Politics & Portfolios (Reprise)

What To Expect When Electing

Presidential elections tend to stir up emotions with investors, and we are once again approaching the "most important election of our time" …. like the election before and the one before that. History indicates that elevated market volatility is likely, especially with ongoing wars and devastating weather in the U.S., which could cause shocks to oil supply and other critical infrastructure. Despite these concerns, the S&P 500 is up nearly 21% through the end of September, which is the highest return in an election year since 1936[i]. Market breadth improved in the third quarter as several sectors outperformed the technology stocks that accounted for most market gains over the prior eighteen months. The Federal Reserve cut its benchmark rate by 50 basis points in September to a range of 4.75% - 5.00%, as a "recalibration of the stance of monetary policy would begin to bring it into better alignment with recent indicators of inflation and the labor market."[ii] With the market pricing a fed funds rate of 3.25% - 3.50% by year end 2025, anticipation of further easing has kept equity markets higher despite political uncertainty.

A critical issue for voters in this election is the economy, specifically inflation, spending, and tax policy. As measured by the consumer price index, prices are now about 20% higher than when President Biden took office. The Russia-Ukraine war and pandemic supply constraints were initial catalysts of inflation, but unprecedented fiscal stimulus and monetary easing through 2021 and 2022 were key drivers of stubbornly high prices. For the 2024 fiscal year ending September 30, the U.S. government borrowed $1.8 trillion, which is about 6% of GDP. This staggering figure came with strong GDP growth (a 3.0% annualized growth rate for Q2) and historically low unemployment (4.2% as of August), and is a record spending rate outside of recessions, crises, or war. Despite the two opposing economic policies being pitched to voters, each campaign shares the same disregard for deficit spending. As measured by the nonpartisan Committee for a Responsible Federal Budget, the Harris and Trump proposals are both expected to build on the U.S. accumulated deficit over the next ten years. As neither candidate has a plan to address the country's debt burden, each set of proposals is not fiscally sustainable, and further government spending and higher tariffs, for example, could be inflationary.

Tax Cuts and Jobs Act of 2017 ("TCJA")

Passed during the Trump administration, the TCJA included several changes to the tax code and is scheduled to sunset at the end of 2025. Some of the notable provisions were:

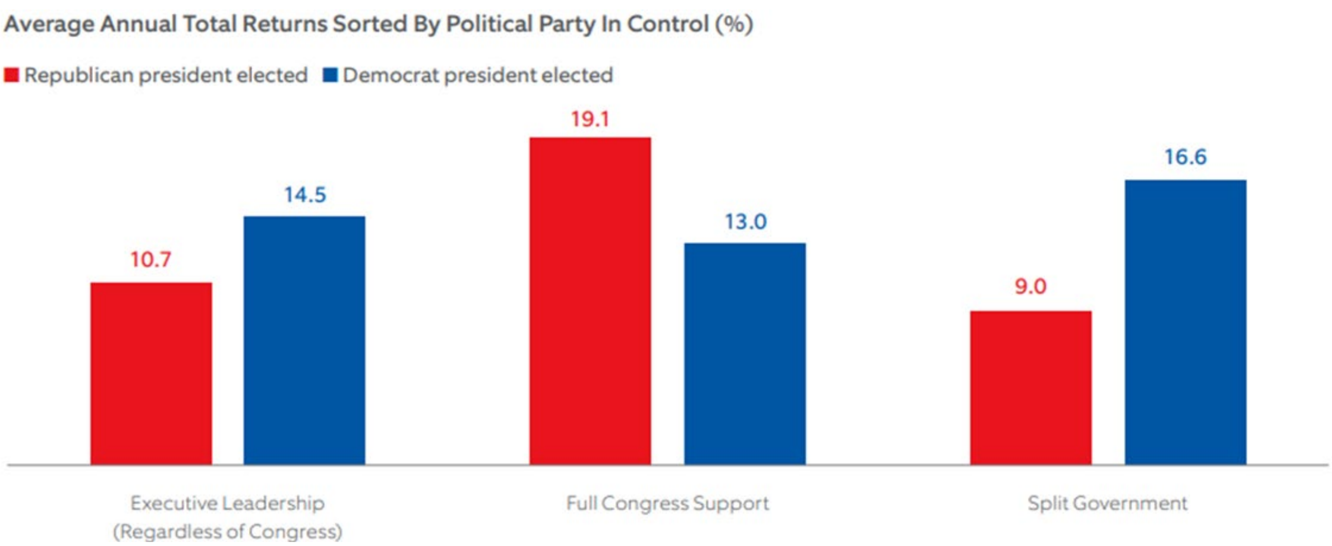
- The top marginal tax rate was lowered to 37% and the tax brackets were expanded.
- The standard deduction was nearly doubled which nearly eliminated itemized deductions.
- State and local taxes ("SALT") deductions were capped at $10,000.
- The estate tax exemption doubled to $13.6 million for single filers and $27.2 million for couples.
- The corporate tax rate was lowered from 35% to 21% (this provision does not sunset).

Harris embraced much of Biden's 2025 fiscal budget but proposed changes as her campaign got underway. As a candidate in 2020, she supported letting the provisions of the TCJA expire, but she now supports extending the tax cuts to all earners under $400,000. For those earning greater than $400,000, she plans to bring back the top 39.6% tax rate and increase the net investment income tax from 3.8% to 5.0%, as well as raise the top long term capital gains rate to 28%. Harris has not yet discussed estate taxes, but it is assumed she will let the estate tax exemptions to be roughly cut in half upon expiration, while also adopting the Biden budget proposal of eliminating the step-up in basis for capital gains greater than $5.25 million for single filers and $10.5 million for couples.

Conversely, Trump is likely to extend most provisions of the TCJA, however, his full tax plans seem to be updated at every campaign stop. The one exception to this is not extending the $10,000 SALT cap deductibility, which is particularly relevant for those living in high tax states. Trump has also proposed lowering the corporate tax rate to 15% for companies that make their products in the U.S., ending taxation of Social Security benefits, as well as several other tax cuts. Although each candidate has made these promises to voters, both have a history of changing their minds, and these proposals can only become legislation with Congressional support.

The Bad News | The Good News

If the "bad news" is that these candidates and their policies do not address the fiscal deficit, the "good news" is that the market historically does not care who's president. RMC discussed the historical performance of the market in assessing "politics & portfolios" in 2020, exhibiting that the market is indifferent to the political party in charge over the long term. Revisiting historical data provides a reminder that making major adjustments to your portfolio based on election predictions, or by being overreactive to political changes, is not advisable. Short term market reactions offer little insight as there are other market forces at play, such as monetary policy, geopolitical conflicts, and economic cycles. Over the long term, markets are driven forward by companies with strong fundamentals and economically relevant products, services, or technologies. The chart below shows calendar year S&P 500 total returns for presidential elections from 1945 through July 2024. The two bars on the left are based on executive leadership, with 40 instances of Republican and 39 instances of Democrat presidents. Those instances are then split for the two other sets of bars, with full Congressional support (Republicans – 7, Democrat – 23) and split government (Republican – 33, Democrat – 16)[iii]. These sample sizes are too small to draw conclusions and include "outlier" years of performance that were not related to legislation. This includes stretches of time of easing monetary policy, which led to strong market returns, versus years of crisis like the dot-com bubble and Global Financial Crisis, which sent the market lower. The takeaway is the equity market has seen robust annual returns under each party and Congressional situation. Maintaining a historical perspective of past elections and abstaining from emotional decisions will keep you invested and committed to your financial plan.



[i] Bloomberg
[ii] FOMC Minutes
[iii] Northern Trust Asset Management

The material provided in this commentary contains the current opinions of RMC Investment Advisors, a SEC-registered investment adviser. These opinions are subject to ongoing evaluation and could change due to economic and market conditions. This commentary is for informational purposes only and should not be considered as investment advice or a recommendation of any particular security or strategy. Please remember that past performance is not indicative of future results.