TIMOTHY F. CREEDON, CFA
Director of Global Equity Research

RAHEEL SIDDIQUI
Senior Investment Strategist

U.S. Election: Near-Term Turbulence, Long-Term Questions

A close election could see increased U.S. equity volatility followed by a relief rally, while resulting policy impacts could take time to play out and may be affected by fiscal constraints.

As the U.S. presidential election approaches, we see a sharply divided nation that is close to evenly split between the two major parties, with very different views for the future reflected in policies on taxes, energy, spending, global engagement and more. Polls have been volatile, as is often the case during close elections, and it is possible the election could remain contested until its closing days, with results coming down to a handful of swing states.

What does this mean for market behavior over the coming months and beyond? Think of election years as a tightly wound spring. As tension driven by uncertainty increases, markets are likely to experience volatility and then show relief once the outcome—whatever it may be—becomes clear. In the case of a competitive election like this one, that tension is greater, and thus the market turbulence and relief rally could be as well.

At the same time, it bears remembering that the ultimate drivers of market behavior are fundamentals—economic growth, earnings, inflation and interest rates—all of which could be affected by policy preferences of the two candidates.

An Election Like No Other

The current U.S. presidential election is one like no other in modern memory. What started out as a close rematch involving the two oldest major candidates in history changed radically with President Joe Biden's weak debate performance, the assassination attempt on Donald Trump and, ultimately, Biden's withdrawal from the ticket—seemingly with Vice President Kamala Harris replacing him as the Democratic standard-bearer.

Even given such major developments, we believe this could remain a tight race. Through Biden's withdrawal, Trump maintained a narrow polling advantage, both on a national level and in most of the crucial swing states that will likely decide the election result (generally considered Georgia, North Carolina, Michigan, Wisconsin, Pennsylvania, Arizona and Nevada). In the limited number of polls against Harris, Trump continues to lead within or near the margin of error—although the differences could narrow in the coming weeks as voters become acclimated to their new choice of candidates.

Despite her low approval ratings, Harris now has the opportunity to redefine herself as the Democratic standard-bearer. She would not be hampered by the age issue, and as a former prosecutor, could prove more of a challenge for Trump in the presidential debate scheduled for September. She has also been an effective administration spokesperson on abortion, which is a key galvanizing issue for Democrats. That said, she only briefly generated momentum in the 2020 primary campaign and dropped out before any votes were cast.

Importantly, many people have only recently started to follow the election, and there remains potential for still-more game-changing events, whether tied to Trump's legal troubles, unrest over Gaza, geopolitical tensions or an unexpected recession, to name a few. The economy has been a key issue for voters, and meaningful changes in inflation and unemployment data could help drive sentiment to one candidate or the other.

POLLS ARE TIGHT AND COULD GET TIGHTER
Trump vs. Harris RealClearPolitics Polling Average

Source: RealClearPolitics, as of July 24, 2024. Includes polls conducted July 5 – 23, 2024.

Issues on the Table

Even with Biden's withdrawal, we anticipate little change in the Republican and Democratic positions on policy—with many contrasts, but also some striking similarities.

Key among the differences is **taxes,** with the GOP seeking to extend—and expand upon—the lower income tax rates established under the Tax Cuts and Jobs Act of 2017. The Democrats would likely seek to allow personal rates to sunset as scheduled after 2025, but raise the tax burden on wealthy Americans while protecting those with lesser incomes. Corporate earnings would also be in their crosshairs, as they would look to not only enforce a global minimum corporate tax, but raise the U.S. corporate rate.

The two parties' approaches to **energy and climate** are also strikingly different, with Democrats wishing to make good on pledges to slash carbon emissions through the development of wind and solar while seeking to curtail oil and natural gas production and the use of traditional gas vehicles. Trump, in contrast, would seek to accelerate domestic energy production by expanding access to federal lands for drilling and reducing red tape. However, recent clean energy spending may be hard to curtail as many projects are in motion, including in Republican-dominated states.

Immigration is arguably Trump's signature issue, and he would look to reimpose many of the limitations established at the border during his first term while potentially seeking to deport many of those who have arrived since 2020. The current administration has been reluctant to act on immigration, in part due to objections on its progressive flank, but recently has become more hawkish, issuing an executive order to halt amnesty applications when border-crossings reach a certain level.

The Democrats and Republicans are on common ground when it comes to **China,** with the current president recently initiating new **tariffs** on certain goods and Trump on record as favoring high levies on electric vehicles. However, Trump has also talked about imposing 10% tariffs more broadly on foreign goods, and in general could take a more transactional approach to international issues, in contrast to the Democrats' affinity for coalition-building. The former president is more skeptical about Ukraine and would look to further pressure NATO members to fund their own defense.

Despite the campaign rhetoric, both parties appear reluctant to address the rapidly growing fiscal **deficit,** and in particular to tackle **entitlements.** On business in general, Trump would probably continue his past efforts to reduce **federal bureaucracy and regulation,** while Harris seems to share Biden's preference for greater government involvement in the economy, which she could be expected to continue over the next four years.

While positions on these and other issues (abortion, health care, etc.) may move the dial for certain constituencies, questions about character and experience may have an impact as well. Ultimately for many U.S. voters, the choice could largely be impressionistic: based on which candidate they perceive as more capable of leading the country out of currently perceived weakness and division.

What to Expect From Markets

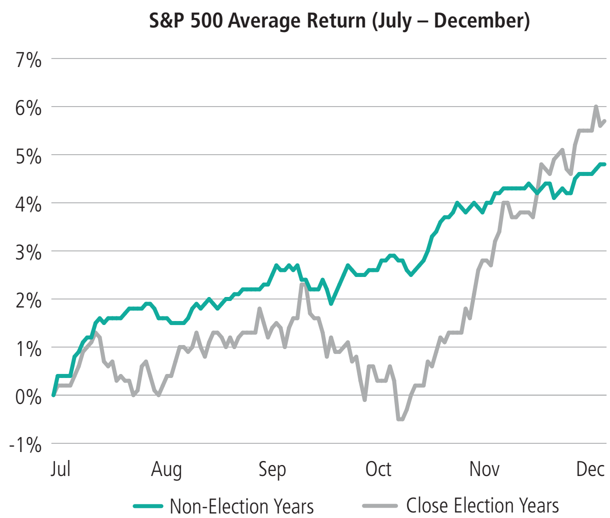
Although it may dismay political junkies, most voters do not focus on the election until after the summer months, and by the same token, most investors don't pay much attention either. Rather, the latter tend to focus on typical bread-and-butter market drivers such as inflation, interest rates, economic growth and earnings. This often changes after the Labor Day holiday, when on average equity market volatility increases.

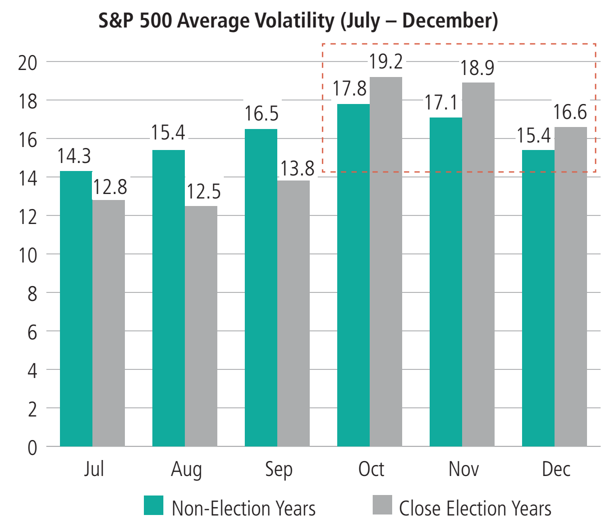
When it comes to volatility, it can be useful to distinguish between predictable and close elections. In a predictable election, where one candidate maintains a sizable polling advantage over the other, we've found that the stock market year isn't generally much different from any other, moving based on the usual fundamental and/or technical factors that influence markets. Rather, it's close elections, akin to the current one, that may deviate from the norm and produce the higher-than-average volatility noted above.

This phenomenon is evident from historical data. As shown, the average performance of the S&P 500 Index in the early months of close election years since 1945 has essentially mirrored that of non-election years. However, starting in September, the market in close election years may move downward for a month or so before starting to advance again as investors become more confident in the outcome.

CLOSE ELECTION YEARS HAVE SEEN INCREASED VOLATILITY FOR STOCKS AROUND THE ELECTION AND THEN A REBOUND ONCE THERE IS CLARITY

S&P 500 Index Around Close Presidential Elections Since 1952





Past performance is no guarantee of future results.

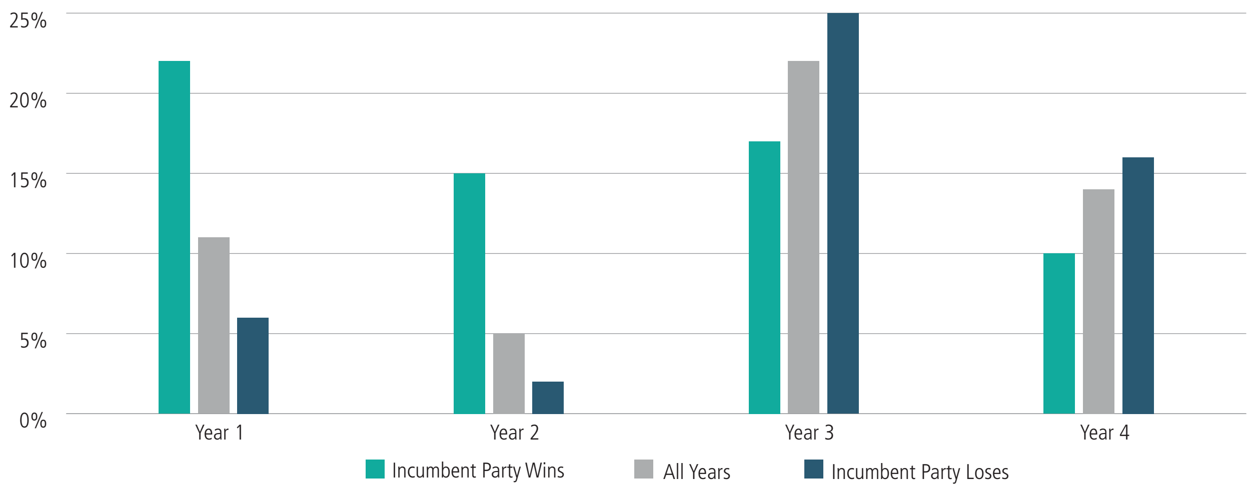
Source: Neuberger Berman and FactSet. Data as of June 20, 2024. Close election years include 1952, 1960, 1968, 1976, 1980, 2000, 2008, 2016 and 2020. Non-election years include all other years starting in 1952. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal.

Power of the Incumbent Party

Further out, the market impacts of the election may be more difficult to predict, given that economic and geopolitical issues can change the context in which the president must act. However, it may be instructive to note how the stock market has performed based on incumbent victory or defeat. As shown below, incumbent party victories have, on average, been followed by two years of strong S&P 500 Index performance relative to the two years after a challenging party victory. This is perhaps due to residual economic and earnings strength from stimulative election-year policies (see second display). The performance trend tends to reverse in years three and four, when the economy may fatigue after the "feast years" that helped to reelect the incumbent in the first place.

PAY ME NOW OR PAY ME LATER

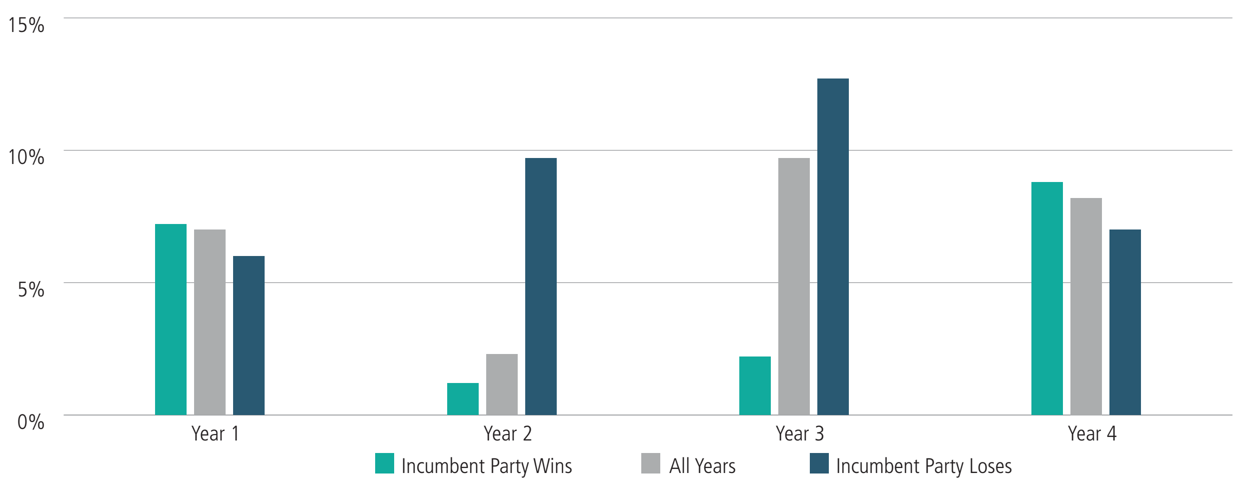
S&P 500 Index Presidential Year Performance (Median) After Incumbent Party Wins/Loses Presidential Race



Past performance is no guarantee of future results.

Source: Neuberger Berman Research and FactSet. Elections since 1952. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal.

S&P 500 Index Earnings-Per-Share Growth (Average) After Incumbent Party Wins/Loses Presidential Race



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Context Matters: United or Divided Government

Although it's useful to see how presidential elections have affected near-term market behavior, what comes afterward in terms of policy developments will likely be more important for investors. Along these lines, a key variable could be whether government leadership is united (with the House, Senate and presidency controlled by one party) or divided (with the House or Senate controlled by one party and the presidency by the other).

United government has historically led to broader policy achievements, and that could be the case this time when it comes to taxes and other budget-related matters. A Republican sweep this year should lead to an extension of the 2017 Trump tax cuts, while Democratic control could extend some tax breaks, which could be paired (as noted above) with higher levies on corporations and the wealthy. For many other issues, a narrow majority in the Senate (below the filibuster's 60-vote threshold) would limit the scope of action to executive orders, which presidents have used more frequently in recent years, but are facing increased scrutiny from the Supreme Court.

The use of executive orders would become especially likely with divided government, and could include actions on trade, immigration and regulation, to name a few. With a Democratic victory, we could see continued efforts to forgive student debt, enforce social policies, discourage energy exploration and speed up adoption of electric vehicles.

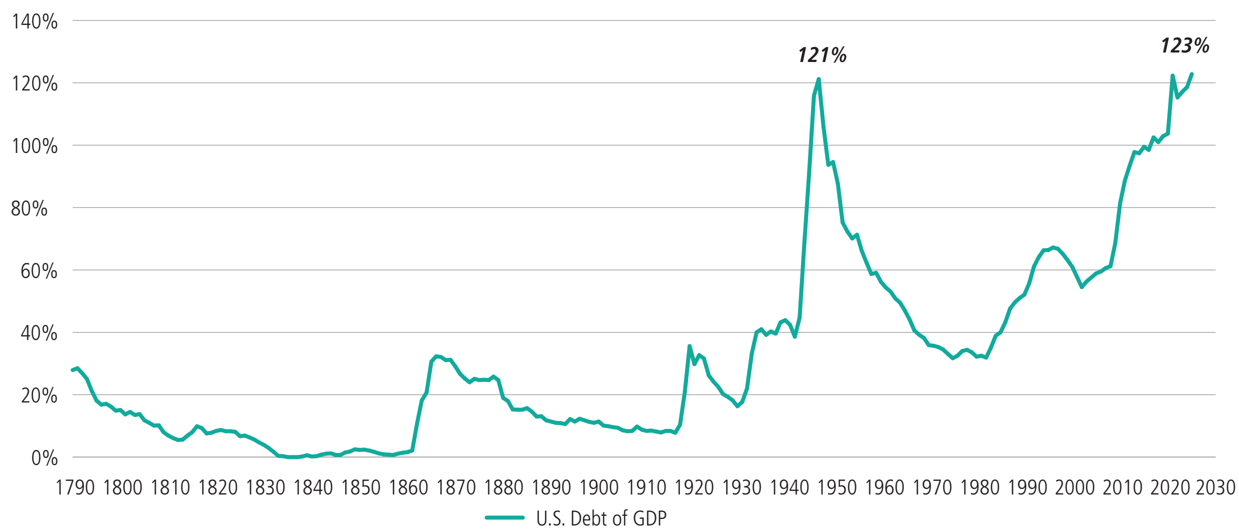
In the event of a Republican victory, we will likely see more aggressive action on the border, as well as the potentially broad use of tariffs to foster domestic manufacturing. Heavily regulated sectors like financials, energy and health care could also see meaningful (although not always predictable) impacts from Republican executive actions. Subsidies for clean energy may be difficult to roll back, given deepening demand for energy from electric cars and data centers. On antitrust, common ground on limiting the power of "big tech" may keep currently aggressive enforcement on track, although we would expect a Trump administration to ease antitrust enforcement in other sectors.

Fiscal Constraints and Implications

In thinking about the current election, we also believe it's important to differentiate between what may be election hyperbole and what each candidate may actually be able to accomplish when the next term begins. More than the last election, the government's level of debt and interest expense is a significant issue that may constrain spending ambitions.

THE U.S. GOVERNMENT DEBT BURDEN IS NOW HIGHER THAN EVER

U.S. Debt as Percentage of GDP



Source: Neuberger Berman and FactSet. Data as of March 31, 2024. Nothing herein constitutes a prediction or projection of future events or future market behavior. Historical trends do not imply, forecast or guarantee future results. Due to a variety of factors, actual events or market behavior may differ significantly from any views expressed or any historical results. Investing entails risks, including possible loss of principal.

At this point, it remains unclear if either side is willing to address the deficit, particularly as the candidates have pledged "not to touch" entitlements. There has been discussion of a bipartisan commission to enforce spending caps (like the commission that selected military bases for closure in the 1990s), but achieving such an outcome may be difficult. As such, it may be left to the markets to eventually force the two political parties to address the issue. When and how markets reach this inflection point is uncertain, though it could come via the pricing of longer-term government debt, which would then have trickle-down effects on other assets. (Look for our additional insights on this issue as the election approaches.)

Conclusion: Focus on Fundamentals

In sum, while investors should expect some near-term turbulence leading up to the election, we believe that economic fundamentals ultimately drive market performance.

The media has covered many key policy differences between the parties on taxes, immigration, climate change, tariffs, regulation and social spending, among others. As discussed, both may take a hard line toward China, commercially and geopolitically, although Harris would be more inclined to leverage international coalitions (including for Ukraine) while Trump may take a more transactional approach to foreign policy. Neither party seems eager to tackle the deficit beyond lamenting its size.

Regardless of their differences, the ultimate impacts on stocks will likely unfold gradually and be affected by myriad economic factors, making a focus on election-year effects an interesting but not altogether productive pastime for investors. Best, in our view, to focus on the underlying policy choices that could emerge once the election is over. Those could have a more significant impact even as both sides face a fiscal picture that is very different from past elections—suggesting the potential for pushback by bond markets as well as more elevated risk premia over time.

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Neuberger Berman
1290 Avenue of the Americas
New York, NY 10104-0001

www.nb.com