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WEALTH MANAGEMENT

INVESTMENT STRATEGY

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US Policy Pulse

2024 General Election Series

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

New in This Edition

- Aggregate national polling shows modest momentum for Vice President Kamala Harris after the Sept. 10 debate. The battleground states remain tight, as former President Donald Trump maintains a lead over Harris in three states, while Harris leads in four states, all of which are within the margin of error.
- The Sept. 10 Harris-Trump debate was an opportunity for both candidates to define themselves and appeal to swing voters. Trade, energy and tax policy were addressed, and are the most sensitive areas to the presidential election outcome.
- An "October surprise" could marginally sway the election in either direction, and we expect greater bond and equity market volatility, consistent with historical trends around Election Day.
- Consumer sentiment increased for the second straight month but remains below the election-year average. Sentiment among independents continued to remain anchored closer to Republicans than to Democrats.
- Our analysis of industries that may benefit from either a Democratic or Republican outcome indicates that those positioned to outperform after a GOP victory continue to show strength versus their Democratic counterparts. However, we caution investors as momentum shifts in the closing weeks of the campaign could create risks for stocks favoring a GOP victory.
- This report is not intended to serve as an endorsement of any political party or to be predictive of electoral results. Rather, this document provides a point-in-time analysis of broad market performance and economic trends.

The 2024 General Election

The 2024 election is just weeks away and will have significant investor implications. The next president will play an important role in developing tax and trade policy, addressing debts and deficits, and navigating geopolitical unrest. We leverage financial market and economic data to guide investors and identify risks and opportunities as they develop. This report focuses on current performance and we encourage investors to view our Feb. 8 *US Policy Pulse* reports, "History of General

Election Performance, Part 1" and "History of General Election Performance, Part 2" for our historical election analysis.

What's New

In our second to last *US Policy Pulse* ahead of Election Day, we are now entering the final 40 days as polls remain tight and candidate policy proposals sharpen. The Sept. 10 Harris-Trump debate, which proved to be policy light, offered the candidates the ability to clarify certain aspects of their policy platforms and an opportunity to shape their broader political messaging. Vice President Harris sought to define herself for voters and doubled down on the economic agenda she unveiled in August, while former President Trump focused on framing the election as a referendum on the Biden-Harris administration. Since this time, Harris and Trump have released more policy related details on the campaign trail. The candidates have focused heavily on economic, tax and social policy proposals. We remind investors that enacted policy is often more tempered than candidate proposals, with many presidential wish-list items never making it through the legislative process.

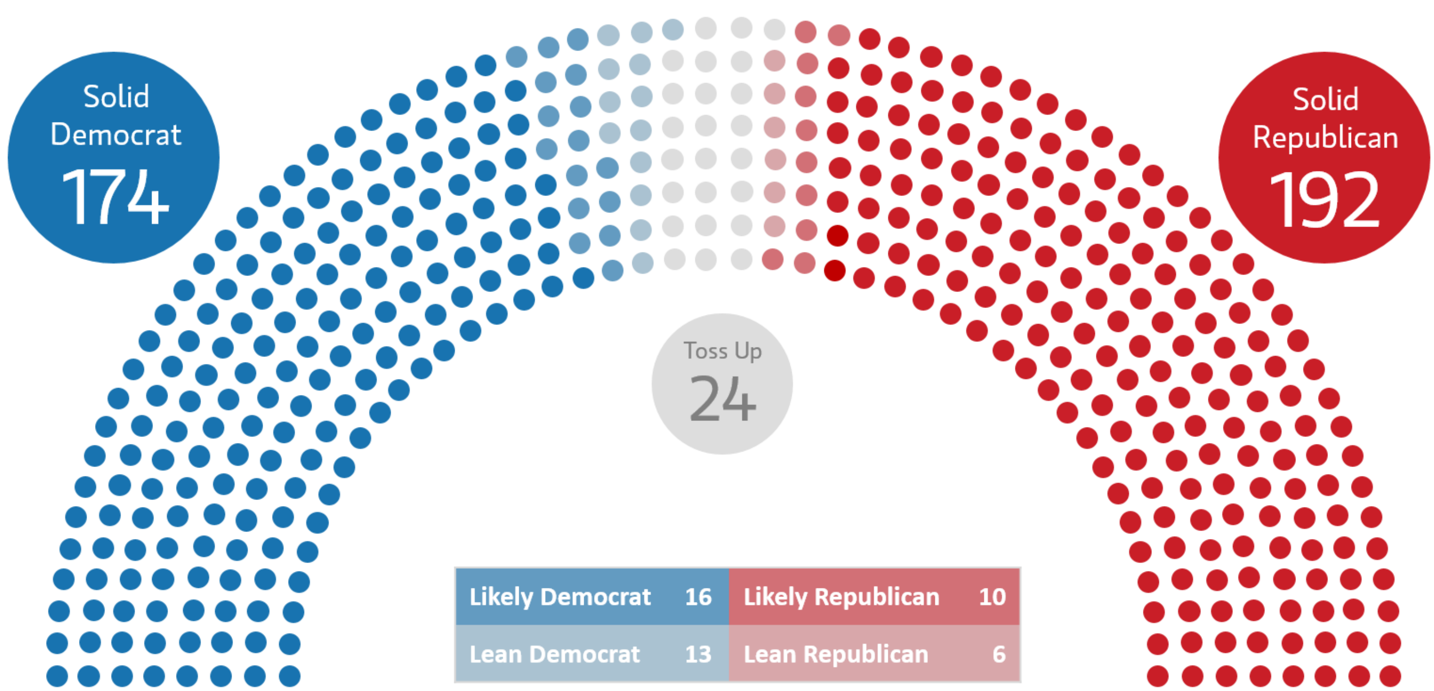
Though the race remains tight in national and battleground state polls, Harris has maintained a narrow aggregate polling lead over Trump since the Democratic Convention. We expect a contentious sprint to Election Day as voter attention turns to the election and candidates compete for votes from independents and swing state voters. In this election of margins, early voting and mail-in voting, along with the possibility of an "October surprise," could influence election results in either direction.

The House of Representatives

Republicans currently maintain a 220-211 majority over Democrats in the House of Representatives, with one GOP and three Democratic seats vacant, allowing for just a few Republicans to defect before control would tip to the Democrats. The balance of power is subject to further change, as every two years all 435 House seats are up for election. The ultimate composition depends on several factors, including candidate electability, voting trend shifts due to redistricting and the combination of retirements and legislators seeking other public offices.

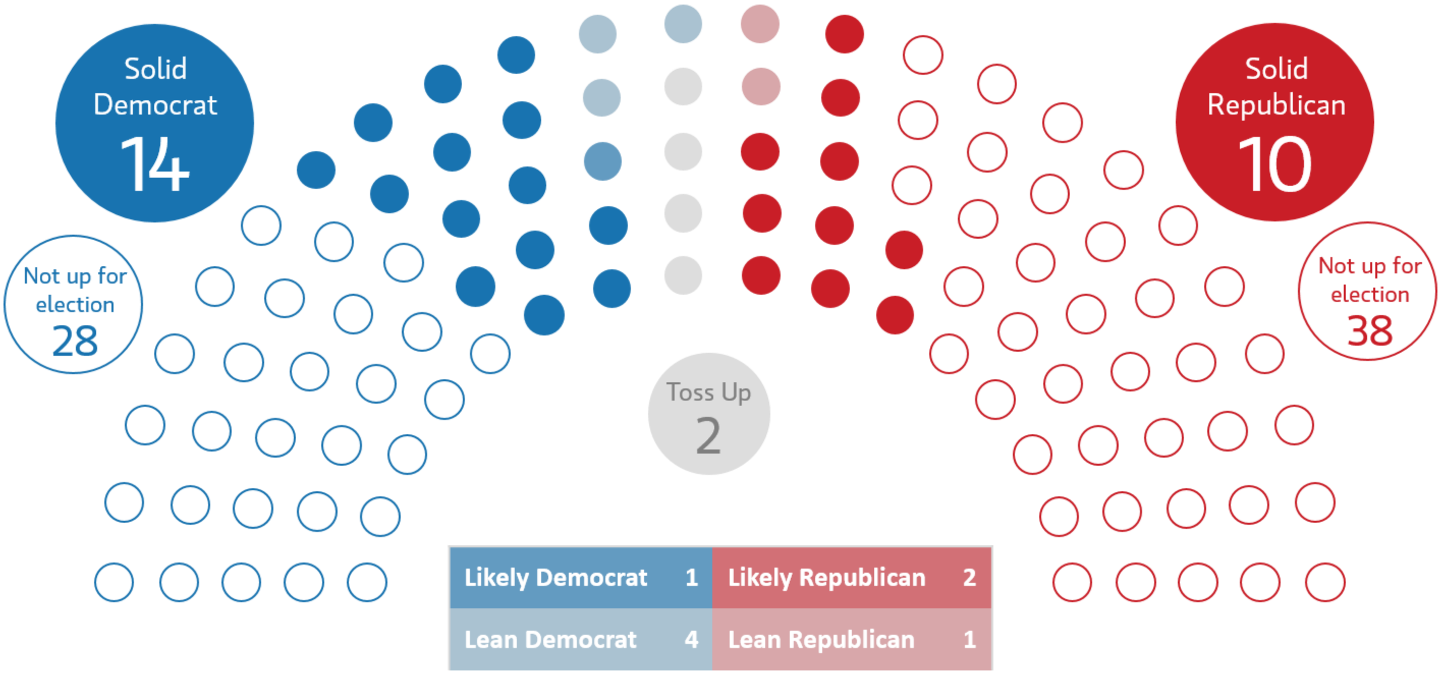
Control of the House is likely to be extremely tight, driven by just a handful of seats. Both parties see opportunity in certain races, and while RealClearPolitics reports that Democrats have a 1.8% congressional polling lead over Republicans, Cook Political Report's (CPR) statistical seat ratings slightly favor Republicans. For example, CPR rates 174 seats as Solid Democrat (not considered competitive) and 29 as Likely Democrat or Lean Democrat. Meanwhile, it rates 192 seats as Solid Republican and 16 as Likely Republican or Lean Republican (see Exhibit 1). If all seats are awarded to their projected parties, Republicans would control 208 seats to the Democrats' 203, and would need to win just 10 of the 24 remaining races to which CPR assigns a Toss Up rating (most competitive). However, we note that enthusiasm for Harris, if continued, could translate to positive results for Democrats running in down-ballot elections.

Exhibit 1: House Race Competitiveness



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Exhibit 2: Senate Race Competitiveness



Source: Cook Political Report, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

The Senate

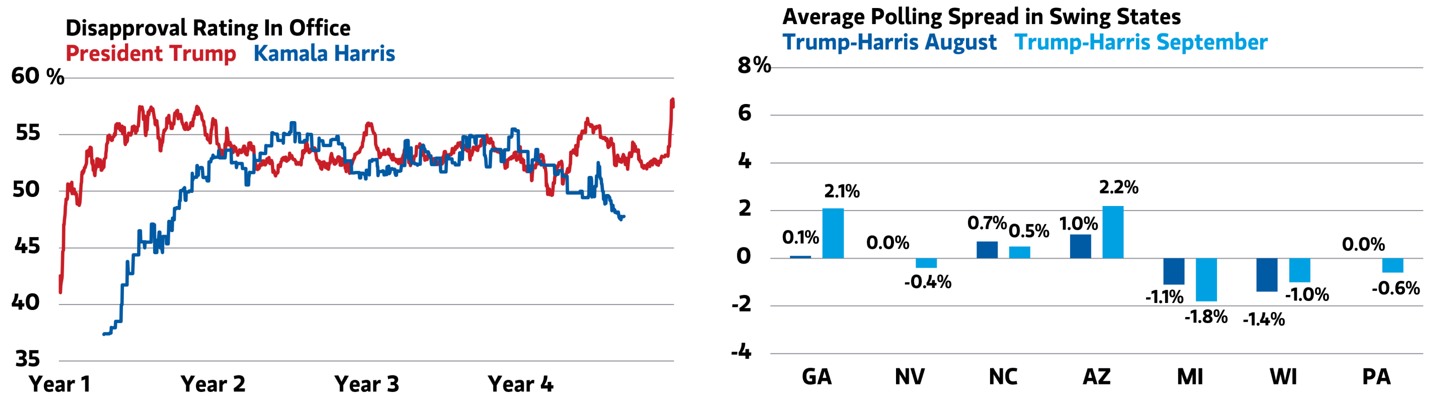
In the Senate, Democrats and independents who caucus with them maintain a slim 51-49 majority over Republicans. Unlike the House, where all seats are up for election every two years, Senate terms are six years, with only one-third of seats up for election every two years. Of the seats up this year, CPR currently rates 14 Solid Democrat, 10 Solid Republican, five Likely Democrat or Lean Democrat and three Likely Republican or Lean Republican. Two seats are rated Toss Up (see Exhibit 2). Importantly, CPR recently moved Montana Sen. Jon Tester's race to Lean Republican from Toss-Up after polling showed a five-point average lead for Republican Tim Sheehy. The development in the Montana Senate race and the overall breakdown inherently puts the Democrats' majority at risk. 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 that Biden won by just 10,000 votes in 2020. Lastly, the retirement of Michigan Democrat Sen. Debbie Stabenow sets up another seat with a potential party flip, now rated as a Toss Up, in another swing state.

The Presidency

Harris's disapproval rating of 47.8% stands below Trump's disapproval rating of 53% at this point in his term (see Exhibit 3, left). According to RealClearPolitics national polling averages, Harris maintains a slim 2.1% lead over Trump, widening the gap from 1.8% last month. That said, Trump holds narrow leads in three of the seven swing states, while Harris holds narrow leads in four swing states, all within the margin of error (see Exhibit 3, right). In this election of margins, we are looking out for any twist in the coming weeks that can ultimately sway the election.

The Sept. 10 debate was an opportunity for both candidates to define themselves and appeal to swing voters. While the composition of Congress may have a greater impact on policy implementation than the presidential outcome, trade, energy, and tax policy may be the most sensitive to presidential leadership. During the debate, Trump doubled down on his intention to potentially levy 60% tariffs on China and a 10% universal tariff. Both candidates indicated that they support the use of traditional energy production, but Harris advocated for a dual-mandate energy policy, which supports both traditional and clean energy initiatives. On taxes, Harris underscored her economic vision, largely following Biden's tax plan with a number of provisions targeting low-income households and first-time homebuyers, while Trump mentioned broad tax cuts, in line with his plan to extend the Tax Cuts and Jobs Act.

Exhibit 3: Trump Remains More Unpopular Than Harris, While Swing State Polling Stays Tight



Source: 538, RealClearPolitics, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Harris faces a challenge of crafting and honing the delivery of her message in the short run-up to Election Day. Conversely, Trump is tasked with reshaping his campaign message, which had been effective and disciplined in the race against Biden and defining Harris to his advantage. While we do not view the Oct. 1 debate between the vice presidential candidates as particularly consequential, it could provide an opportunity for both candidates to detail their policy agendas.

Macroeconomics, Markets and the Election

Macroeconomic Indicators

Though not the only determinant, voter sentiment on the economy, namely in regard to GDP in the months before the election, is correlated with presidential outcomes. 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, we have seen a disconnect between GDP performance and voter support this year. Annualized second quarter GDP growth of 2.8% corresponded with a net zero change in Biden's approval rating, indicating that mixed economic data may have caused a breakdown in this relationship.

This disconnect may be attributed to voters' perceived wealth, which is often connected to inflation and the "economic pinch." For example, Morgan Stanley & Co. Research's latest AlphaWise survey shows inflation, jobs and the economy to be the top concern for 63% of consumers. US gasoline prices have moderated from their year-to-date peak in mid-April, but average gas prices are up over 35% since Biden took office, while food inflation is up a cumulative 21%. That said, headline CPI has moderated and now stands at 2.5% versus 2.9% last month, though consumer pressures may have contributed to the drag on Biden's approval rating, which could have an impact for Harris.

The Federal Reserve's 50-basis-point cut in the fed funds rate earlier this month may only be the start of a cutting cycle as declining inflation and a weaker labor market are driving market expectations for further monetary policy action. Though financial conditions may loosen as a result, interest rates will likely remain high compared with the past decade and may continue to weigh on households and employment. While the economy may not play as central a role in Harris's election prospects as they did with Biden's, the patchwork of geopolitical pressure, inflationary and economic outcomes, and the related drag on consumer confidence creates headwinds.

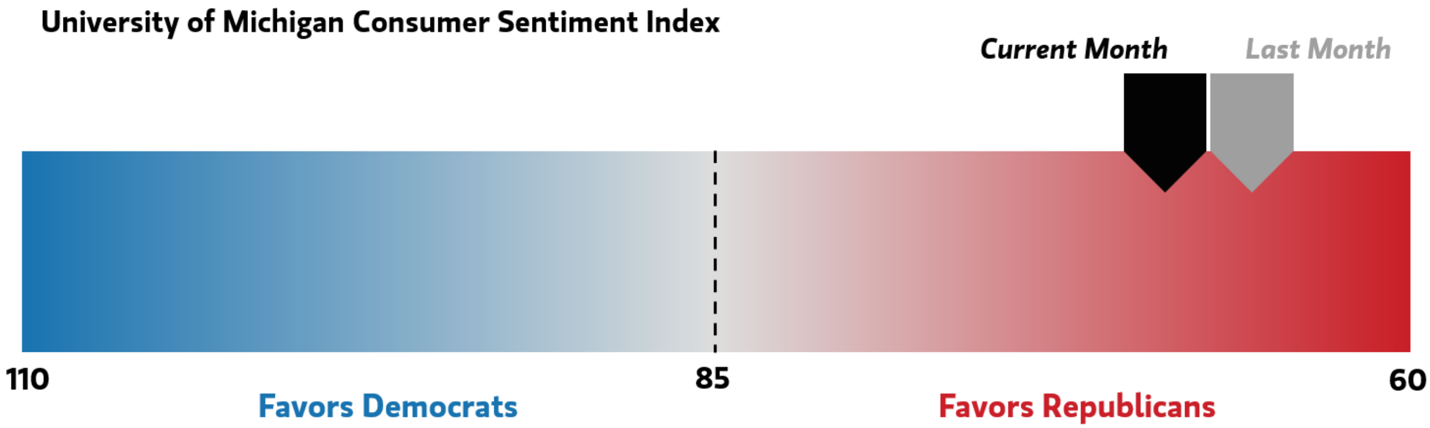
The University of Michigan Consumer Sentiment Index (MCSI), a proxy for consumer confidence, increased for a second straight month to 69 on a preliminary basis in September, from 67.9 in August. The index remains below its pre-pandemic level and its historical election year average of 85.7, indicating that while sentiment is modestly improving, consumer struggles are ongoing. In fact, going back to 1978, consumer sentiment has never been this low in September of an election year, and the only two election cycles where it hovered near these levels resulted in party changes.

The index has a 0.5 positive correlation with incumbent presidential results. The index averaged 92 when the incumbent party won and 80 when the incumbent party has lost. While the MCSI continues to favor Republicans, this month's data has ended a four-month long deterioration in consumer sentiment, and we emphasize that it is just one of many possible leading indicators of election results. We encourage investors to consider economic conditions holistically (see Exhibit 4).

Analyzing consumer sentiment by political party, we unsurprisingly see higher readings among Democratic voters and lower readings among Republican voters, which is consistent with history, reflecting higher sentiment from those in favor of the White House incumbent's party.

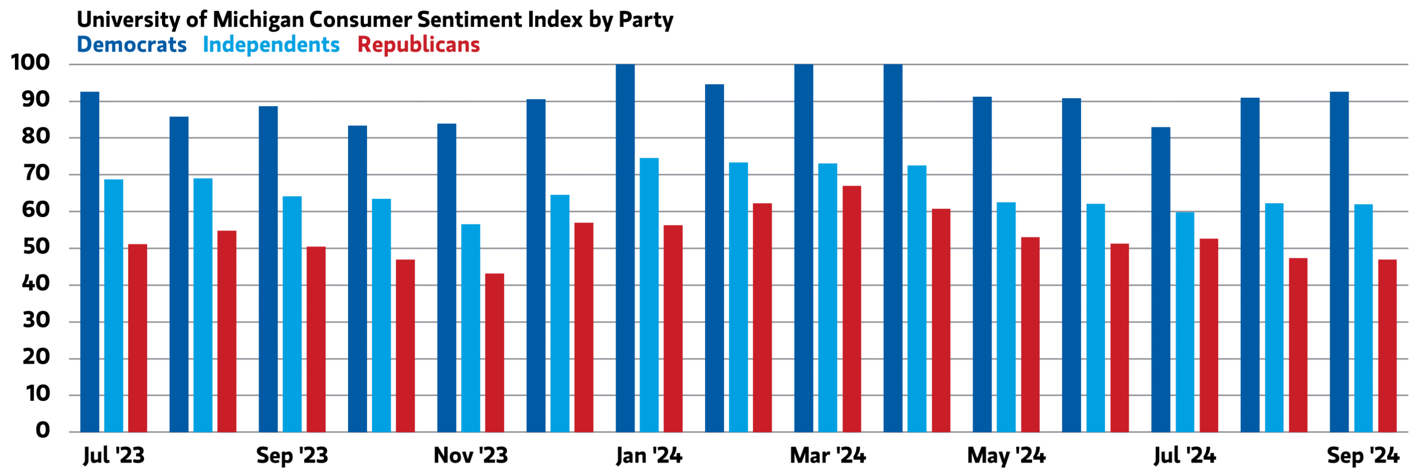
Sentiment fell slightly among Republicans and independents from August to September but rose by 1.7 points among Democrats, partly due to Democratic voter enthusiasm around Harris entering the race, a continuation of sentiment from the July jump. However, the index among independents remains closer to Republicans than that of Democrats overall (see Exhibit 5). The alignment in sentiment could perhaps point to how cohorts may vote in November.

Exhibit 4: Consumer Sentiment Rose Modestly but Still Favors Republicans



Note: Latest index reading is preliminary
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Exhibit 5: Consumer Sentiment Rose For Democrats, But Independents Remain Closer to Republicans Than Democrats

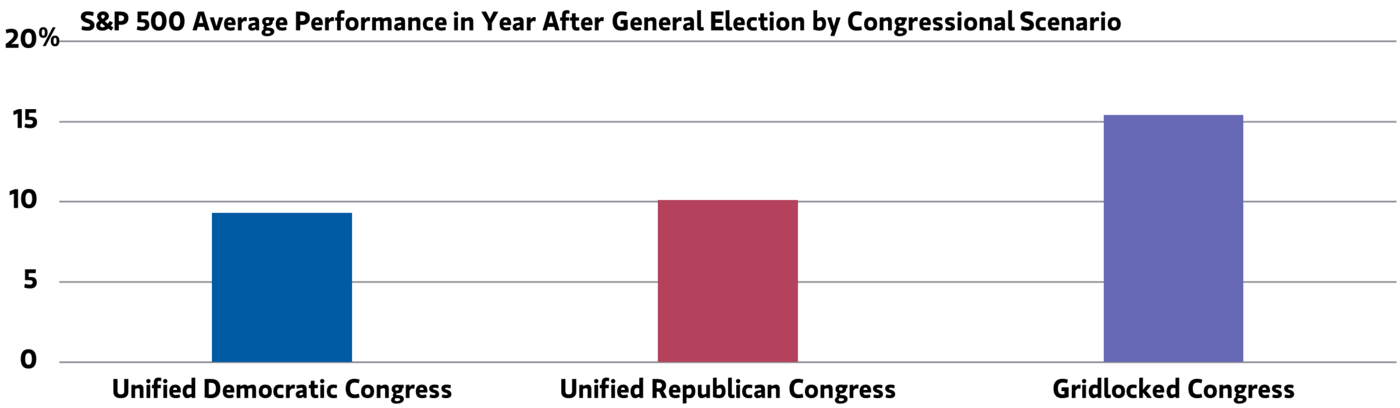


Note: Latest index reading is preliminary
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Market Indicators

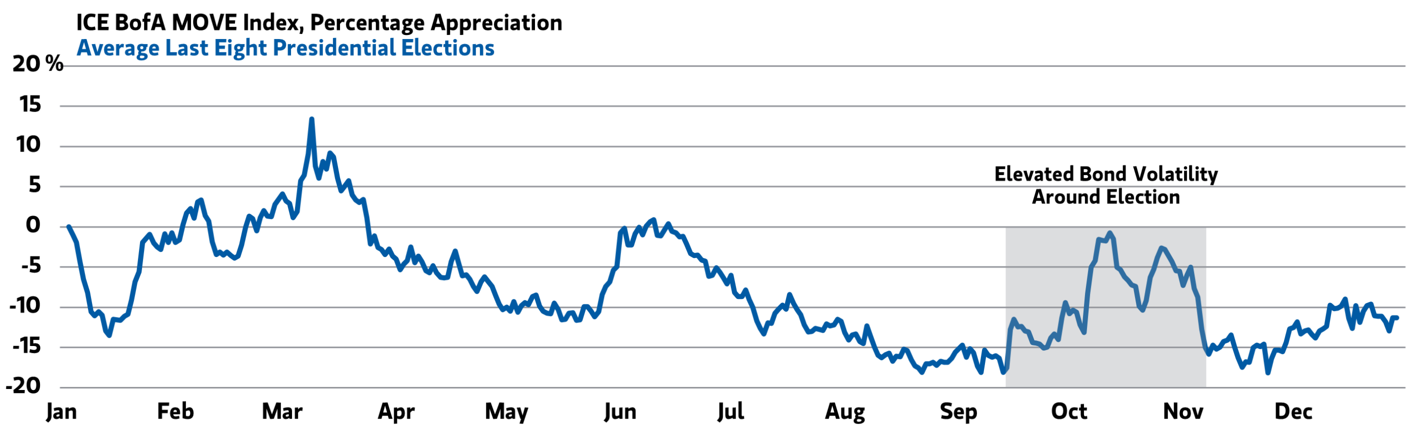
On average, the S&P 500 Index has risen in election years. As investors position their portfolios ahead of the election, our analysis indicates that the stock market tends to be strongest amid gridlocked outcomes (split control of Congress and the White House) because the gridlock places restraints on sweeping policy changes (see Exhibit 6). The US dollar and US Treasuries tend to strengthen around elections, as investors seek safety amid political uncertainty. Additionally, market volatility is common surrounding elections, as shown by a 15% rise in bond volatility, on average, from mid-September of an election year lasting through the election (see Exhibit 7). This year, the confluence of election factors mixed with macroeconomic and geopolitical influences may drive further bond market volatility.

Exhibit 6: Equity Markets Tend to Perform Best Under Gridlocked Congressional Outcomes



Note: Analysis from 1970 onward. Performance excludes dividends.
Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 25, 2024

Exhibit 7: Bond Volatility Tends to Rise Around Elections, But Then Subsides Post-Election



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Analyzing equity performance by sector and industry, patterns emerge that may serve as point-in-time investment opportunities as Election Day approaches. For example, policy platforms can impact a sector or industry's regulation and profitability. In the instance that investors anticipate a Republican win, utilities, energy, financials and industrials may track the strong performance as they tend to outperform in election years when Republicans have won. Conversely, information technology and consumer discretionary performed favorably when a Democrat was the eventual winner (see Exhibit 8).

Industrials, for example, tend to perform well and in line with the S&P 500 on a 12- and 24-month horizon after a Democratic presidential victory, and the sector has closely tracked this dynamic today. When the odds of a Democrat victory in 2024 have improved, industrials have outperformed the broader market, and vice versa (see Exhibit 9). Driving this dynamic is defense, infrastructure and trade. On defense, Trump has promised to end the war in Ukraine, which has negatively impacted near-term defense sentiment. Similarly, Democrats may be seen as more favorable for infrastructure-related stocks and the fiscal tailwinds associated with them through recent legislation. Lastly, though we view deglobalization as a secular theme, a Democratic victory may slow the pace of deglobalization through fewer trade barriers. Despite this market dynamic, we maintain a positive long-term outlook on these drivers. Current geopolitical tensions will continue to drive robust defense spending and national security prioritization, while infrastructure could continue benefitting as fiscal spending and strong private-sector capex remains. We see similar risks and opportunities in other sectors and industries that are moving in-line with presidential election odds.

Exhibit 8: Election Year Sector Returns in The Run Up to a Democrat or Republican Victory

Average Performance in Republican-Win Election Year

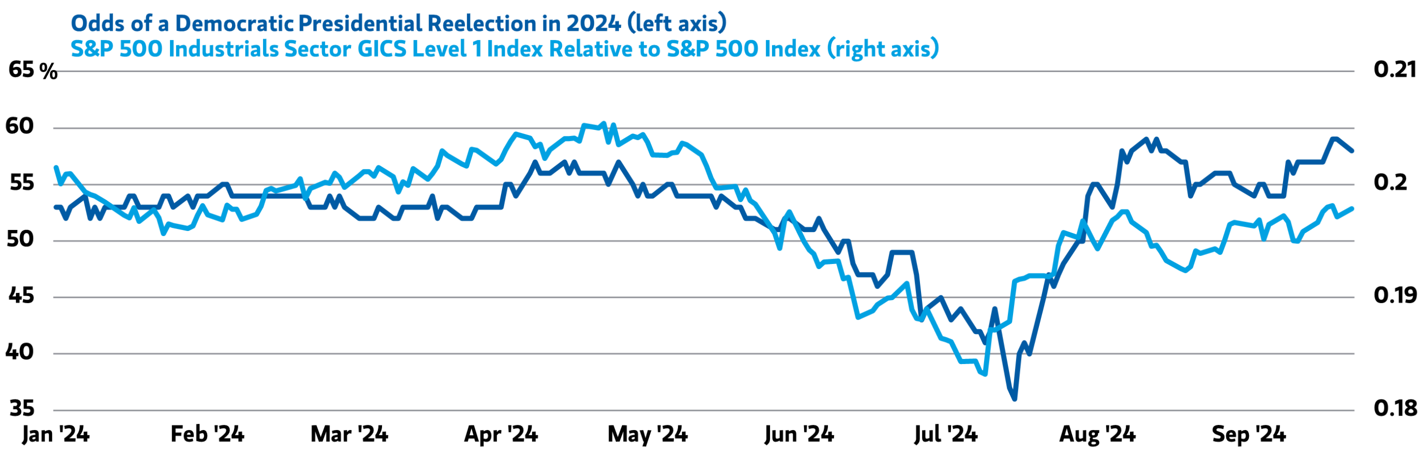
	Full Year	Q1	Q2	Q3	Q4	YTD
S&P 500	2.8%	1.4%	0.1%	-0.1%	1.3%	19.8%
Information Technology	-8.9%	4.4%	-3.3%	-3.8%	-6.4%	27.1%
Health Care	10.5%	-2.3%	10.4%	-1.9%	3.7%	12.9%
Energy	21.9%	3.2%	6.7%	6.7%	3.8%	7.6%
Consumer Discretionary	-1.4%	-0.6%	-3.5%	-1.4%	3.5%	13.0%
Consumer Staples	7.7%	-2.5%	5.7%	-2.5%	8.5%	16.7%
Communication Services	-2.0%	5.8%	-3.4%	-4.1%	-2.8%	25.0%
Utilities	27.8%	8.3%	2.8%	10.3%	4.5%	26.9%
Real Estate	10.9%	5.6%	-0.4%	0.9%	4.8%	12.0%
Materials	2.4%	-4.0%	-3.4%	-0.7%	11.2%	11.9%
Financials	17.3%	0.2%	-1.6%	9.0%	9.8%	20.1%
Industrials	12.2%	0.5%	2.5%	3.9%	5.1%	17.8%

Average Performance in Democratic-Win Election Year

	Full Year	Q1	Q2	Q3	Q4	YTD
S&P 500	3.2%	-3.3%	3.7%	2.0%	0.0%	19.8%
Information Technology	11.1%	0.7%	6.5%	2.4%	-1.0%	27.1%
Health Care	0.6%	-5.3%	2.2%	2.8%	0.3%	12.9%
Energy	-10.3%	-12.1%	10.6%	-5.8%	1.0%	7.6%
Consumer Discretionary	9.4%	0.5%	5.0%	4.2%	-0.7%	13.0%
Consumer Staples	4.7%	-2.6%	2.4%	5.3%	-0.4%	16.7%
Communication Services	2.0%	-8.7%	7.2%	-0.8%	4.4%	25.0%
Utilities	-7.4%	-7.9%	4.5%	-3.0%	-0.9%	26.9%
Real Estate	-11.3%	-2.9%	3.1%	0.8%	-12.0%	12.0%
Materials	0.8%	-0.4%	4.1%	-1.1%	-1.7%	11.9%
Financials	6.1%	-3.6%	-1.9%	3.8%	3.3%	20.1%
Industrials	1.9%	-2.8%	0.7%	2.3%	1.3%	17.8%

Note: Percents 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 Sept. 24, 2024

Exhibit 9: Industrials Have Closely Tracked Democratic Election Odds

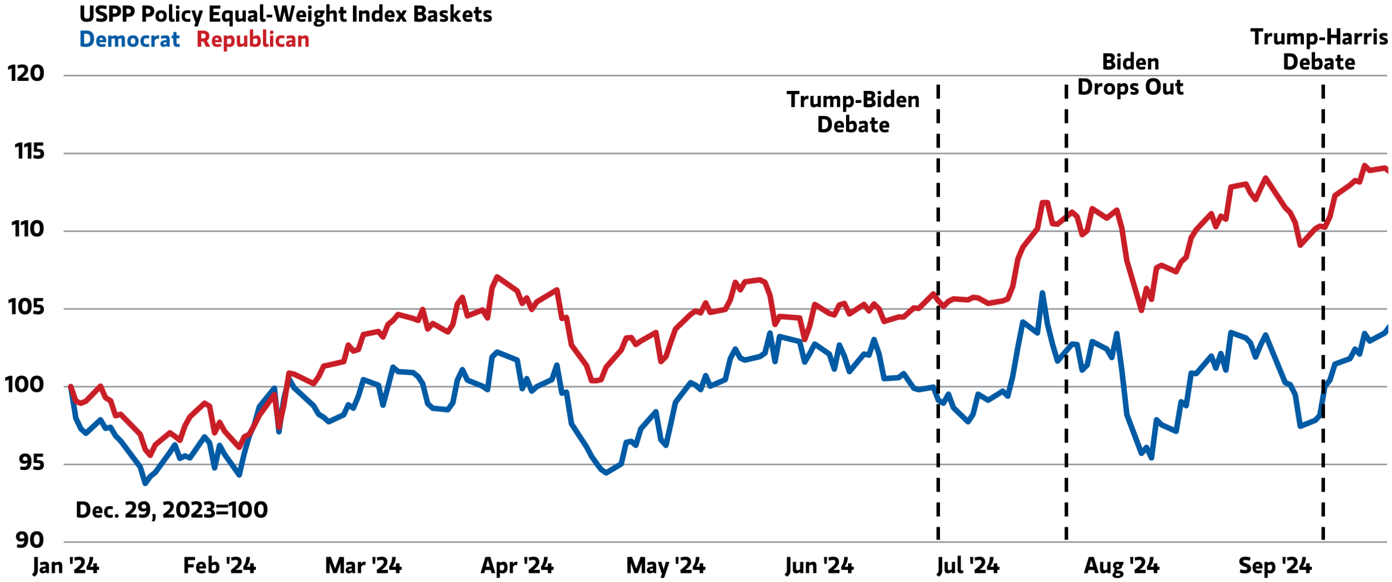


Source: Bloomberg, PredictIt.org, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

We developed two political party equal-weight baskets, each tracking 12 sector and industry exchange-traded funds (ETFs) positioned to benefit from either a Democratic or Republican victory. For example, sectors and industries that we expect to benefit from Democratic policymaking are clean energy, including electric vehicles (EVs) and solar; managed care; infrastructure; defense and technology, including cybersecurity and semiconductors. Areas that we consider likely to benefit most from a Republican win are traditional energy, master limited partnerships, utilities, materials, real estate, block-chain technology, banks, pharma and biotechnology. The Republican basket has outperformed the Democratic basket by 10% this year, below the maximum 12.3% spread in early September, though momentum shifts in the closing weeks of the campaign could create risks for stocks favored by a GOP victory (see Exhibit 10).

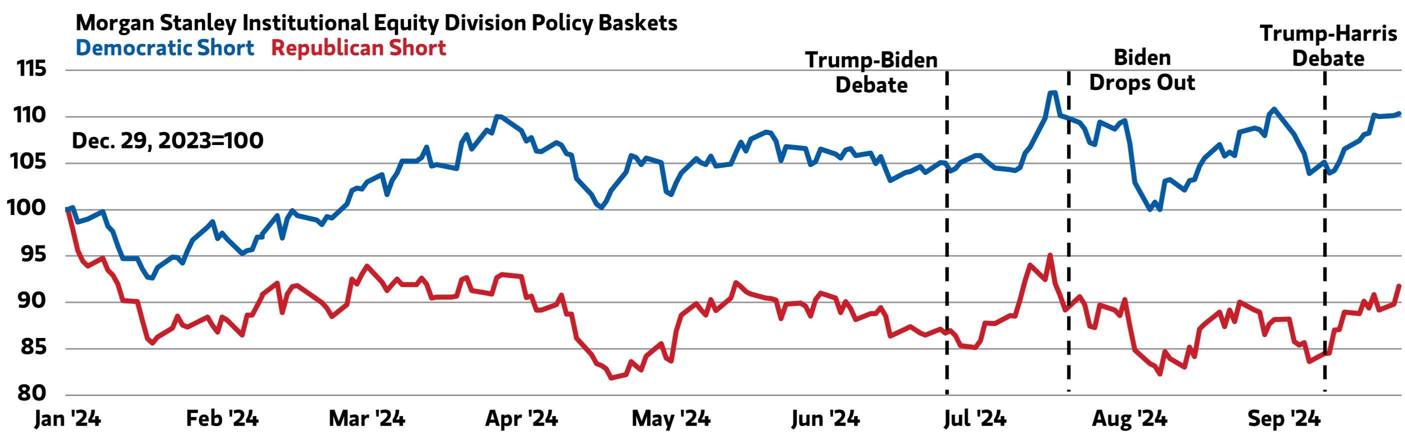
Analyzing election-related market performance from a different angle, we considered two baskets of stocks from Morgan Stanley's Institutional Equity Division: a Democratic short basket, which contains stocks that may be disadvantaged if a Democrat wins the White House, and a Republican short basket, which contains stocks that may perform poorly if a Republican wins (see Exhibit 11). The Republican short basket, down more than 21% for the year to date, has continued to underperform, indicating that investors could already be hedging against a Trump victory by selling stocks they anticipate would be negatively affected. In other words, the market may be bracing for changes to the status quo, mostly impacting companies with exposure to potentially higher tariffs, tax and regulatory cuts, and less support for clean energy and EVs.

Exhibit 10: Republican Equal-Weight Basket Has Outperformed the Democratic Basket



Source: Bloomberg, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Exhibit 11: Investors May Be Avoiding Stocks Vulnerable to a Trump Presidency



Source: Bloomberg, Morgan Stanley Institutional Equity Division, Morgan Stanley Wealth Management Global Investment Office as of Sept. 24, 2024

Investment Conclusion

A highly consequential election is just weeks away. The future of trade, tax, and energy policy are most sensitive to the outcome of the Presidential election, though the makeup of the Senate and House of Representatives shape the final policy outcome. In recent weeks, Harris has outperformed Trump in the polls and maintained a strong fundraising presence that may have shifted momentum slightly in her favor. That said, the race remains tight, and we expect a contentious final sprint to Election Day as campaigning accelerates in the competition for swing state votes. An "October surprise" could also marginally sway the election in either direction. Expect greater market volatility, consistent with historical trends around Election Day.

The economy, including the trajectory of inflation, the labor market and growth, will be crucial to monitor as Election Day approaches as well. Meanwhile, consumer sentiment data has increased for the second straight month, due in part to sustained Democratic voter enthusiasm around Harris entering the race, but overall remains below election-year averages. Sentiment among independents is still anchored closer to Republican sentiment than Democratic, which could perhaps point to how this cohort votes come Election Day. Analyzing market returns in election years, we find that opportunities may emerge in energy, utilities, financials and industrials if investors anticipate a Republican win. Should investors expect a Democratic win, information technology and consumer discretionary are likely to outperform, while health care could also be a notable beneficiary. Finally, when assessing performance of our USPP Policy Equal-Weight Index Baskets and the Morgan Stanley Institutional Equity Division Policy Baskets, we see the stock market may be positioning for a GOP victory, though momentum shifts in the closing weeks of the campaign could create risks for stocks favoring a GOP victory. The election is still six weeks away, and many more twists and turns are possible.

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

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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.

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.

Investing in foreign markets entails greater risks than those normally associated with domestic markets, such as political, currency, economic and market risks. **Investing in currency** involves additional special risks such as credit, interest rate fluctuations, derivative investment risk, and domestic and foreign inflation rates, which can be volatile and may be less liquid than other securities and more sensitive to the effect of varied economic conditions. In addition, international investing entails greater risk, as well as greater potential rewards compared to U.S. investing. These risks include political and economic uncertainties of foreign countries as well as the risk of currency fluctuations. These risks are magnified in countries with **emerging markets and frontier markets**, since these countries may have relatively unstable governments and less established markets and economies.

Treasury Inflation Protection Securities' (TIPS) coupon payments and underlying principal are automatically increased to compensate for inflation by tracking the consumer price index (CPI). While the real rate of return is guaranteed, TIPS tend to offer a low return. Because the return of TIPS is linked to inflation, TIPS may significantly underperform versus conventional U.S. Treasuries in times of low inflation.

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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.

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Growth investing does not guarantee a profit or eliminate risk. The stocks of these companies can have relatively high valuations. Because of these high valuations, an investment in a growth stock can be more risky than an investment in a company with more modest growth expectations.

Value investing does not guarantee a profit or eliminate risk. Not all companies whose stocks are considered to be value stocks are able to turn their business around or successfully employ corrective strategies which would result in stock prices that do not rise as initially expected.

Environmental, Social and Governance ("ESG") investments in a portfolio may experience performance that is lower or higher than a portfolio not employing such practices. Portfolios with ESG restrictions and strategies as well as ESG investments may not be able to take advantage of the same opportunities or market trends as portfolios where ESG criteria is not applied. There are inconsistent ESG definitions and criteria within the industry, as well as multiple ESG ratings providers that provide ESG ratings of the same subject companies and/or securities that vary among the providers. Certain issuers of investments may have differing and inconsistent views concerning ESG criteria where the ESG claims made in offering documents or other literature may overstate ESG impact. ESG designations are as of the date of this material, and no assurance is provided that the underlying assets have maintained or will maintain and such designation or any stated ESG compliance. As a result, it is difficult to compare ESG investment products or to evaluate an ESG investment product in comparison to one that does not focus on ESG. Investors should also independently consider whether the ESG investment product meets their own ESG objectives or criteria. There is no assurance that an ESG investing strategy or techniques employed will be successful. Past performance is not a guarantee or a dependable measure of future results.

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