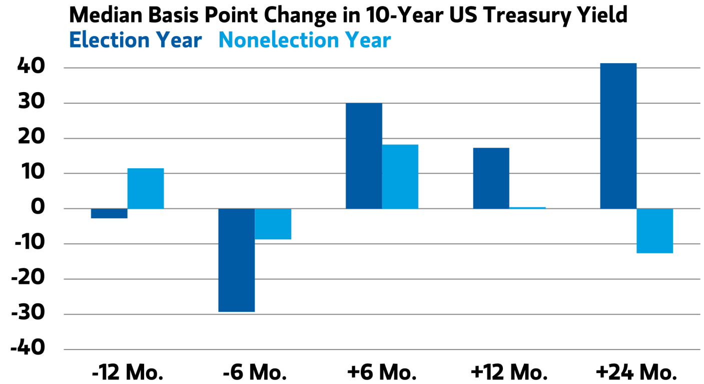
Exhibit 4: US Dollar Appreciates Around Election Years and Remains Volatile



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

US Treasury rates are also sensitive to the electoral cycle, with the median change in the 10-year Treasury yield generally experiencing greater swings in presidential election years. For example, in the six months preceding the election, median 10-year US Treasury rates fell 29.3 basis points versus 8.76 basis points in nonelection years. This likely signals a combination of seasonal trades and anticipation of policy changes. During a president's first six months, we see corresponding yield strength, more so than in nonelection years—an increase of 30 basis points compared to 16 basis points in the first half of nonelection years. Median yields continue rising post-election, whereas yields in nonelection years remain relatively flat. Again, the swing in yields from before to after Election Day signals investor restraint as new policy action from the White House and Congress take shape (see Exhibit 5).

Exhibit 5: 10-Year US Treasury Yield Experiences Greater Volatility Around Election Day



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

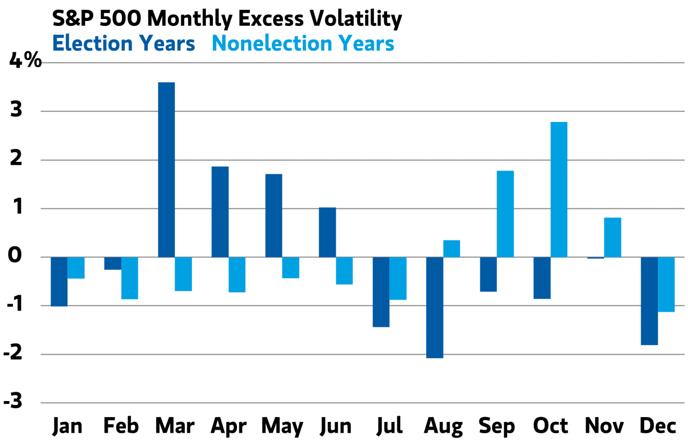
Equity Market Performance and Electoral Cycle Outcomes

Volatility

Election years historically display greater levels of equity volatility than nonelection years. The basis and severity of this phenomenon varies, with outcomes driven in part by investor uncertainties regarding the impact of future economic, legislative or regulatory policies. Elevated volatility lasts through the January-June primary season. Volatility then subsides, as certainty surrounding the candidates rises and markets digest election results and investors adjust expectations based on the president-elect's policy platform. Exhibit 6 shows the average excess monthly equity market volatility in presidential election years, relative to nonelection years. Election-year average 60-day volatility, beginning in 1984 to capture our expanded primary season, is 2.5% higher than in nonelection years during the same time period, 18.5% versus 16%. Investors can expect decreased market volatility during the second half of the year as candidate platforms become clearer and provide guidance for investors. We also note a strong drop in volatility particularly in December, due in part to slowing seasonal trading activity and the development of new policy-oriented investment strategies.

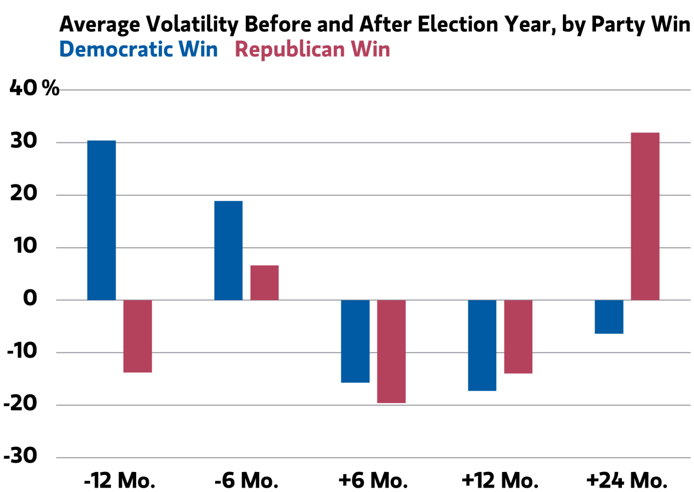
Market volatility was also affected by which party won the White House. Volatility was higher the year prior to Democratic wins but lower in the year prior to Republican wins. Democratic wins saw greater increases in volatility than Republican wins in the six months prior—a 18.9% increase versus a 6.6% increase. In part, this may be attributed to concerns that Democrats may enact higher taxes or take stronger regulatory actions. As detailed in Exhibit 7, average volatility subsided for both parties during the first six months in office, down 15.7% for Democrats and nearly 20% for Republicans.

Exhibit 6: Excess Market Volatility Subsides in the Months Leading up to Election



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Jan. 1, 2024

Exhibit 7: Volatility Fell in First Six Months of a Presidential Term

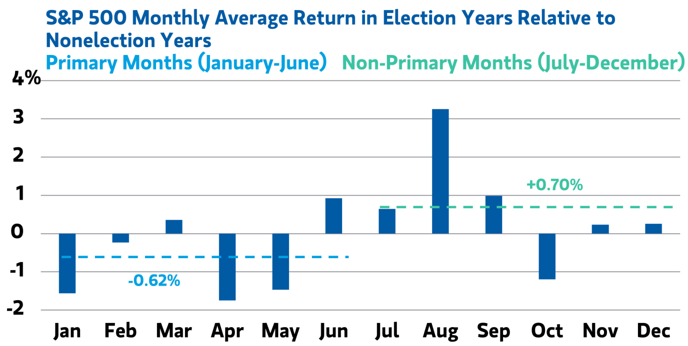


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Market Performance

Investors should also be aware of patterns that may affect market returns. Since 1928, the S&P 500 generated strong returns as candidate uncertainty declined (see Exhibit 8). Monthly excess average returns, relative to nonelection years, reach 3.25% in August compared with -1.47% over the six months prior to the presidential contest. The peak in August coincides with the confirmation of party nominees and a move to the final months of the campaign. Notably, S&P 500 average returns are generally greater in election years after the primaries.

Exhibit 8: Historical Excess Equity Returns Are Positive in the Months Prior to the Presidential Election

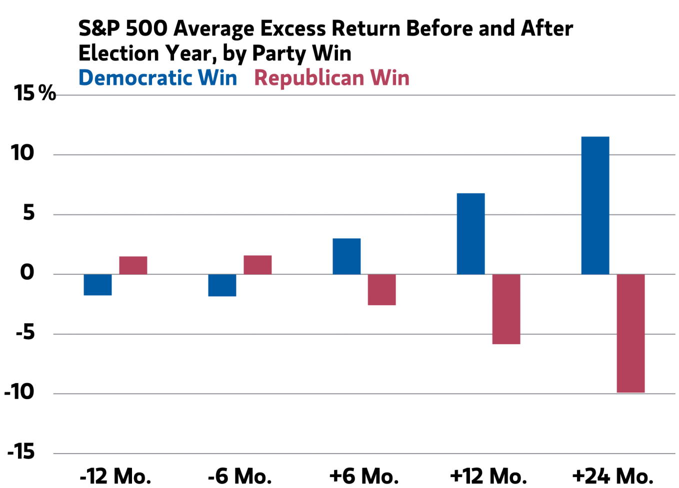


Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2023

Exhibit 9 shows the S&P 500 average excess returns for Democratic and Republican presidential election years. Overall, markets underperformed during Republican regimes, with excess returns down during the first two years in office. Conversely, market performance under a Democratic administration saw positive excess returns over the same period.

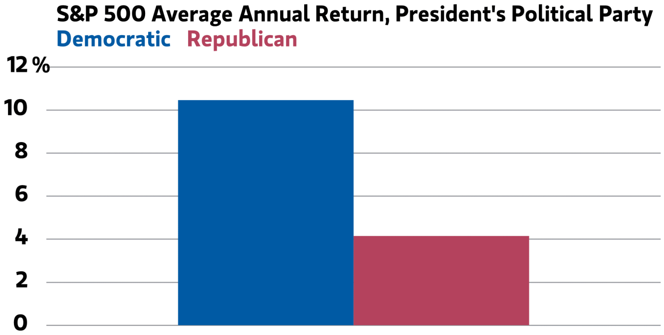
Evaluating S&P 500 average annual returns for all years since 1928 by political party, Democratic presidencies report higher returns than Republican presidencies by more than six percentage points (see Exhibit 10).

Exhibit 9: Excess Returns Have Been Positive in the Months Following a Democratic Presidential Win



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Exhibit 10: The Stock Market Has Performed Better Under Democratic Presidents



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Exhibit 12: Sectors Have Seen Mixed Performance in Election Years With Republican Winners

Republican Win Average Performance in Election Year

	-12 Mo.	-6 Mo.	-3 Mo.	+3 Mo.	+6 Mo.	+12 Mo.	+24 Mo.
S&P 500	2.8%	1.4%	-0.1%	-3.1%	-0.2%	3.1%	-1.5%
Information Technology	-8.9%	0.6%	-3.8%	-7.1%	-2.1%	3.8%	-3.7%
Health Care	10.5%	8.0%	-1.9%	-2.7%	0.6%	4.0%	2.1%
Energy	21.9%	10.1%	6.7%	1.0%	0.2%	4.4%	3.4%
Consumer Discretionary	-1.4%	-4.0%	-1.4%	0.7%	4.3%	5.3%	2.1%
Consumer Staples	7.7%	2.4%	-2.5%	-1.5%	-2.3%	1.2%	-0.9%
Communication Services	-2.0%	2.8%	-4.1%	-4.9%	-7.5%	-9.6%	-15.3%
Utilities	27.8%	11.5%	10.3%	0.7%	2.2%	-3.8%	-4.7%
Real Estate	10.9%	5.1%	0.9%	-2.0%	4.6%	7.3%	24.0%
Materials	2.4%	-6.8%	-0.7%	0.1%	0.9%	8.2%	4.3%
Financials	17.3%	-1.5%	9.0%	-5.0%	-0.3%	4.4%	-0.8%
Industrials	12.2%	2.9%	3.9%	-2.9%	0.5%	4.0%	-6.8%

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 Feb. 5, 2024

Sector Returns

Stock market strength under Democrats can also be seen in sector returns. Exhibits 11 and 12 indicate that all sectors showed positive returns six, 12 and 24 months after election years when Democrats won, with information technology (33.6%), consumer discretionary (29.7%) and financials (26.7%) having the greatest first-year gains. Republican wins showed positive performance in five sectors over the 24-month horizon, while materials (8.2%), real estate (7.3%) and consumer discretionary (5.3%) had the strongest first-year average gains.

Exhibit 11: All Sectors Have Seen Steady Gains Under Democratic Administrations

Democratic Win Average Performance in Election Year

	-12 Mo.	-6 Mo.	-3 Mo.	+3 Mo.	+6 Mo.	+12 Mo.	+24 Mo.
S&P 500	3.2%	-0.4%	2.0%	2.0%	10.3%	23.6%	31.4%
Information Technology	11.1%	6.3%	2.4%	4.2%	15.8%	33.6%	57.9%
Health Care	0.6%	-2.7%	2.8%	-0.1%	9.1%	22.1%	41.7%
Energy	-10.3%	-4.9%	-5.8%	8.6%	15.5%	22.9%	41.3%
Consumer Discretionary	9.4%	4.3%	4.2%	3.1%	10.8%	29.7%	38.1%
Consumer Staples	4.7%	-0.2%	5.3%	0.8%	4.9%	14.7%	24.4%
Communication Services	2.0%	-2.2%	-0.8%	3.0%	9.0%	15.5%	19.5%
Utilities	-7.4%	-3.8%	-3.0%	1.5%	3.2%	11.2%	15.0%
Real Estate	-11.3%	-0.4%	0.8%	-7.6%	2.6%	20.6%	26.9%
Materials	0.8%	2.1%	-1.1%	2.3%	8.5%	22.0%	24.4%
Financials	6.1%	-6.0%	3.8%	2.0%	14.2%	26.7%	30.9%
Industrials	1.9%	-2.9%	2.3%	0.6%	9.5%	23.0%	30.2%

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 Feb. 5, 2024

Returns by Congressional and Presidential Outcome

When considering the outcomes of an election cycle, it's not only important to consider who controls the White House, but also which party controls the House of Representatives and the Senate. This is a critical element when looking to policy as an input for investment strategies, as Congress is in many ways more influential than the president when formulating a tax agenda or fiscal policy, for example. As detailed in Exhibits 13 and 14, Democratic control of the executive and legislative branches was more positive for markets within the first two years in office than during a Republican sweep, with value, growth, small-cap and large-cap stocks all performing well during the 12 and 24 months after Inauguration Day.

Exhibit 13: Both Value and Growth Performed Well Following Democratic Sweeps

Party Sweep		+6 Mo.	+12 Mo.	+24 Mo.
Value Stocks				
	Republican	3.4%	5.9%	4.7%
	Democratic	11.2%	22.9%	18.3%
Growth Stocks				
	Republican	-0.6%	4.6%	1.0%
	Democratic	11.1%	21.0%	16.3%

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

Exhibit 14: Small-Cap and Large-Cap Stocks Also Performed Well Following Democratic Sweeps

Party Sweep		+6 Mo.	+12 Mo.	+24 Mo.
Small-Cap Stocks				
	Republican	5.7%	10.1%	5.8%
	Democratic	9.1%	19.3%	21.2%
Large-Cap Stocks				
	Republican	1.9%	5.7%	2.9%
	Democratic	11.0%	21.8%	18.5%

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

This dynamic does not change much when the House and Senate are controlled by different parties. Value and growth stocks again reported greater average returns within the first year when a Democrat held the White House and Congress was split, 22.9% and 26.1%, respectively. Similarly, under a Democratic president and a split Congress, small-cap and large-cap stock performance was stronger, at 30.9% and 25.0%, respectively (see Exhibits 15 and 16).

Exhibit 15: Value and Growth Stocks Performed Better With a Democratic President and a Split Congress

White House Win/Split Congress		+6 Mo.	+12 Mo.	+24 Mo.
Value Stocks				
	Republican	9.5%	9.4%	23.6%
	Democratic	15.6%	22.9%	33.7%
Growth Stocks				
	Republican	3.5%	7.6%	22.6%
	Democratic	12.1%	26.1%	39.0%

Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

Exhibit 16: Small-Cap and Large-Cap Stocks Also Performed Well With a Democratic President and a Split Congress

White House Win/Split Congress		+6 Mo.	+12 Mo.	+24 Mo.
Small-Cap Stocks				
	Republican	10.7%	7.5%	34.0%
	Democratic	17.7%	30.9%	31.1%
Large-Cap Stocks				
	Republican	6.9%	4.8%	32.8%
	Democratic	14.2%	25.0%	36.0%

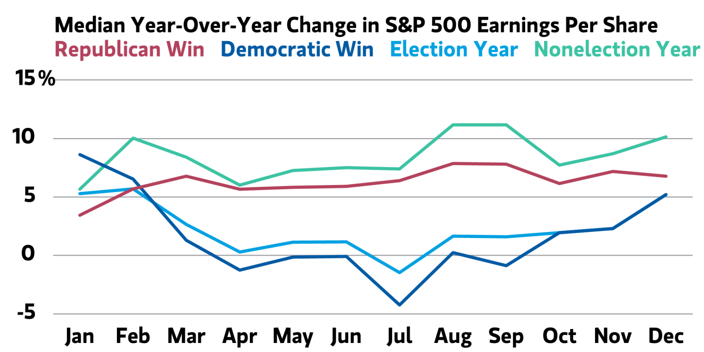
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Feb. 5, 2024

Fundamental Performance

Equity market fundamentals play a foundational role in forward expectations. The magnitude of the impact of policy action varies by administration and Congress, leaving valuations somewhat exposed to the election. That said, while political outcomes frequently contribute to industry regulation and corporate profits, fundamentals are typically more influenced by the business and economic cycle.

As seen in Exhibit 17, in the period prior to Democratic wins, the year-over-year percent change in median earnings-per-share (EPS) growth suffered in the primary months (January-July), although recent recessions may be impacting these results. In the year before a Republican win, historical median EPS estimates were largely unchanged. Notably, EPS growth began to converge post-election, at 6.8% under Republicans and 5.2% under Democrats.

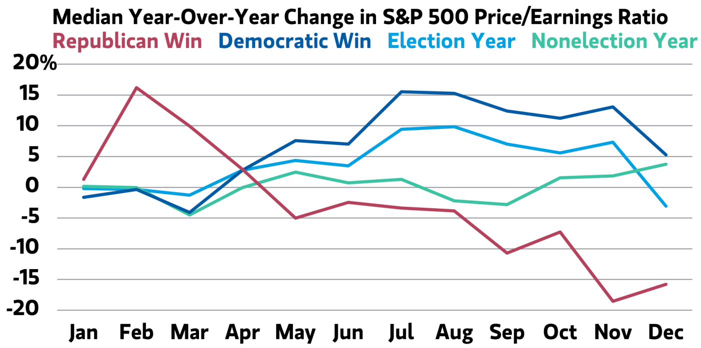
Exhibit 17: S&P 500 EPS Improved in the Months Leading up to a Democratic Win



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Analyzing performance in all years since 1990, we see volatile P/E ratios throughout the election season, with median multiples up 5.3% when Democrats win versus down 15.8% when Republicans win. While political outcomes and corresponding policy may impact profitability and earnings, this differential is likely explained by the business and economic cycle. Valuation expansion tends to slow in the second half of election years, ending down 3% on average, whereas multiples increase slightly through the fall and winter in nonelection years, ending with a 3.7% increase (see Exhibit 18).

Exhibit 18: P/E Multiples Growth Slows in the Second Half of Election Years



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Dec. 31, 2023

Investment Conclusion

In our review of historical market data, we see that the business cycle is more relevant to market performance than political party. However, we also observe that, from a macroeconomic lens, GDP growth tends to be stronger during presidential election years than in other years and appears more robust under Democratic presidential control. Additionally, we saw that the US dollar exhibited higher volatility and tended to appreciate surrounding election years. We believe investors can expect continued dollar volatility as macro factors and election year patterns drive currency value.

Analysis of market performance indicated that average volatility increased in the months prior to Election Day but then tapered off in the six-months following, regardless of party win. When assessing equity returns, we found that Democratic administrations reported stronger S&P 500 average annual returns for all years in office when compared with GOP administrations. Election outcomes also impacted sector leadership: consumer discretionary performed well under both parties one year after election, while information technology and financials outperformed one year after a Democratic win and materials and real estate outperformed one year after a Republican win.

Finally, index level returns have generally been positive post-election across most outcomes and administrations. This is likely due to a reduction in uncertainty, risk and volatility stemming from unknown election outcomes. Although elections and policy may impact corporate profitability, fundamentals are primarily driven by the business cycle, reinforcing our key conclusion of the importance of the business cycle to performance. However, investors should also expected volatility and remain informed on potential sector and industry implications based on the incoming administration's policy goals.

Disclosure Section

Index Definitions

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

https://www.morganstanley.com/wealth-investmentsolutions/wmir-definitions

Glossary

Volatility This is a statistical measure of the dispersion of returns for a given security or market index. Volatility can either be measured by using the standard deviation or variance between returns from that same security or market index. Commonly, the higher the volatility, the riskier the security.

Risk Considerations

The returns on a portfolio consisting primarily of **environmental, social, and governance-aware investments (ESG)** may be lower or higher than a portfolio that is more diversified or where decisions are based solely on investment considerations. Because ESG criteria exclude some investments, investors may not be able to take advantage of the same opportunities or market trends as investors that do not use such criteria.

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