Morgan Stanley

WEALTH MANAGEMENT

INVESTMENT STRATEGY

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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

- Two key risks are in focus for President Biden: stickier-than-expected inflation weighs on consumers and moves out Federal Reserve rate cut expectations this year, and recent geopolitical developments may impact commodity markets.
- Congress finalized a fiscal year 2024 budget and now has renewed urgency to pass the long-stalled supplemental foreign aid bill given fresh geopolitical tensions. Meanwhile, the House GOP majority has shrunk to just one.
- With Biden and former President Trump the presumptive nominees, fundraising efforts are now in full stride. Biden has a $100 million funding advantage.
- Two Senate Democrats and an independent who caucuses with the Democrats have announced 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 switch control to the Democrats.
- Biden's disapproval rating remains historically high amid a strong economy, though progress has been made in March. Trump, meanwhile, continues to lead polling in nearly all swing states, but his lead has shrunk.
- Consumer sentiment declined in April and remains below the election-year average, which by historical standards, now indicates a Republican presidential victory. Recently, small business sentiment has fallen to a 12-year low.
- 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 2024 election is just months away and will have significant investor implications. The next president 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 Biden and former president Trump are on track for the first US presidential election rematch since 1956. Two important risks to Biden's reelection campaign are in the spotlight: the economy and foreign policy. Stickier-than-expected inflation data in recent weeks have potentially pushed out expectations for the timing and depth of Fed rate cuts in 2024. Higher-for-longer rates carry a risk of overtightening but can also weigh on the consumer and pressure market performance, leaving voters dissatisfied. Secondly, recent developments in the Middle East also threaten a broader escalation of war. In addition to having significant future US foreign policy implications, this may raise the geopolitical risk premium on equity, bond and commodity markets, further exacerbating inflation.

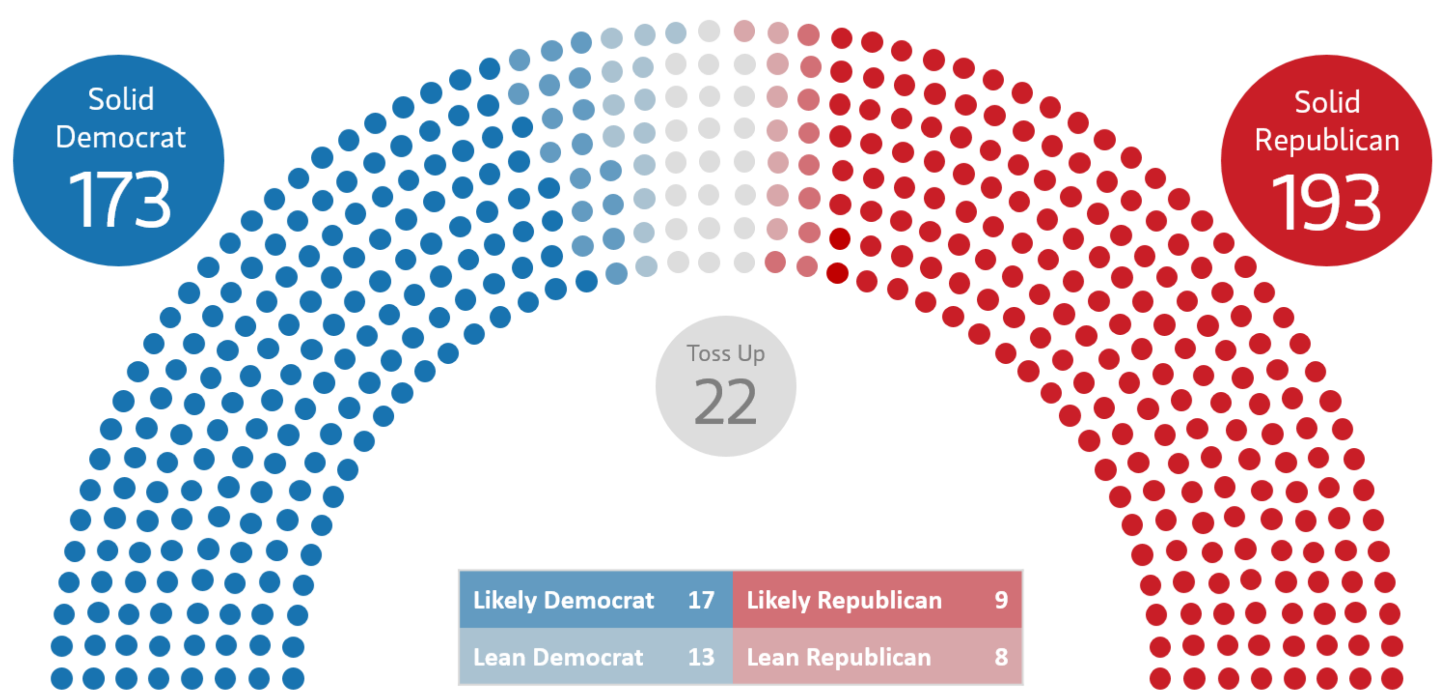
Meanwhile, Congress passed a fiscal-year 2024 budget and successfully avoided the April 30 sequester deadline that would have triggered a 1% automatic cut to discretionary spending. A supplemental funding bill for Ukraine, Israel and Taiwan, which has been stalled due to immigration and Ukraine disagreements, may now see renewed urgency in line with geopolitical escalation, although it is unclear if aid to Israel will be passed separately. Congress is also considering a tax bill that would expand the child tax credit and restore three major business tax cuts 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, Rep. Mike Gallagher (R-WI) will depart Congress on April 19, narrowing the majority to 217-213, which allows for just one Republican to defect this year. The balance of power is subject to change further, as every two years all 435 House seats are up for election. 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, 44 House members (20 Republicans and 24 Democrats) are leaving their seats either due to retirements or in pursuit of other office. We expect more departures to be announced ahead of states filing deadlines.

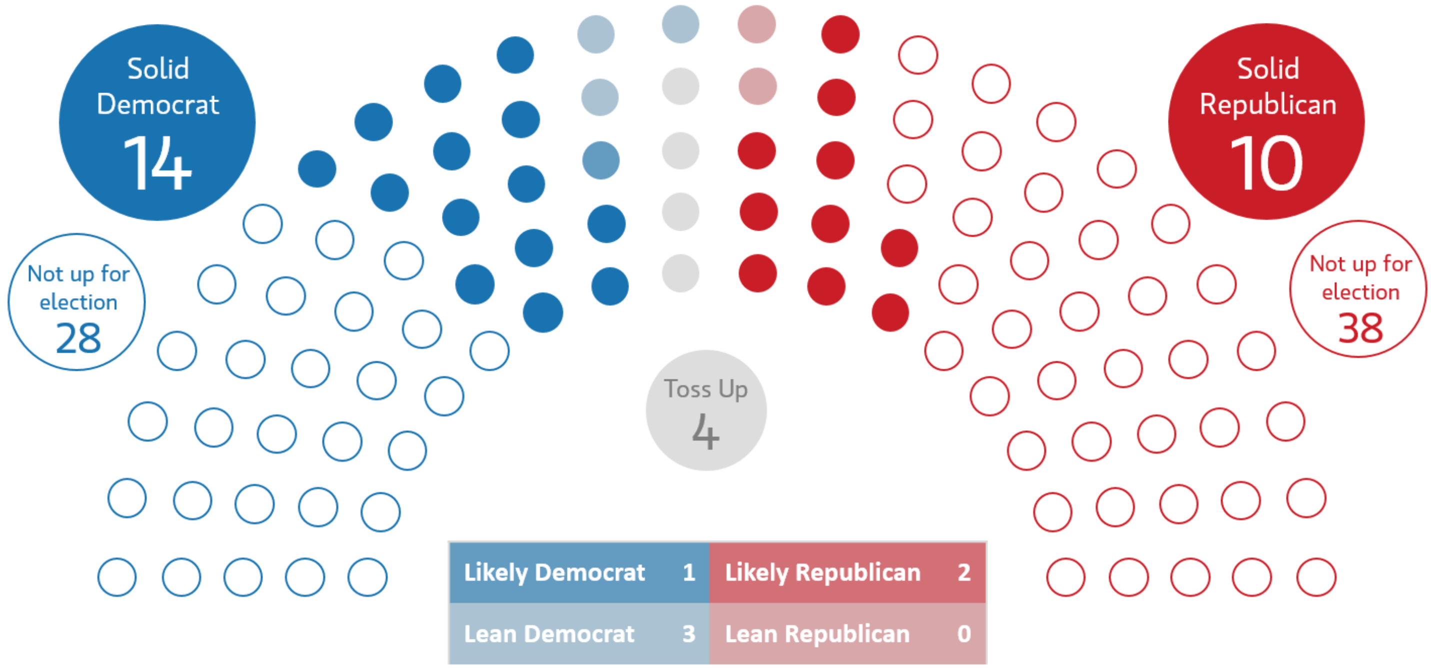
While both parties see opportunity in certain races, we anticipate the House is likely to fall under Democratic control, primarily due to advantages from recent congressional redistricting. Furthermore, the Cook Political Report (CPR) projects that 173 seats are solidly Democrat—not considered competitive—while 30 seats are likely or lean Democrat. It projects 193 solidly Republican races, with 17 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 April 16, 2024

Exhibit 2: Senate Race Competitiveness



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of April 16, 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, Senate terms are six years so only one-third of seats are up every two years. Of those seats up this year, CPR now rates 14 solid Democrat (up one from last month), 10 solid Republican, four likely or lean Democrat (down two from last month) and two likely or lean Republican. Four seats are now considered "toss ups," up one from last month (see Exhibit 2). We believe this breakdown puts the Democratic majority in the Senate at risk: specifically, the retirement of Sen. Joe Manchin (D-WV) opens a seat in a state where 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.

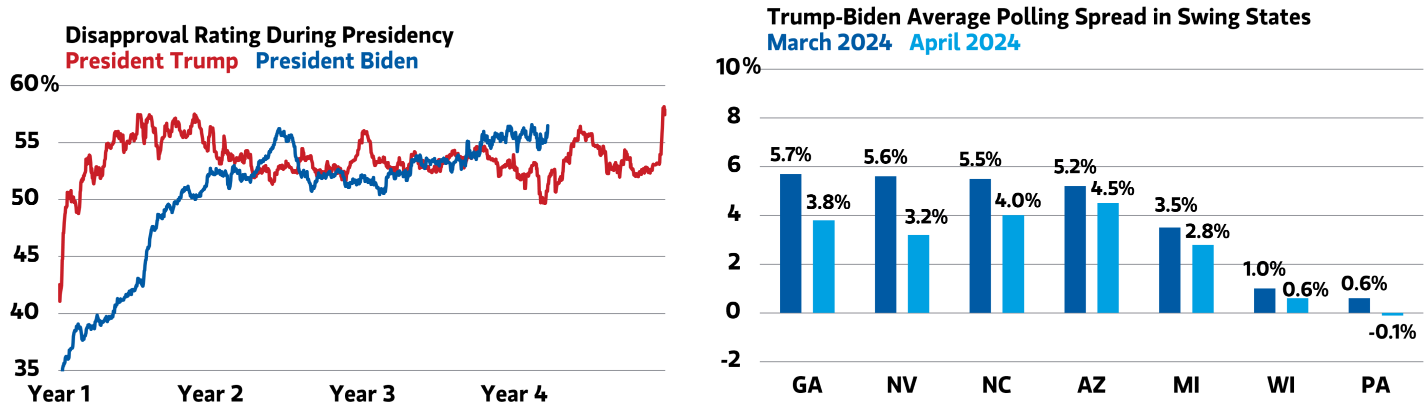
The Presidency

Biden's historically high disapproval rating of 56% exceeds former President Trump's 50% at this point in his term (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. Inflation has fallen but has remained stickier than expected and many voters still view high costs of living as their top concern. Escalating Ukraine and Middle East wars, as well as immigration issues, further pressure his favorability.

In contrast, according to RealClearPolitics polling averages, Trump currently leads Biden in six of seven swing states, each of which were decided by less than three percentage points in 2020. However, Trump's lead has noticeably shrunk since last month, perhaps due to mounting legal troubles and robust campaigning efforts by Biden in swing states since his State of the Union address (see Exhibit 3, right). In fact, Biden raised over $90 million in March for a cumulative $192 million of cash on-hand, while Trump raised $65.5 million in March and has $93 million on hand. Though fundraising does not ensure victory, the pace of donations positions Biden to undertake significant media ads in key swing states prior to election.

As the longest US presidential election campaign kicks off, we expect both candidates to focus their rhetoric on painting starkly different pictures of America, especially on economics and foreign policy.

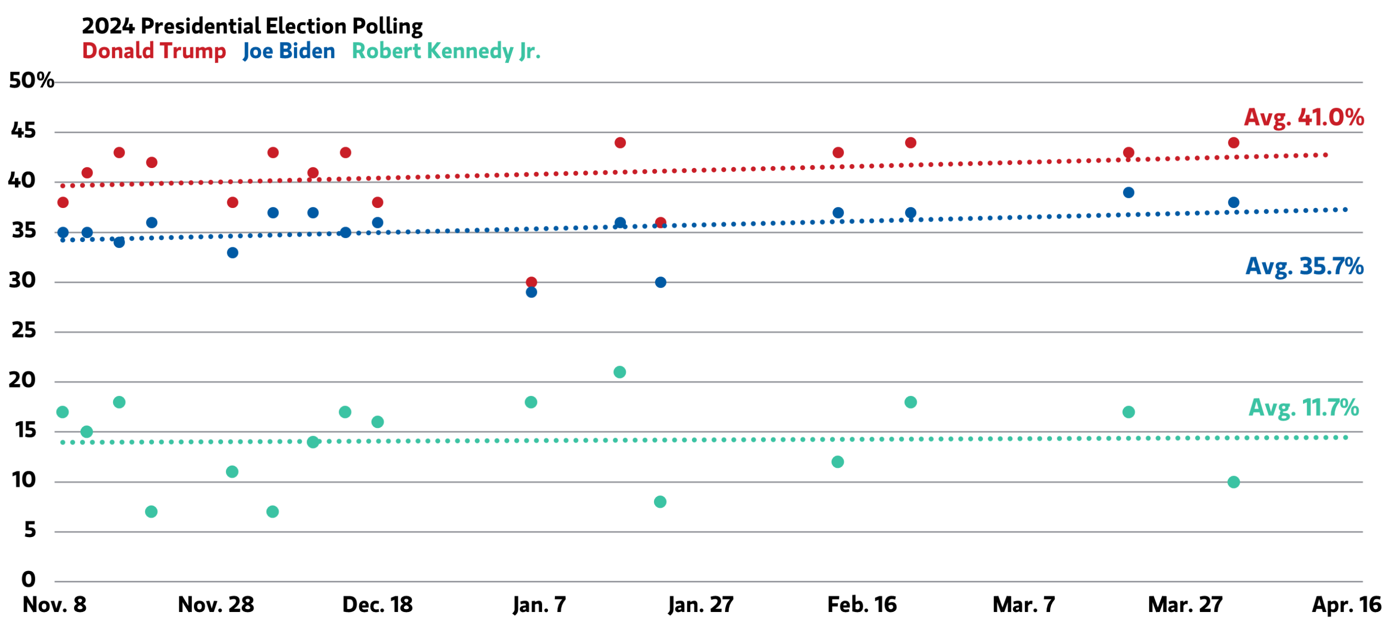
Exhibit 3: President Biden Remains Unpopular Among Voters, While Trump's Lead in Swing States Has Shrunk



Source: 538, RealClearPolitics, Morgan Stanley Wealth Management Global Investment Office as of April 16, 2024

Polling for Trump, Biden and Robert Kennedy Jr., the leading independent, shows notable disparities as well. In three-way average polling, Trump leads Biden by 5.3 points, up from a 4.5 point spread last month, while Robert Kennedy Jr. polls at 11.7% (see Exhibit 4). Though 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. As in 2016 and 2020, where just a football stadium's worth of votes decided the outcome, Kennedy's polling is crucial to watch in 2024, as third-party candidates often divert votes away from major-party candidates. Throughout their campaigns, 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 April 16, 2024

Macroeconomics, Markets and the Election

Macroeconomic Indicators

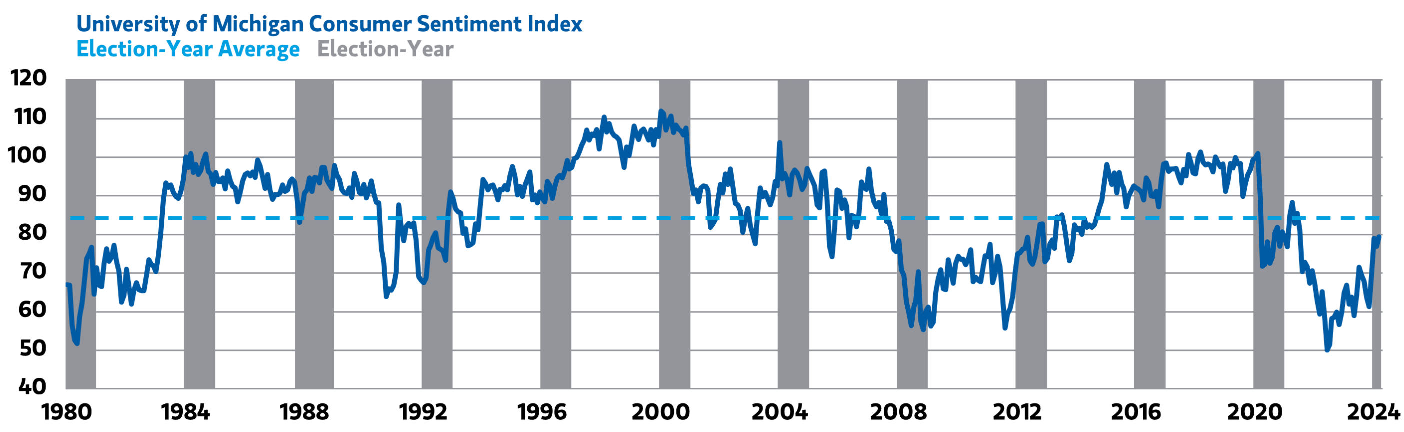
Perhaps the most important indicator of a sitting president's reelection chances is voter sentiment about the economy. While not the singular determinant, presidential outcomes are correlated with GDP performance in the months prior to an election. According to the Center for the Study of Democratic 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 since October.

The disconnect between GDP and approval ratings 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 64% of consumers. As geopolitical risks weigh, oil prices are up almost 20% this year, while average US gasoline prices, important to voters, are up over 10% year-to-date and more than 50% since Biden took office. Wage growth is slowing and unemployment is on an uptrend, and while inflation has fallen since its mid-2022 peak, progress is stalling, increasing the likelihood of the Fed keeping interest rates higher for longer and raising the risk of overtightening. As such, much of Biden's reelection chances hinge on a patchwork of geopolitical, inflationary, economic, and Fed dynamics, and the extent of drag on consumer confidence.

The University of Michigan Consumer Sentiment Index (MCSI), a proxy for consumer confidence, fell to a preliminary reading of 77.9 in April from 79.4 in March, while consumers' inflation expectations increased for the one- and five-to 10-year periods. Although consumer sentiment has been recovering since mid-2022, it remains below its pre-pandemic level and 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 in April of an election year five other times, three of which resulted in the unseating of the incumbent and another time resulting in a party change, given it was an open election.

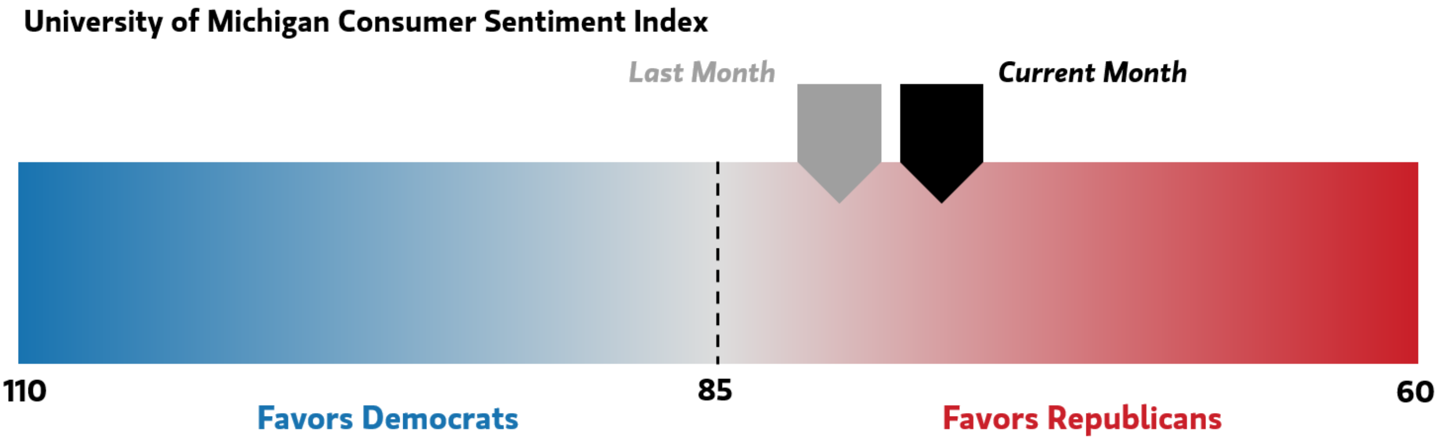
We will be tracking the MCSI monthly data and its correlation with electoral results. In fact, the index has a positive correlation of 0.5 with incumbent presidential wins and losses, with the index at 92, on average, when the incumbent party wins and at 80, on average, when the incumbent party loses. While the MCSI continues to point to a Republican win we emphasize that it is but one of many possible leading indicators of election results and we encourage investors to consider economic conditions holistically through policy, macroeconomic and market developments (see Exhibit 6).

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



Note: Latest index reading is preliminary
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of April 16, 2024

Exhibit 6: Consumer Sentiment Still Favors Republicans



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of April 16, 2024

Market Indicators

On average, the S&P 500 rises in election years. As investors seek to position their equity portfolios ahead of the election, we find that overall, the market tends to outperform in the second half over the first half of election years relative to nonelection years as confirmation of party nominees dispels some uncertainty. When analyzing market performance by sector, patterns emerge that may serve as opportunities for investors around elections since political outcomes and policy platforms can impact an industry's regulation and profitability. For example, if investors anticipate a Republican win, Utilities, Energy, Financials and Industrials may track the strong 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, though most sectors historically performed well in the second quarter of the election year (see Exhibit 7). We believe that investment opportunities in certain sectors and industries may arise as Election Day approaches.

For example, recent budget uncertainty has pressured defense stocks, and though this overhang is now neutralized following the passage of a budget, US election uncertainty still hangs over the industry. As such, the S&P 500 relative to the defense sector has closely tracked Biden's reelection chances. When his chances have improved, defense has underperformed the broader market while defense has outperformed when his odds have fallen (see Exhibit 8). Although this follows the traditional assumption that Republican presidents are more supportive of defense sentiment, this view may change in 2024, as Trump and many GOP members appear less receptive to Ukraine funding and favor an end to the war, which may negatively impact defense sentiment in the near term.

Exhibit 7: Sector Returns By Democrat and Republican Election-Year Wins

Republican Win Average Performance in Election Year

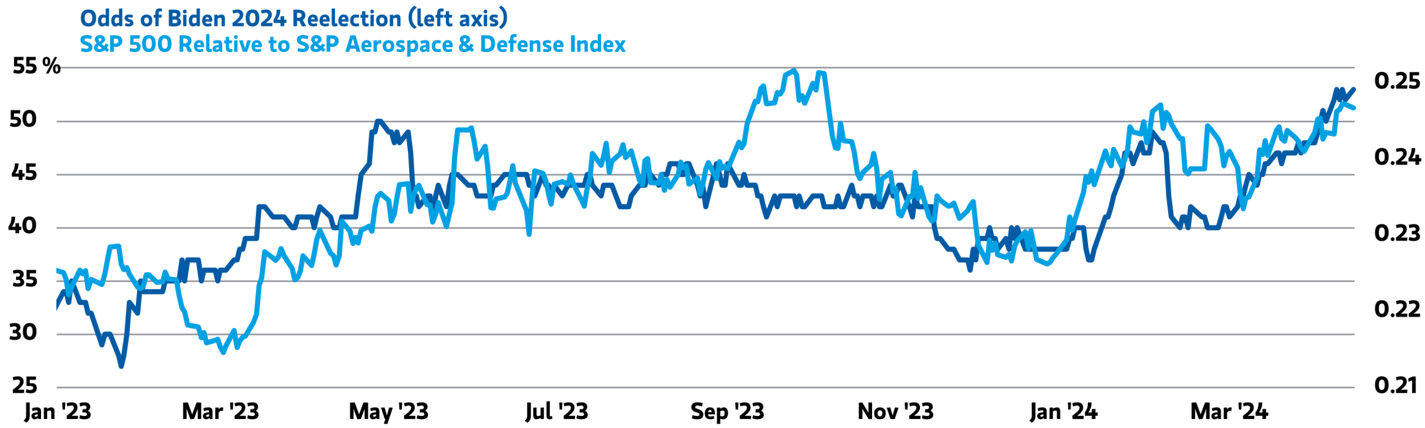
	Full Year	Q1	Q2	Q3	Q4	YTD
S&P 500	2.8%	1.4%	0.1%	-0.1%	1.3%	5.9%
Information Technology	-8.9%	4.4%	-3.3%	-3.8%	-6.4%	9.1%
Health Care	10.5%	-2.3%	10.4%	-1.9%	3.7%	1.6%
Energy	21.9%	3.2%	6.7%	6.7%	3.8%	12.8%
Consumer Discretionary	-1.4%	-0.6%	-3.5%	-1.4%	3.5%	-0.1%
Consumer Staples	7.7%	-2.5%	5.7%	-2.5%	8.5%	2.3%
Communication Services	-2.0%	5.8%	-3.4%	-4.1%	-2.8%	15.8%
Utilities	27.8%	8.3%	2.8%	10.3%	4.5%	-1.0%
Real Estate	10.9%	5.6%	-0.4%	0.9%	4.8%	-8.8%
Materials	2.4%	-4.0%	-3.4%	-0.7%	11.2%	3.6%
Financials	17.3%	0.2%	-1.6%	9.0%	9.8%	5.2%
Industrials	12.2%	0.5%	2.5%	3.9%	5.1%	6.9%

Democratic Win Average Performance in Election Year

	Full Year	Q1	Q2	Q3	Q4	YTD
S&P 500	3.2%	-3.3%	3.7%	2.0%	0.0%	5.9%
Information Technology	11.1%	0.7%	6.5%	2.4%	-1.0%	9.1%
Health Care	0.6%	-5.3%	2.2%	2.8%	0.3%	1.6%
Energy	-10.3%	-12.1%	10.6%	-5.8%	1.0%	12.8%
Consumer Discretionary	9.4%	0.5%	5.0%	4.2%	-0.7%	-0.1%
Consumer Staples	4.7%	-2.6%	2.4%	5.3%	-0.4%	2.3%
Communication Services	2.0%	-8.7%	7.2%	-0.8%	4.4%	15.8%
Utilities	-7.4%	-7.9%	4.5%	-3.0%	-0.9%	-1.0%
Real Estate	-11.3%	-2.9%	3.1%	0.8%	-12.0%	-8.8%
Materials	0.8%	-0.4%	4.1%	-1.1%	-1.7%	3.6%
Financials	6.1%	-3.6%	-1.9%	3.8%	3.3%	5.2%
Industrials	1.9%	-2.8%	0.7%	2.3%	1.3%	6.9%

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 April 16, 2024

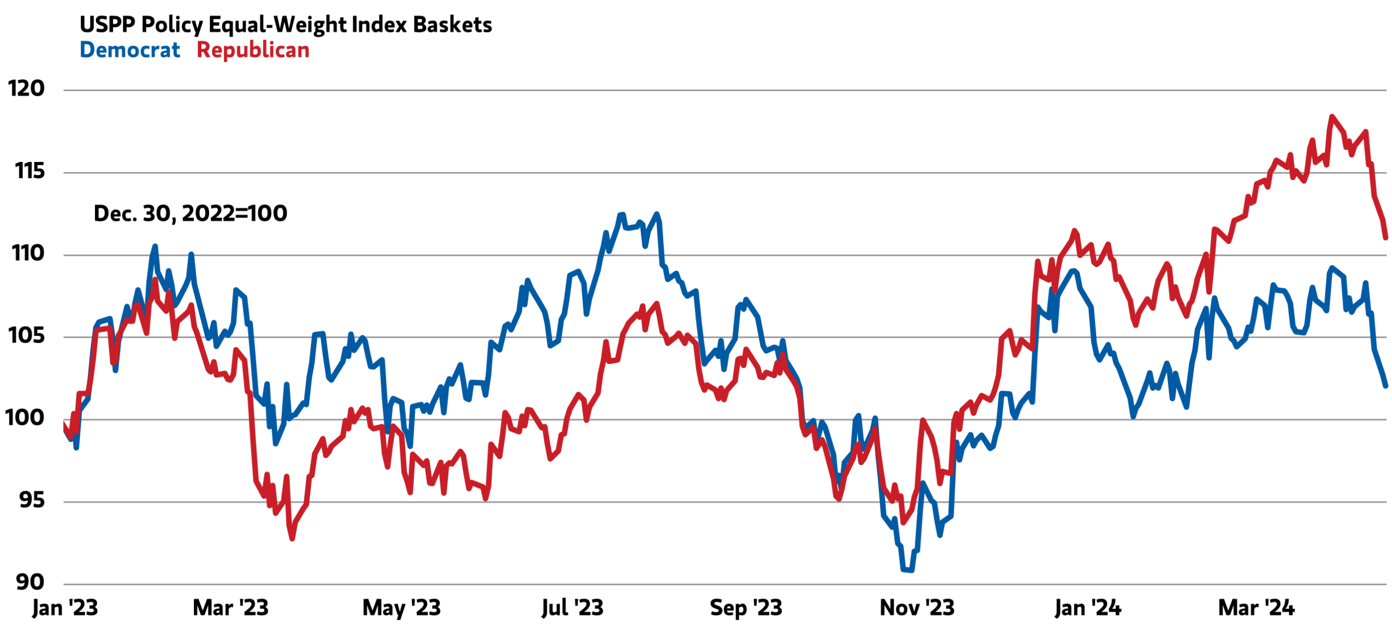
Exhibit 8: Defense Has Closely Tracked Biden's Reelection Odds



Source: Bloomberg, PredictIt.org, Morgan Stanley Wealth Management Global Investment Office as of April 16, 2024

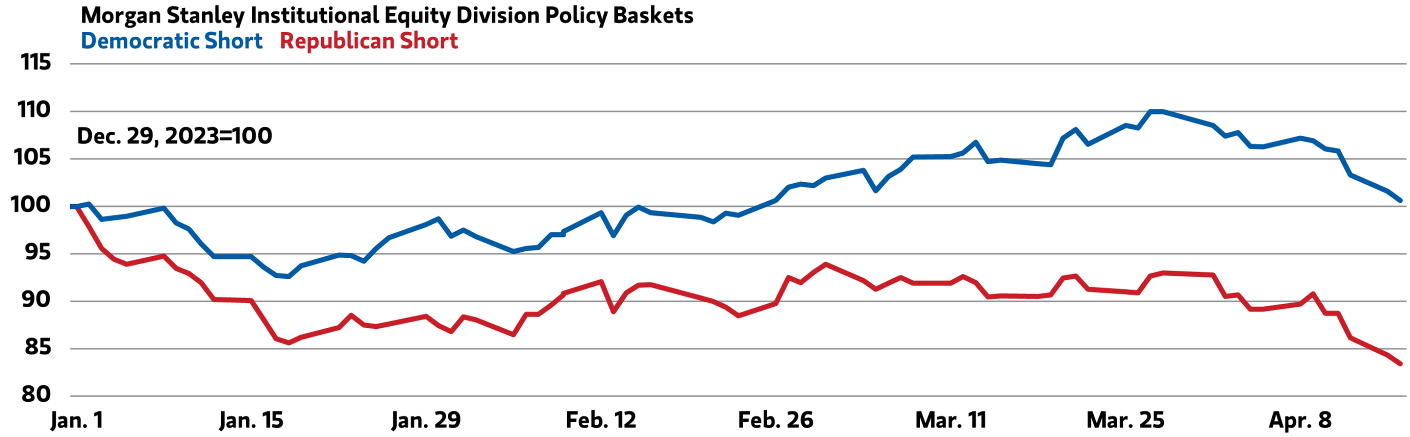
In further analyzing election-related market performance, we developed two political party equal-weight baskets, each tracking 12 sector and industry exchange-traded funds (ETFs) positioned to benefit from either a Democrat or Republican victory. For example, sectors and industries that we expect to benefit from Democratic policymaking include clean energy, including electric vehicles (EVs) and solar; 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, blockchain technology, banks, pharma and biotechnology. The Republican basket has extended its outperformance of the Democratic basket by 9% since 2022, potentially indicating market positioning for a Republican win (see Exhibit 9). In 2024, the Republican basket leads by over 4%, partially led by its energy, financials and materials exposure.

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



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of April 16, 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 April 16, 2024

Analyzing election-related market performance from a different angle, we considered 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 continued its year-to-date relative underperformance to more than 17%, indicates that investors could already be hedging against a Trump victory by selling stocks that would be negatively affected. In other words, the market may be bracing for changes to the status quo, mostly impacting 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. Inflation surprises and rising geopolitical tensions add further uncertainty to the election campaign. After passing a fiscal 2024 budget, Congress is now focused on negotiating a foreign aid supplemental bill in the wake of escalating geopolitical tensions and passing a tax bill that would expand the child tax credit and restore expired Tax Cuts and Jobs Act 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.

Disclosure Section

Important note regarding economic sanctions. This event may involve the discussion of country/ies which are generally the subject of selective sanctions programs administered or enforced by the U.S. Department of the Treasury's Office of Foreign Assets Control ("OFAC"), the European Union and/or by other countries or multi-national bodies. The content of this presentation is for informational purposes and does not represent Morgan Stanley's view as to whether or not any of the Persons, instruments or investments discussed are or may become subject to sanctions. Any references in this presentation to entities or instruments that may be covered by such sanctions should not be read as recommending or advising on any investment activities involving such entities or instruments. You are solely responsible for ensuring that your investment activities in relation to any sanctioned country/ies are carried out in compliance with applicable sanctions.

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

Risk Considerations

Equity securities may fluctuate in response to news on companies, industries, market conditions and general economic environment.

An investment in an **exchange-traded fund** involves risks similar to those of investing in a broadly based portfolio of equity securities traded on an exchange in the relevant securities market, such as market fluctuations caused by such factors as economic and political developments, changes in interest rates and perceived trends in stock and bond prices. Investing in an international ETF also involves certain risks and considerations not typically associated with investing in an ETF that invests in the securities of U.S. issues, such as political, currency, economic and market risks. These risks are magnified in countries with emerging markets, since these countries may have relatively unstable governments and less established markets and economics. ETFs investing in physical commodities and commodity or currency futures have special tax considerations. Physical commodities may be treated as collectibles subject to a maximum 28% long-term capital gains rates, while futures are marked-to-market and may be subject to a blended 60% long- and 40% short-term capital gains tax rate. Rolling futures positions may create taxable events. For specifics and a greater explanation of possible risks with ETFs¸ along with the ETF's investment objectives, charges and expenses, please consult a copy of the ETF's prospectus. Investing in sectors may be more volatile than diversifying across many industries. The investment return and principal value of ETF investments will fluctuate, so an investor's ETF shares (Creation Units), if or when sold, may be worth more or less than the original cost. ETFs are redeemable only in Creation Unit size through an Authorized Participant and are not individually redeemable from an ETF.

Bonds are subject to interest rate risk. When interest rates rise, bond prices fall; generally the longer a bond's maturity, the more sensitive it is to this risk. Bonds may also be subject to call risk, which is the risk that the issuer will redeem the debt at its option, fully or partially, before the scheduled maturity date. The market value of debt instruments may fluctuate, and proceeds from sales prior to maturity may be more or less than the amount originally invested or the maturity value due to changes in market conditions or changes in the credit quality of the issuer. Bonds are subject to the credit risk of the issuer. This is the risk that the issuer might be unable to make interest and/or principal payments on a timely basis. Bonds are also subject to reinvestment risk, which is the risk that principal and/or interest payments from a given investment may be reinvested at a lower interest rate.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

Because of their narrow focus, **sector investments** tend to be more volatile than investments that diversify across many sectors and companies. **Technology stocks** may be especially volatile. Risks applicable to companies in the **energy and natural resources** sectors include commodity pricing risk, supply and demand risk, depletion risk and exploration risk. **Health care sector stocks** are subject to government regulation, as well as government approval of products and services, which can significantly impact price and availability, and which can also be significantly affected by rapid obsolescence and patent expirations.

REITs investing risks are similar to those associated with direct investments in real estate: property value fluctuations, lack of liquidity, limited diversification and sensitivity to economic factors such as interest rate changes and market recessions.

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. The companies identified and investment examples are for illustrative purposes only and should not be deemed a recommendation to purchase, hold or sell any securities or investment products. They are intended to demonstrate the approaches taken by managers who focus on ESG criteria in their investment strategy. There can be no guarantee that a client's account will be managed as described herein.

Disclosures

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