MFS Investment Management

2024
US Election Perspectives

Market Insights

SUMMARY

As we enter the final months of the 2024 election cycle, alliances are being formed, policy positions are crystalizing and those yet undecided are moving closer to their preferred candidate. In this preview, we'll put the election into historical context and highlight some of the key policy similarities and differences of the candidates. Tax policy will be a focus and will be heavily influenced by whether one party controls both the executive and legislative branches or if power is split between them. Tariffs and regulation are two other areas of focus. Both Republicans and Democrats have become more protectionist over the last decade, while the regulatory environment is in flux following a pivotal Supreme Court ruling early this summer.

While we feel it's important for investors to familiarize themselves with the policy proposals of the major party candidates, historically, electoral outcomes haven't had major lasting impacts on market performance. Markets have been able to withstand wars, recessions and even pandemics while prospering over the long term. Surprisingly, the historical stock market performance disparities are modest regardless of which party controls the White House and Congress. The best results tend to come during periods of divided government, but markets can react in unexpected ways, as they did in 2016. While it's tempting to get caught up in political narratives, investors would be wise to stay focused on their investment goals and objectives and keep politics out of their portfolios.

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Fiscal Spending and Tax Policies

The United States has run a fiscal deficit for nearly a quarter century, a trend which is expected to continue for at least the next decade. While deficits are a hot topic among Washington's deficit hawks and a small subset of voters, budget shortfalls tend to fly under the radar of most of the electorate. The pandemic accelerated already-high levels of spending, with more than $4.6 trillion of stimulus deployed during a three-year period, at one point pushing the deficit to over 15% of GDP. The impact on an economy flush with cash was clear: Both consumer spending and inflation surged.

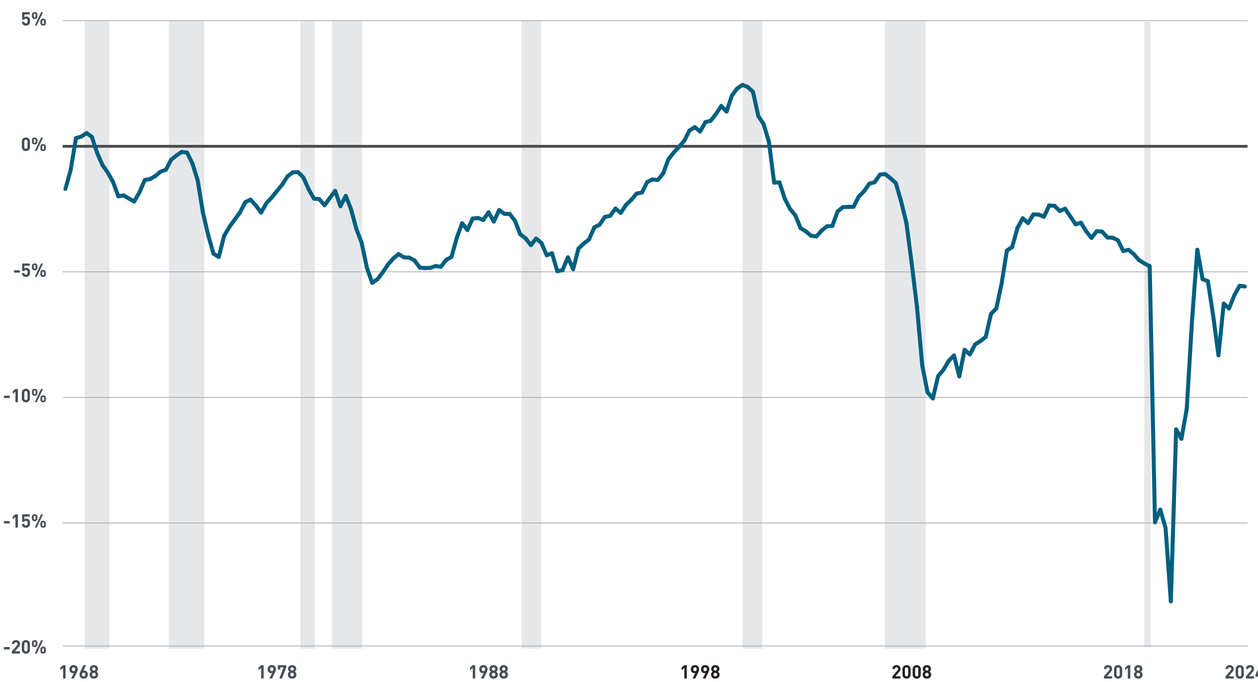
Regardless of who prevails in November, we expect both candidates would run substantial fiscal deficits. However, the nature of the candidates' spending priorities is quite different. Harris is running on a platform of $25,000 tax credits for first-time homeowners and a $6,000 credit for the families of newborns. She plans to raise the corporate tax rate to 28% from the current level of 21%. She also plans to address what she sees as price gouging by grocery stores, although the validity of the issue and the mechanism to correct it are unclear. Harris has also promised to raise the federal minimum wage and eliminate taxes on tips for restaurant and hospitality workers, an idea first proposed by former President Trump.

In addition to eliminating taxes on tips, Trump has pledged to extend and make permanent the Tax Cut and Jobs Act of 2017, passed during his first term and slated to expire at the end of 2025. The tax changes that reduced corporate taxes from 35% to 21% as part of this package will not expire, but those for individuals will. Strengthening and modernizing the US military is one of the former president's 20 key agenda items, so under Trump 2.0, we would expect defense spending, which has remained stagnant for years, to increase.

While some policies can be enacted by executive order, more significant changes require Congressional approval, making the composition of the next Congress a critical lynchpin.

EXHIBIT 1: DEFICITS REMAIN UNUSUALLY HIGH

US DEFICIT/SURPLUS AS % OF GDP



Source: Bloomberg. Quarterly data from 31 December 1968 to 30 June 2024. Shaded areas represent US recessions.

The Labor Market

The slowing labor market has come into sharper focus for the market. Here's how the two candidates might influence employment trends in the US.

Immigration

Economies run on labor, and labor requires headcount. Absent increases in productivity, an economy needs an expanding workforce to grow. If Trump is elected, he's promised to secure the southern border, decrease illegal immigration and deport millions of undocumented immigrants. Harris is running on a platform of securing the border while broadening legal immigration and creating a pathway to citizenship for those already in the country. In a country where the birth rate is below the replacement level, some amount of immigration is necessary to avoid the rapid aging of the working population and workforce shrinkage seen in many European countries and in China. Though immigration is a polarizing topic, in our view, the US economy is unlikely to thrive without it.

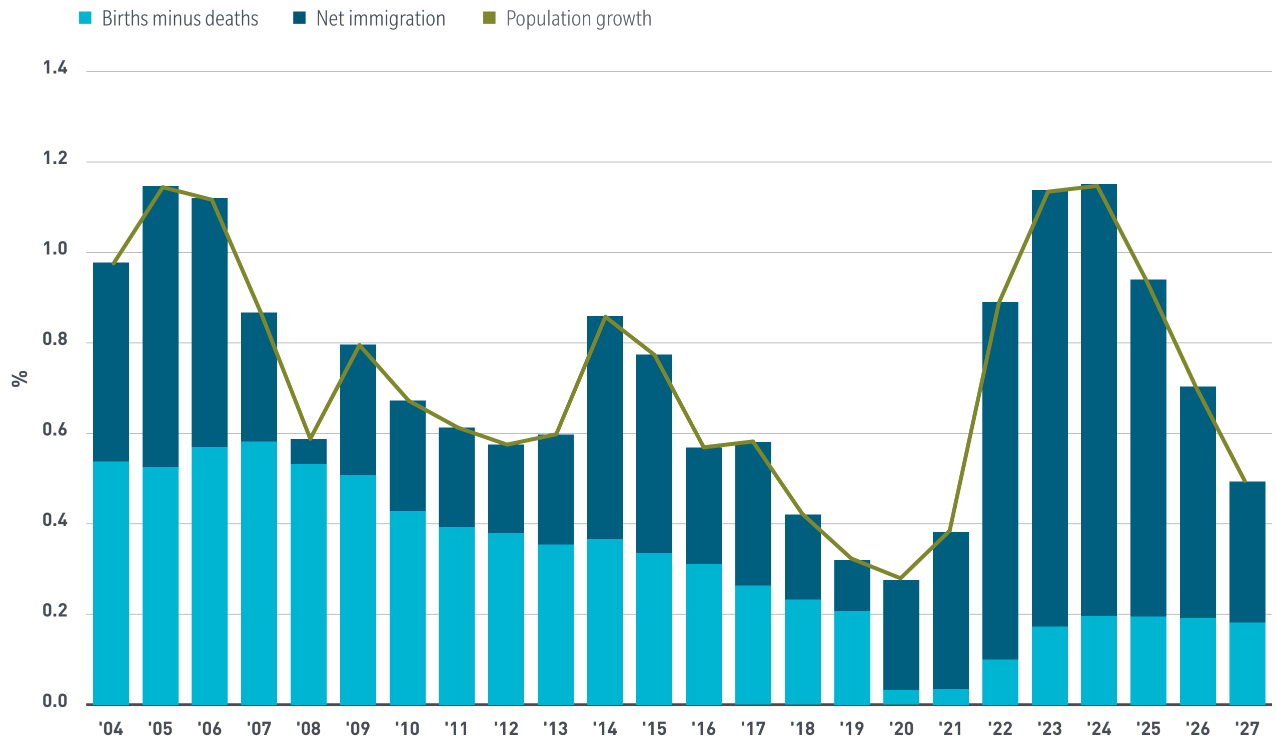
Unions

Democrats have historically won the union vote, but Trump's 2016 victory was secured by stronger-than-normal support from union members in key battleground states. For Harris to win, she will need to secure the labor vote, but will also need to convince other working-class voters that her economic plan will ease the financial strains they've felt over the past four years, something the administration she has been a part of has struggled to do.

Taxes on Tips

Both candidates have supported eliminating taxes on tips for service workers. However, most service workers do not make enough to pay income taxes, so the economic benefit from this policy is likely to be muted. Harris has suggested increasing the $2.13 federal subminimum wage for tipped workers. That wage has remained unchanged since 1991 and is much lower than the federal minimum of $7.25 an hour for non-tipped workers. While consumers pay most of tipped workers' wages today, raising the subminimum wage would increase costs for businesses, many of which are already struggling with higher labor costs for other positions.

EXHIBIT 2: IMMIGRATION AN IMPORTANT SOURCE OF LABOR SUPPLY



Source: US Congressional Budget Office January 2024 report, The Demographic Outlook: 2024–2054.

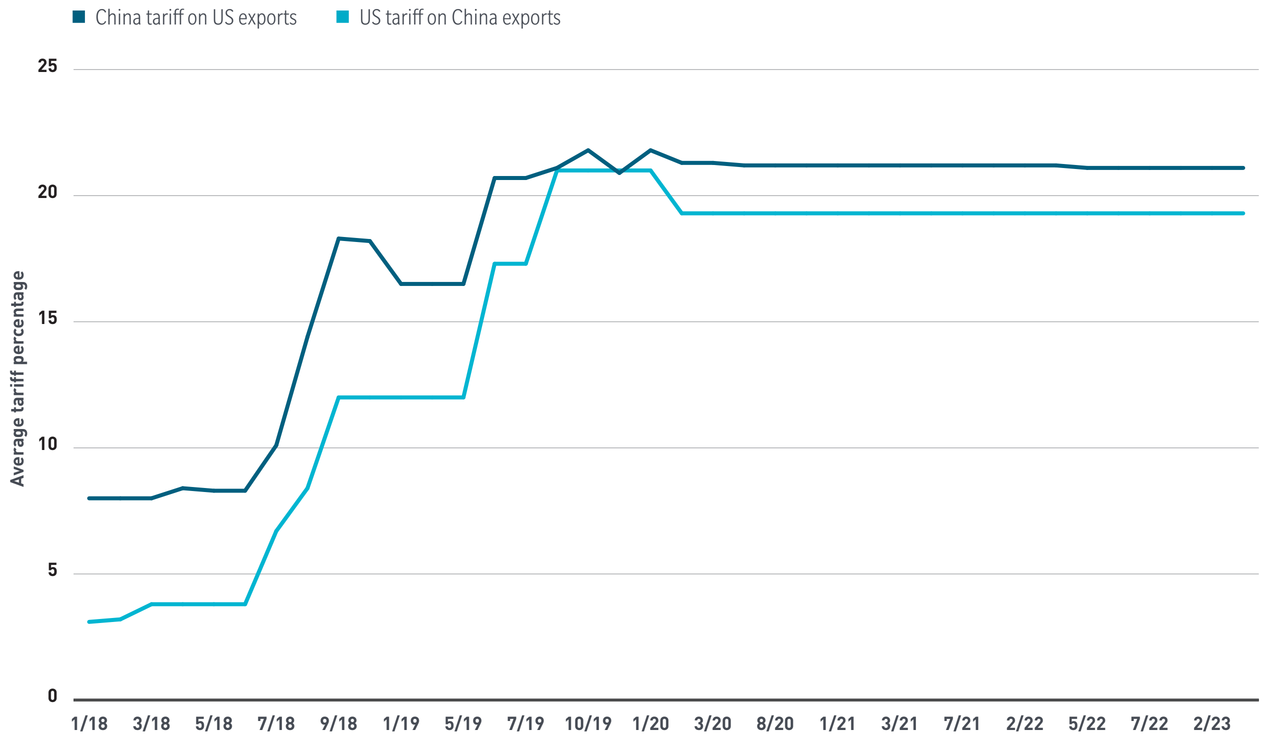
Tariffs Become Commonplace

While former President Trump implemented the most extensive use of tariffs since the 1930s, his successor, President Joe Biden, kept most of them in place and, with respect to China, even expanded them. We expect a second Trump term to bring an increased use of import duties to protect American industries and to use the threat of them as a foreign policy tool. Vice President Harris would likely keep the existing tariffs on Chinese goods in place but might be less motivated to place them on key trading partners such as the European Union, Canada and Mexico. Trump has proposed a 60% tariff on all imports from China and a levy of as much as 20% on goods imported from elsewhere. Harris has been less specific on tariffs but is expected to maintain existing duties on Chinese imports, in line with the policy of the Biden administration. Since the imposition of tariffs early in the first Trump term, many consumer cyclical companies have diversified their manufacturing bases away from China and into other Asian countries and Mexico. However, increased tariffs on goods from China would remain a headwind to economic growth.

Decades ago, tariffs were used to provide the federal government with needed revenue and to protect American industries and jobs. Today, proponents of tariffs also deem them necessary to protect American intellectual property. Regardless of their rationale and historical effectiveness, the levying of tariffs in today's global trade environment will likely continue to be met with retaliatory duties by affected countries, hampering global trade and potentially increasing costs to the consumer over the long term.

Tariffs can be effective in specific cases, but their cumulative effect usually results in higher prices for Americans, lower economic growth and increased geopolitical tensions. Lastly, over the past 100 years, Congress has ceded more and more power over tariffs to the executive branch, and we would expect the candidates to take advantage of this authority to enact their individual agendas.

EXHIBIT 3: AN EYE FOR AN EYE



Source: Bloomberg, average tariff rate, monthly from 1/31/2018 through 4/1/2023.

Contrasting Approaches to Regulation

Harris's agenda is centered around regulating costs for consumers.

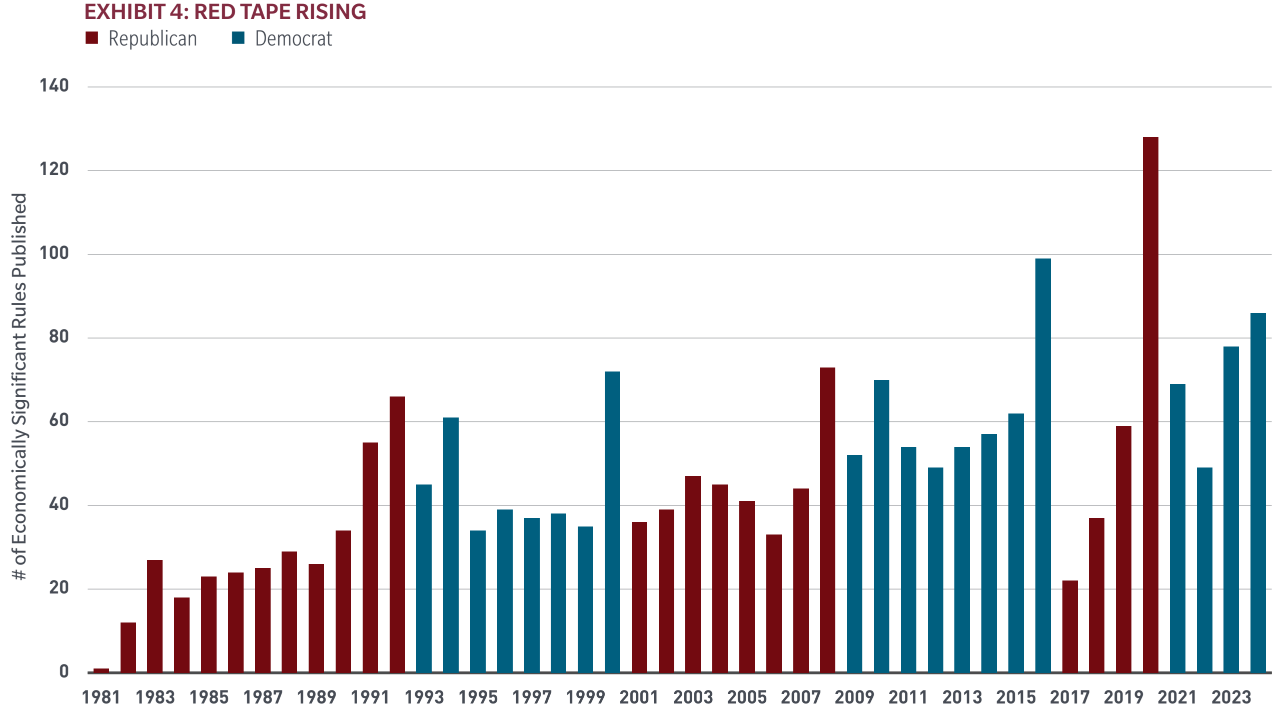
- **Housing** – Harris has pledged to reduce regulation to stimulate construction of new homes, provide financial support for first-time buyers and create programs to boost affordable rental housing. These policies are positive for homebuilders and construction material companies.
- **Groceries** – She has said she will enact price controls and prevent large mergers in the grocery industry. Historically, price controls have led to decreased investment and lower competition, which could have the opposite than intended effect on prices.
- **Health Care** – The vice president wants to cap "out of pocket" prescription medication costs and remove preferred Medicare price negotiation rules for biologics, potentially benefiting drug companies that specialize in small molecule drugs.
- **Energy** – Harris is pro renewable energy while her policies toward the fossil fuel industry are seen as neutral to negative for the sector, though she has backed away from earlier support for a ban on fracking.

Trump seeks to reduce regulations that stifle economic growth.

- **Climate** – Trump would leave the Paris Climate Accord and eliminate Biden's 2023 emission regulations, both of which would be harmful for renewable energy companies.
- **Energy** – He promises to reduce red tape for drilling and pipelines. While this would benefit midstream companies, and could initially benefit exploration and production companies, reduced regulation could eventually hurt them by increasing crude supply and driving down prices.
- **Manufacturing** – The former president's use of tariffs could encourage US manufacturing, though he could potentially defund portions of the Inflation Reduction and CHIPS Acts. That would leave a mixed bag for companies tied to non-residential construction.
- **Banking/Finance** – Trump wants to reduce regulations on private companies seeking to raise capital and to promote pro-cryptocurrency policies. Efforts to curtail Dodd-Frank regulations could benefit financial institutions by lowering their compliance costs but increasing the risks to a boom/bust cycle for banks and consumer lenders.

While presidential administrations have traditionally had wide latitude in imposing regulations, recent Supreme Court decisions could potentially increase Congress's role in setting the regulatory agenda at the expense of the executive branch. How much of the campaign's rhetoric will come to fruition? PolitiFact reported that only 23% and 28%, respectively, of the policy promises that Trump and Biden made during their first campaigns were kept. Time will tell, but we don't believe investing based on campaign rhetoric is a sound philosophy.

EXHIBIT 4: RED TAPE RISING



Source: George Washington University Regulatory Studies Center. 2024 data is through May 2024. Each year is a presidential year (February to January).

Divided Government a Positive for Stocks

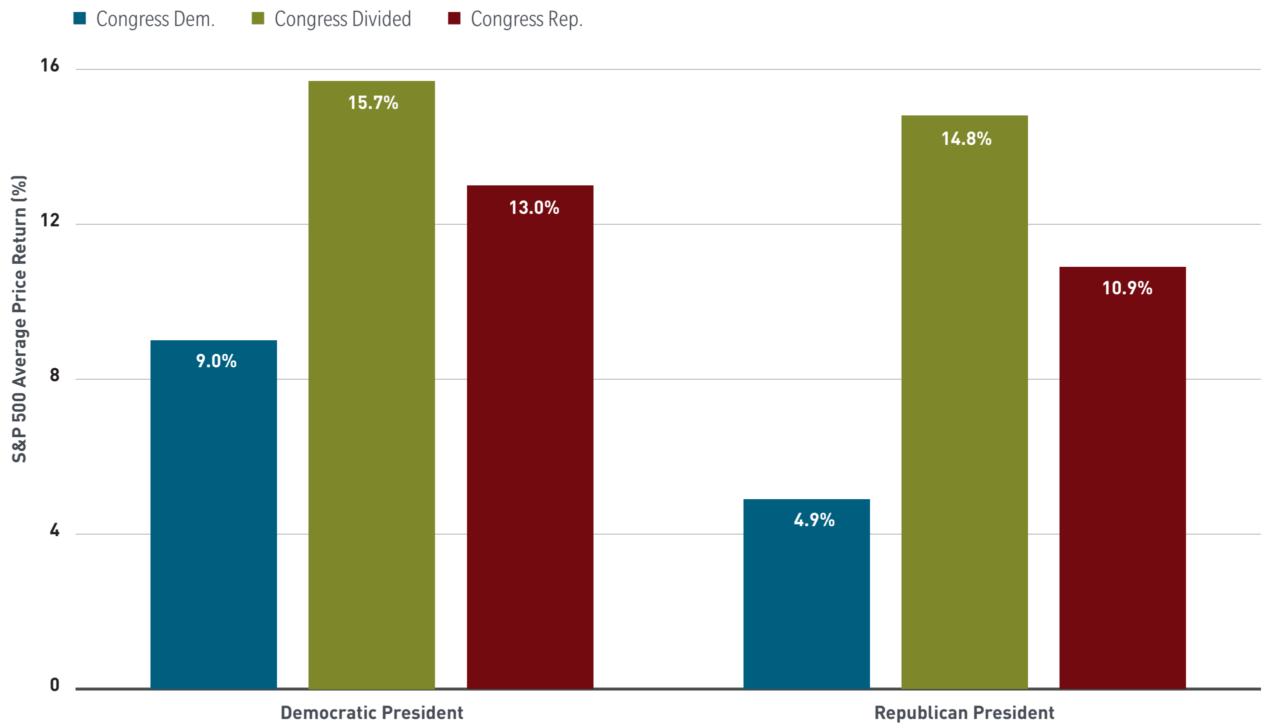
Our research shows that US equity returns have historically been strong in presidential election years, averaging 7.5% since 1928. In our opinion, the second-best year for returns typically come in the last year of the four-year presidential cycle, with most of the returns generated in the year's second half. But what's most surprising is that stock volatility, as measured by annual standard deviation, is nearly identical during election years and non-election years, going back to 1928.

Markets hate uncertainty, and that tracks with the fact that they perform better in the fourth year of a president's first term than that of a lame duck president. However, this is an unusual election given Biden's atypical lame-duck status, so we can potentially rip up that script.

Historical analysis shows that equity markets don't have a strong preference for which party controls Congress. The reality is that the best performance has been achieved with a divided Congress regardless of who is in the White House because having checks and balances in place between the branches of government helps prevent the passage of overly ambitious policies which can create uncertainty and volatility in the markets.

While presidential elections matter to the economy and the markets, we believe they matter less than most investors think. Presidents may influence inflation, but they don't control supply chains, the velocity of money or base effects. They can propose tax rates, but they can't anticipate how companies and the public will react to them. And while they may govern during a bull market (and hope to take credit for it), there are many factors that determine the fate of the stock market that are outside of the control of politicians. This election is important, but in our view, rigorous fundamental analysis of companies and markets will have more to do with investor outcomes than political analysis.

EXHIBIT 5: MARKETS PREFER DIVIDED GOVERNMENT



Source: Bloomberg, annual data as of 30 December 1932 to 29 December 2023. Price returns are in USD.

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