OCTOBER 2024

Electionomics

Executive Summary

- Elections can create both short-term noise that may not impact the underlying economic backdrop, as well as concrete policy changes with lasting, tangible ramifications. Distinguishing between the two dynamics is crucial.
- While we expect prediction odds and official polls to remain volatile heading into November, both candidates have outlined key policy priorities that may be enacted if elected, which could have significant impacts on stock and bond markets.
- We view the U.S. election and its potential policy ramifications as just one of many possible market drivers for 2025, therefore increasing the importance of contextualizing any election-related view within the broader macroeconomic environment.
- We remain focused on the fundamental picture and how it might be altered by different political outcomes. The significant uncertainty surrounding the election and each party's economic agenda reinforces the importance of a disciplined and diversified asset allocation.

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Back in May, our Focus*Point* article titled "2024 U.S. Elections: Four Key Issues for Markets and the Economy," outlined the potential impacts of different election outcomes on four major policy pillars (fiscal, immigration, trade, and monetary) in the context of a considerable degree of uncertainty around political agendas, voting polls, and the macroeconomic environment. Our expectations for a volatile election season have been accurate, with a lot happening since then—and still many weeks to go.

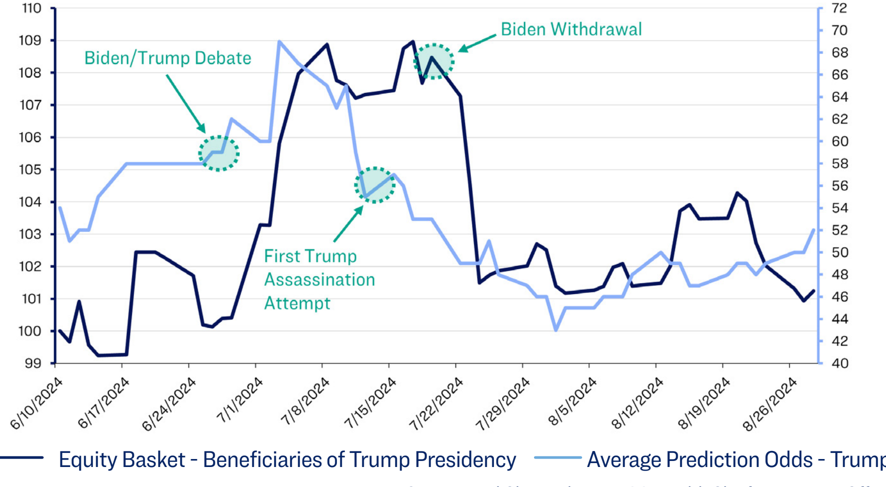
As long-term investors, our goal is to identify secular and cyclical trends that carry the potential to alter fundamentals, and hence impact market performance. Elections can create both short-term noise with no effect on the underlying economic backdrop as well as concrete policy changes with tangible ramifications, and distinguishing between the two dynamics is crucial. Sometimes, the policy positions that candidates take on the campaign trail wind up having real ramifications for investors. Other times, elections create lots of temporary noise that never materializes into meaningful impacts on the economy.

There are two primary reasons why overreacting to short-term election-related noise often produces disappointing absolute and relative investment returns:

1. The probability distribution of a complex political outcome like the U.S. presidential election keeps shifting. The events of the past three months offered a relevant case in point. President Biden's underwhelming performance at the presidential debate on June 27 boosted the odds of a Trump presidency and Republican majority in both the House and Senate, thereby driving strong gains in those asset classes perceived to be most favorably exposed to such an outcome. However, Biden's withdrawal on July 21 and enthusiasm about his replacement on the Democratic ticket, Vice President Kamala Harris, caused a rapid reversal of what was dubbed the "Trump trade"[1] (Figure 1).

FIGURE 1

Average prediction odds shifted following the announcement of VP Harris as the new Presidential candidate.



Source: Real Clear Politics, TIAA Wealth Chief Investment Office

2. We expect prediction odds and official polls to remain volatile and show a tight race heading into November, and the inevitable desire by markets to identify the next election-related investable trend will have to contend with said volatility, and with the difference between political agendas and the likelihoods of them being executed. But even when policy proposals are implemented, they don't always have the dramatic impact often predicted from the campaign trail. For example:

    A. In the run-up to the 2020 election, many analysts thought a Biden presidency would be a boon for utilities stocks, given his campaign focus on clean energy, infrastructure spending, renewables and power-grid upgrades. However, despite legislative action like the bipartisan Infrastructure bill and the Inflation Reduction Act—with the latter expected to drive over $600 billion in new solar panel investments over the next decade—the utilities sector has significantly underperformed under Biden (-15% relative to the S&P 500 through September 23). Why? These measures were overwhelmed by the sector's fundamental drivers, including its vulnerability to higher interest rates and investors' long standing preference for higher-growth industries.

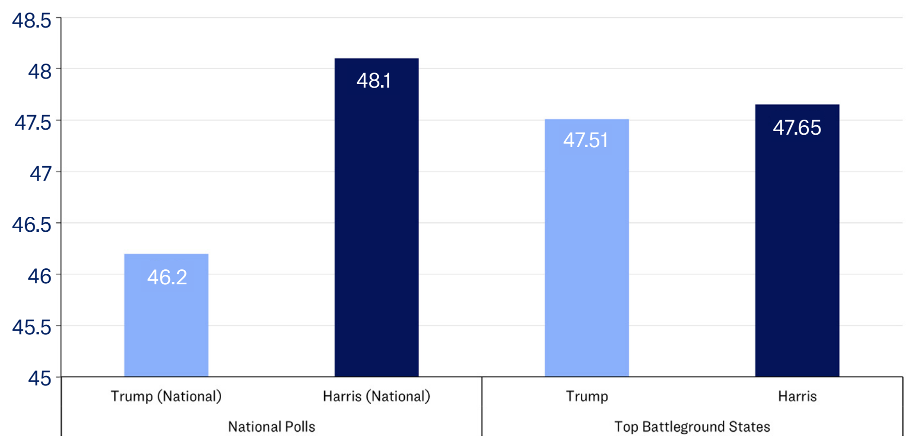
    B. One of Biden's first measures following his inauguration was introducing a moratorium on new oil and gas leases for federal lands and waters, which led to negative views on the oil-and-gas sector. However, about 26 million onshore acres and 12 million offshore acres were already under lease, which minimized the immediate impact of the moratorium; the focus shifted to very supportive fundamentals for energy stocks. Oil production and inventory levels did not ramp up quickly enough to meet rising demand following the post-COVID economic recovery, therefore causing oil prices and energy stocks to rise ~65% and ~155% between 2021 and 2022, respectively.

Both strategically and tactically, therefore, it is important for investors to remain focused on macroeconomic and asset-class-specific fundamentals—and then assess how (or if) different election scenarios could affect them. Current prediction odds and polls suggest the election will be a coin-toss, with improved chances for Democrats following Biden's withdrawal, especially in the top battleground states. In these states, Harris and Trump are virtually tied, and polls are well within the typical 3% statistical margin of error (Figure 2).

Below, we examine what a Trump or Harris presidency could mean for the economy and for financial markets based on what we know about each candidate's economic agenda and policy priorities (Figure 3). We focus on those measures most likely to disrupt current macroeconomic projections and their likelihood to be enacted.

FIGURE 2

In battleground states, Harris and Trump are virtually tied and polls are well within the 3% statistical margin of error.



Source: Real Clear Politics, TIAA Wealth Chief Investment Office. Average of all polls as of 9/18/24

Economic Priorities

Both candidates have top policy priorities that may be enacted if elected, which could have impacts on both the stock and bond markets. If elected, VP Harris has indicated that her economic agenda would focus on four key areas:

- Implementing middle-class tax cuts by granting up to a $6,000 credit for newborns in their first year of life, restoring a pandemic-era tax credit of $3,600/child for middle- and lower-income households, and expanding the earned income tax credit for lower income workers.
- Supporting the housing market, including up to $25,000 in downpayment aid for first-time homebuyers, a tax credit for developers who build starter homes with the goal of creating three million new housing units over four years, and an expanded tax credit for building affordable rental units.
- Extending the Tax Cuts and Jobs Act (TCJA)[2] tax cuts set to expire at the end of 2025 for all individuals earning less than $400,000.
- Cutting prescription drug costs, capping out-of-pocket medical expenses, and eliminating medical debt.

To pay for the additional federal spending related to these measures, VP Harris has outlined a series of tax increases ranging from a higher corporate tax rate, a higher tax on capital gains and a restoration of the top individual tax rate of 39.6% for anyone earning more than $400,000 (or $450,000 if filing jointly).

Former President Trump's economic agenda would focus on three key issues:

- Extending all expiring provisions of the TCJA.
- Repealing the tax on Social Security benefits.
- Cutting the corporate tax rate further from 21% to 15% for companies that make products in America.

While details on how Trump's measures would be funded have been limited, the focus seems to be on leveraging a sweeping increase of trade tariffs. In particular, Trump has publicly teased a 60% levy on all Chinese goods and a broad 10% tariff on all goods imported into the U.S.

FIGURE 3

Based on what we know about each candidate's economic agenda and other policy priorities, a Trump or Harris presidency could drive different outcomes in financial markets.

Harris: Economic Agenda	Key Measures	Potential Market Impact
Care Economy	• $6,000 newborn credit • $3,600/child tax credit for middle- and lower-income families • Expansion of earned income tax credit in lower income jobs	• Boost International Stocks relative to U.S. Stocks • Boost Large Cap Stocks relative to Small Cap Stocks • Boost Growth Stocks relative to Value Stocks • Boost utilities (especially renewables stocks), REITs, homebuilders, industrials stocks • Weigh on healthcare, medical insurance, consumer discretionary stocks • Support yield curve steepening • Support non-U.S. currencies relative to the U.S. Dollar
Housing	• $25,000 downpayment aid for first-time homebuyers • Tax credit for home developers	
Taxes	• Extension of TCJA tax cuts for all individuals earning less than $400,000 • Corporate Tax Rate from 21% to 28% • Long-term capital gains tax rate from 20% to 28% for incomes >$1mn • Top individual tax rate back to 39.6% for all individuals earnings more than $400,000 ($450,000 married couples filing jointly) • Tighten estate and gift tax rules • 21% minimum tax on global intangible low-taxed income • Raise net investment income and additional Medicare tax rates • No taxes on tips • Increase tax deduction for startup expenses for small businesses from $5,000, to $50,000	
Healthcare	• Cut prescription drug costs • Cap out-of-pocket medical expenses • Eliminate medical debt	
Green Energy	• Protect and expand the climate policies contained in the IRA	
Trump: Economic Agenda	**Key Measures**	**Potential Market Impact**
Taxes	• Extend all expiring provisions of the TCJA • Repeal taxes on social security benefits • No taxes on tips	• Boost U.S Stocks relative to International Stocks • Boost Small Cap Stocks relative to Large Cap Stocks • Boost Value Stocks relative to Growth Stocks • Boost financial, defense, consumer discretionary, industrial, oil & gas stocks • Weigh on stocks with a large share of international revenues • Support inflation-protected bonds • Support the U.S. dollar relative to non-U.S. currencies
Tariffs	• 60% tariff on all Chinese goods and 10% tariff on all goods imported into the U.S.	
Deregulation	• Block the implementation of tighter banking regulations • Eliminate plant emission standards issued by the EPA • Significantly ease concession standards for new oil and gas drilling leases	

Realistically, most of the policies described above are unlikely to become law, at least in their proposed forms, unless the election yields a unified government. Even then, most legislation needs 60 votes in the Senate to avoid a legislative filibuster, meaning most bills need bipartisan support to pass the Senate and become law. That said, a key exception to this 60-vote requirement is the budget reconciliation process, designed to ensure that Congress can modify existing law to address the nation's revenue and spending levels. In recent decades, Congress has used budget reconciliation to pass the President George W. Bush tax cuts in 2001, elements of the Affordable Care Act (ACA) in 2010, the TCJA in 2017, and the Inflation Reduction Act in 2021. Therefore, a unified government can use the reconciliation process to avoid bipartisan compromise and pass measures most directly impacting fiscal policy, including changes to the tax code.

With this in mind, the heavy focus by both parties on tax cuts and public spending makes it likely that the most important election impact on financial markets could come from a swelling federal budget deficit. This would put upward pressure on interest rates, as the already-large rise in government debt projected by the Congressional Budget Office (CBO) over the next 10 years could be revised higher by as much as $3 to $5 trillion.

However, we would expect this pressure to translate into a higher long-term fair value for interest rates, rather than necessarily into an immediate and durable rise in yields, which in the short-term could remain sensitive to risks to economic growth associated with trade tariffs, higher taxes, and the ongoing unfolding of the business cycle.

Treasury Inflation-Protected Securities could also become increasingly attractive relative to traditional Treasury bonds as both parties' economic agendas contain inflationary elements. Former President Trump's tariff plan could boost domestic prices as businesses adjust to higher import duties. Meanwhile, housing prices, a large component of the Consumer Price Index (CPI) inflation basket, could rise under VP Harris's plan to provide first-time homebuyers with $25,000 in downpayment aid. The plan would fuel demand at a time of still-limited supply of existing and new homes. While her policy goal of constructing three million new homes, if achieved, could eventually bring housing supply and demand back in balance, its impact is likely to significantly lag the inflationary effect of the downpayment assistance program.

Within equities, our view is that an increase in the corporate tax rate, as proposed by the Harris campaign, would weigh on U.S. stocks by reducing earnings growth, squeezing profit margins, and absorbing cash that could be otherwise reinvested or distributed to shareholders. In this scenario, which would be more realistic if Democrats win both the White House and Congress, defensive equity sectors—especially utilities, given their ability to pass tax hikes onto customers—could outperform. Real Estate Investment Trusts (REITs) might also gain favor, since they are not subject to corporate tax as long as they distribute at least 90% of their earnings to shareholders.

Using the Internal Revenue Service (IRS) data, we estimate that resetting the top personal income tax rate to 39.6% (from 37%) on income over $400,000 a year (or $450,000 if married filing jointly) could yield around $55 to $60 billion in additional income tax revenue in both 2025 and 2026. In all likelihood, this measure alone would not be enough to meaningfully reduce consumer spending, as only 0.3% of total disposable income would be affected. Moreover, wealthier households already have a lower propensity to spend, with the top 20% of households accounting for 51% of total income but only 38% of total spending. Still, there are some investments that could be affected by higher marginal tax rates:

- Higher taxes could have a broader impact on consumer sentiment and weigh on those equity sectors more reliant on robust consumption, including consumer discretionary stocks.
- Raising the tax rate on long-term capital gains could motivate investors with large unrealized gains to book their profits before the measure becomes effective. That could increase market volatility, especially in those sectors that have outperformed most over the past few years.
- Any changes to the tax code resulting in higher tax rates could support municipal bonds, making their tax exemption more valuable.

Tax policy isn't the only policy that hangs in the balance. Given Democrats' emphasis on infrastructure investments and housing affordability, a big win by Democrats could boost industrial and homebuilder stocks. It could also be a drag on pharmaceutical stocks and health insurance companies, given Democrats' ongoing efforts to slash drug costs and cap out-of-pocket expenses.

As we said, most of the more partisan economic measures would likely require one party controlling both Congress and the White House to be enacted. Trade policy and tariffs, however, could be implemented more easily via Presidential executive action. This remains one of our key risks to watch heading into 2025.

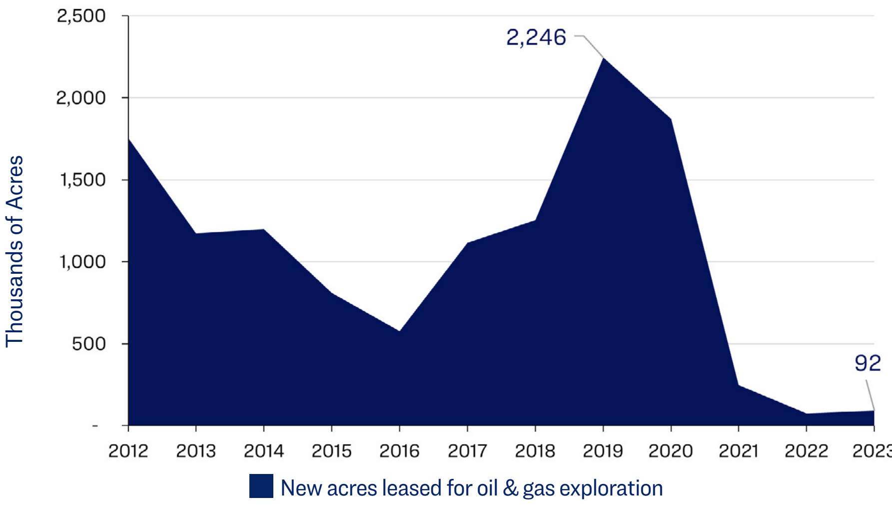
If Trump wins, our view is that a ramp up in trade tensions would offset any pro-growth benefit from further tax cuts. It could induce volatility in equity markets, where large-cap companies have global footprints and where higher import prices could weigh on consumption. There could also be more volatility in fixed income markets, which could face renewed inflation. In this scenario, small cap stocks might outperform relative to large cap stocks, since the former generate most of their revenues domestically (~80%, relative to ~60% for large cap). It could also favor U.S. stocks relative to stocks from international developed and emerging markets. Higher tariffs would likely boost the U.S. dollar's fair value in the short-term, further reducing the attractiveness of non-U.S. stocks for U.S. investors.

The outcome of the election could also have more narrow impacts on specific industries such as banking and green energy:

- **Banking:** A Trump presidency would likely lead to less stringent capital rules, especially for small and regional banks. Financial stocks would stand to benefit through lower compliance and regulatory costs, more capital available to distribute to shareholders, and fewer balance sheet constraints. However, weaker banking supervision could also allow banks to accumulate excessive risks, which is what led to the Silicon Valley Bank collapse in 2023.
- **Green energy:** VP Harris would likely protect and expand the climate policies contained in 2022's Inflation Reduction Act, which allocated $369 billion to clean energy and decarbonization initiatives. Renewable energy companies, industrial businesses specializing in electrical infrastructure, and electric vehicle manufacturers would be direct beneficiaries. On the other hand, former President Trump has been an outspoken critic of the IRA. While fully repealing it would be challenging, he would likely seek to withdraw the power plant emission standards recently issued by the Environmental Protection Agency (EPA); that would favor power generation stocks. In addition, a Republican government would likely make much more land available for domestic oil-and-gas exploration, the pace of which slowed markedly during the Biden administration (Figure 4). That said, our view is that the energy sector would continue to be primarily driven by global demand and supply dynamics, in line with the lessons learned during the past two presidential cycles.

FIGURE 4

The pace of new oil and gas drilling has slowed markedly during the Biden administration.



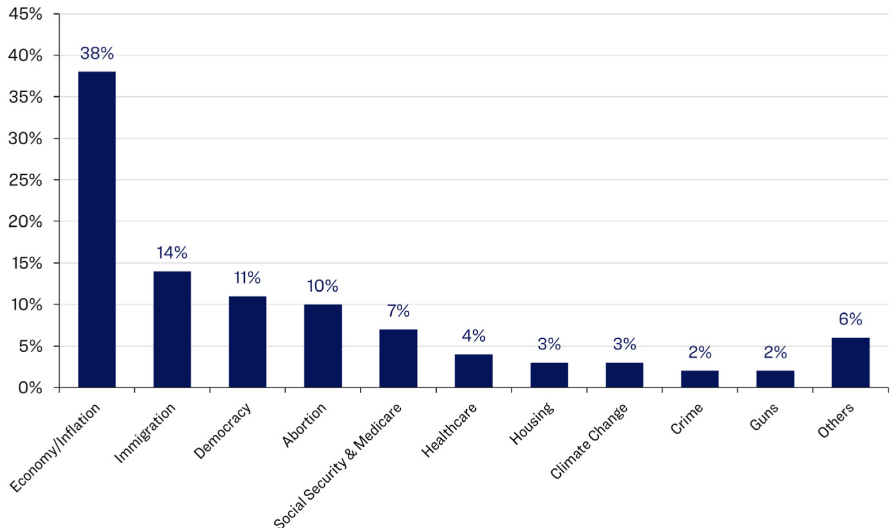
Source: Bureau of Land Management, TIAA Wealth Chief Investment Office

Immigration Policy

According to the latest Morning Consult/Bloomberg poll, immigration is the second single most important issue to voters (Figure 5). Therefore, we should expect increased attention to immigration reform and border security issues following the election, regardless of who is in the Oval Office. While Harris would likely adopt a middle-of-the-road approach—focused on limiting rather than blocking asylum claims at the border and supporting a broad immigration reform package that would require Congressional approval—former President Trump has pledged to deport millions of unauthorized immigrants and drastically reduce the flow of migrants into the U.S.

FIGURE 5

While the overall health of the economy remains the single most important issue, immigration is the second most important issue for voters.



Source: Morning Consult/Bloomberg Poll, TIAA Wealth Chief Investment Office

As we first discussed here, the Congressional Budget Office (CBO) estimates that the foreign-born U.S. population grew by 2.7 million and 3.3 million, respectively, in 2022 and 2023 and projects a net immigration flow of 7.7 million between 2024 and 2026. However, during President Trump's first term, the unauthorized foreign population was roughly flat, according to CBO data. If the net change in unauthorized residents fell to zero again during a second Trump presidency, we estimate that the labor force could have approximately 600,000 fewer people in 2026 than what is projected by the CBO (assuming labor force participation rates remain constant).

A smaller labor force could reduce the long-term growth potential of the U.S. economy, although the impact would likely be minimal in the near term. It could also stoke inflation, as immigration-driven population growth has tempered wage inflation. Restrictive immigration policies could tighten the labor market and exert upward pressure on wages, with two potential ramifications:

- If businesses are unable to raise prices to reflect higher labor costs, corporate profit margins would shrink. This could cause a decline in the average return on equity enjoyed by stockholders and thus in average equity valuations too.
- Alternatively, if increased costs are passed onto consumers, it could reignite inflation. Volatility would rise in the fixed income market, while businesses with strong pricing power could benefit.

Federal Reserve And The U.S. Dollar

We have also been focused on the potential impact that the election could have on the U.S. dollar, and we shared our thoughts in this recent Focus*Point*. Among the risks that we discussed in that report, the preservation of the Fed's monetary policy independence is key to supporting the dollar's role as the global reserve currency, and any attempt to impinge on it would likely lead to significant volatility across asset classes, and risk de-anchoring U.S. inflation expectations.

Conclusions

We view the U.S. election and its potential policy ramifications as just one of many possible market drivers for 2025, therefore increasing the importance of contextualizing any election-related view within the broader macroeconomic environment. Growing uncertainty about the trajectory of economic and labor market data, the ongoing monetary easing cycle by the Fed and other global central banks, and disappointing economic activity in China are only some of the crucial dynamics at play. As a result, we remain focused on the fundamental picture and how it might be altered by different political outcomes. In this regard, the election could present three different sets of risks and opportunities:

- **A unified government.** We view this scenario as potentially the most disruptive for financial markets. Were the same party to control both the executive and legislative branches, it would increase chances for larger budget deficits and more partisan fiscal policies.
- **A divided government.** Investors would most likely prefer this scenario, since it would lower the probability of rising budget deficits and higher corporate tax rates. However, it would also lead to more political brinkmanship and could cause many provisions of the TCJA to expire without being renewed at the end of 2025. It could also create volatility as the debt ceiling will have to be lifted once again, likely by the end of next summer.
- **Trade tariffs.** In 2018, the Trump administration implemented most tariffs under authority granted by sections 232 and 301 of the Trade Expansion Act of 1962, bypassing Congress. Given the significant ramp up in trade levies that are at the core of former President Trump's economic agenda, and the broad latitude at his disposal to act via executive power rather than Congressional approval, intensifying trade tensions could be a key development for markets in 2025.

The significant uncertainty surrounding the election and each party's economic agenda reinforces the importance of a disciplined and diversified asset allocation. Therefore, we recommend clients stay the course and remain anchored in their long-term investment strategies.

To learn more about how the 2024 U.S. presidential election might impact your financial plan, talk to your TIAA Wealth Management advisor today.

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[1] Market trades that are perceived to reflect the fundamental ramifications of a Trump presidency, including lower taxes and trade tariffs.

[2] Most of the changes introduced by the Tax Cuts and Jobs Act went into effect on January 1, 2018. Major elements of the legislation include reducing tax rates for corporations and individuals, increasing the standard deduction and family tax credits, eliminating personal exemptions and making it less beneficial to itemize deductions, limiting deductions for state and local income taxes and property taxes, further limiting the mortgage interest deduction, reducing the alternative minimum tax for individuals and eliminating it for corporations, doubling the estate tax exemption, and reducing the penalty for violating the individual mandate of the Affordable Care Act (ACA) to $0. Many tax cut provisions contained in the TCJA—including individual income tax cuts—are scheduled to expire in 2025, while many of the business tax cuts expire in 2028.

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