# Politics and **Your Portfolio**

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***"Leadership is not about the next election, it's about the next generation."***
– Simon Sinek, Best-selling author and motivational speaker on business leadership

## Executive Summary

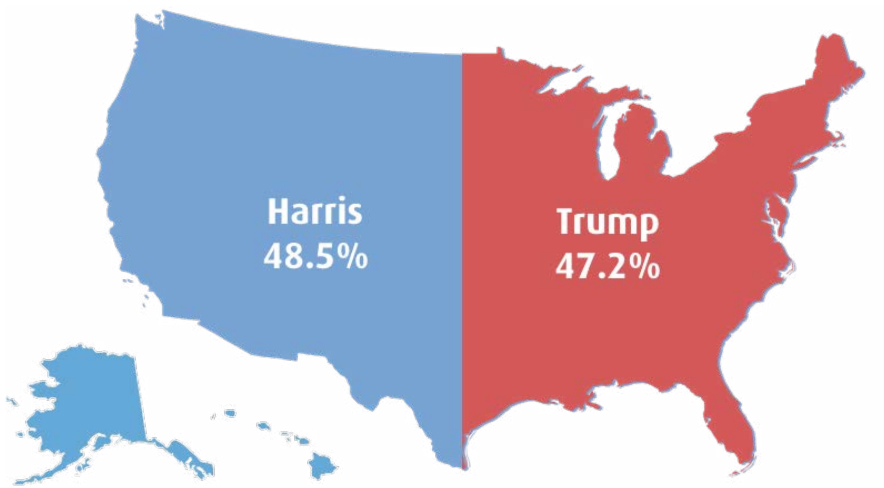
- The Outcome of the 2024 U.S. election will likely hinge on the results in just a handful of battleground states, including Pennsylvania, Wisconsin, Michigan, Arizona, Nevada, Georgia, and North Carolina. Polls have moved a bit in both directions in the wake of the extraordinary twists and turns of the past few months, but statistically remain a "dead heat."
- Though the bulk of the headlines (and polls) are focused squarely on the top of the ticket, the composition of each legislative branch matters too. Key tasks that Congress and the White House must hash through, include addressing the expiration of individual tax cuts initiated in the 2017 Tax Cut and Jobs Act by the end of 2025, and the renegotiation of the U.S., Mexico, and Canada Free Trade Agreement in 2026.
- Asset markets often prefer that the Executive Branch and one, or both, Houses of Congress are controlled by different parties, believing split governance leads to a more balanced approach than the left or right swing that can occur with a single party sweep. One nuance to splitting governance, however, is that the Senate is responsible for approving key cabinet and regulatory body heads, so it could theoretically make life difficult for a president from a different party.
- Both presidential candidates are espousing very different approaches regarding two core issues: tax and tariff policy. While the president does have substantial sway over tariff policy, tax legislation is the purview of Congress, so will entail negotiation and agreement between both branches.
- While it is tempting to want to tilt investment choices in anticipation of a particular election outcome, mixing politics and your portfolio has a poor record of success. Corporate America — and the markets that reflect it — has survived dozens of election cycles as well as numerous troubling headlines on its long-term march higher. Company progress, and ultimately portfolio performance, is much more closely tied to corporate fundamentals and economic cycles. There will be plenty of time to absorb and adjust to post-election shifts in policy as the Congress and the White House settles in for their new term in early 2025.

As the 2024 U.S. election nears, the two most frequently asked questions we are hearing from clients are: "What are the implications for the economy?" and "What should I be doing with my portfolio?" To help frame the issues, Michael Miranda, Head of Investments for BMO North American Private Wealth, recently convened a panel of BMO experts[1] to discuss the political, economic, and potential portfolio construction implications of the upcoming election.

One key throughline of the conversation was that *politics* do not drive long-term investment performance, *fundamentals* do.

There are numerous examples of prior election cycles where markets or specific industry sectors were expected to perform one way based on a specific election outcome, only to end up in the exact opposite direction after the fact. That said, there are several key fundamental issues up for debate in the next couple of years which will undoubtedly be influenced by the party composition of the Executive and Legislative branches. These include reinstating or letting expire some of the Trump-era tax cuts (Tax Cut and Jobs Act of 2017 expires in 2025), and renegotiating the United States-Mexico-Canada Agreement (USMCA) which faces a built-in automatic review in 2026.

**Chart 1: Head-to-Head Popular Vote (9/25/2024)**




Source: Silver Bulletin

Once this year's results are tallied, a deeper dive into potential policy implications can truly commence. In the meantime, we explored some of the key policy issues that both parties are putting forth, and we discuss these in our first two sections: "Political Backdrop" and "Policy Backdrop".

Staying focused on building sturdy portfolios that can participate in a variety of economic outcomes helps to ride through volatility. Because we believe in the overwhelming weight of historical evidence that *politics* do not drive long-term investment performance and *fundamentals* do, sections three and four outline our views on the "Economic Cycle – Current and Prospective" and "Portfolio Implications" for investors.

## Political Backdrop – Polls, Finances, and Battleground States

Despite a continual stream of utterly unexpected and unpredictable events, the race for U.S. President remains neck and neck in the most recent round of polls, according to BMO Financial Group's Head of U.S. Government Affairs, Ashley Ellefritz. Polls conducted just after the second presidential debate (Chart 1) between Vice President Harris and former President Trump show the Vice President ahead of former President Trump by roughly 1.5%. This is a large (in political terms) swing in momentum as the Democrats have moved up by 3-4% from where the ticket stood under President Biden. However, any lead remains well within the margin of error on both sides. Further, the unique attributes of the U.S. Electoral College system gives Republicans a slight natural advantage due to the number of low-population states that historically vote Republican. It is surmised that the Democrats' lead in the polls needs to be greater, all things considered, to reflect the ultimate results more closely.

There is great distrust for poll results amongst most of the electorate given the wide divergence between what polling showed going into the final days of recent elections and the ultimate outcome. Fewer and fewer voters – especially in younger age cohorts such as Millennial and Gen Z – are participating in polls altogether.

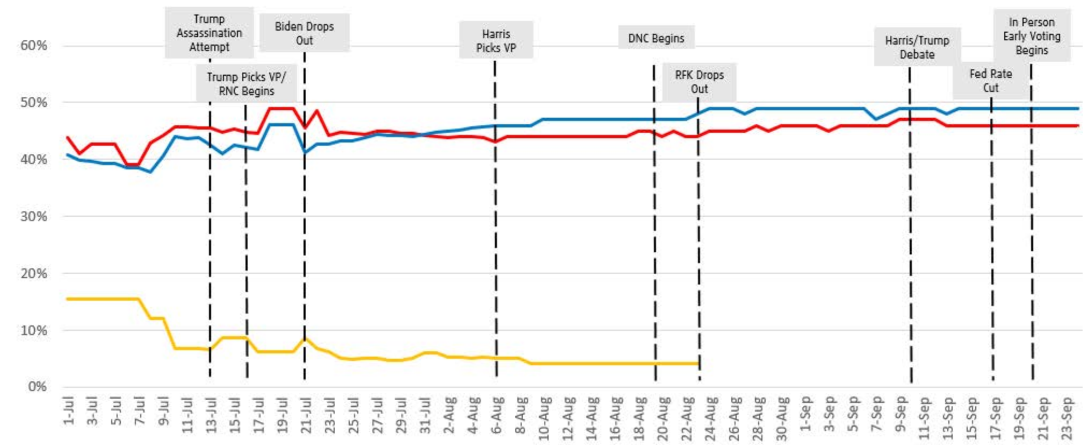
Polling results have moved notably for the Democratic party on some key events of the past several months (Chart 2), including:

1. President Biden's exit
2. Kamala Harris solidifying the nomination and notable fundraising success
3. The Democratic Party National Convention and selection of Governor Tim Walz as her running mate
4. Vice President Harris' performance in the second presidential debate

Chart 2 also illustrates the steadiness of former President Trump's poll numbers. The biggest take away is perhaps the notion of how entrenched core members of each party's base are, helping reiterate that this election will come down to a fierce contest for turnout and courting of a very slim minority of as-yet-undecided voters – particularly in battleground states.

Ms. Ellefritz projects that polling science has gotten better since the last election. Key unknowns, especially in swing states, could be other ballot issues that drive turnout (e.g., reproductive rights, local environmental issues) and demographic changes. There are projected to be millions fewer older, potential voters at one end of the age spectrum than there was in the mid-terms or the 2020 elections, while 41 million Gen Z will be eligible to vote this go 'round, which is 8 million more than the 2022 mid-terms[2].

**Chart 2: Trends in the Popular Vote**




Source: Real Clear Politics

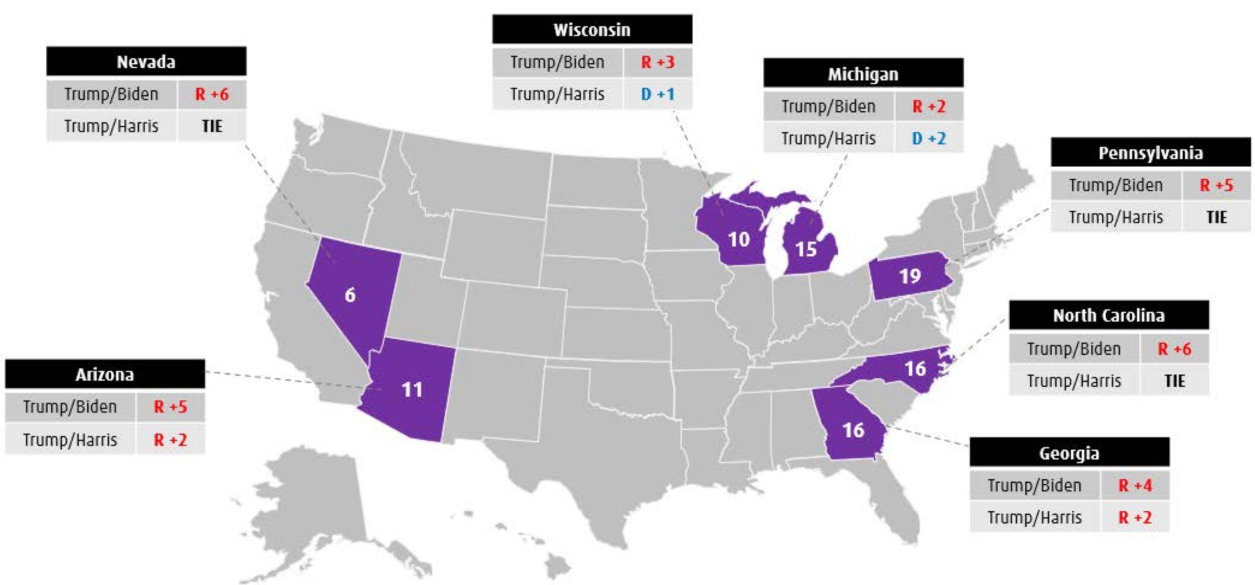
While current polls show Vice President Harris slightly ahead in the popular vote, the path through the Electoral College is far trickier, with the election coming down to results in just a handful of battleground states (Charts 3 and 4).

It often surprises many that U.S. elections are not won simply by a majority of the popular vote – they are won by the candidate that obtains at least 270 of the 538 electoral college votes. Every election cycle has a handful of states that end up greatly influencing the presidential outcome, in part due to the number of votes those states contribute to the Electoral College and the way those delegate votes are cast is based on unique rules within each state. Two states split their votes pro rata based on the popular vote cast in that state, while in most others, all votes go to whichever party wins the popular vote. According to Ms. Ellefritz, the 2020 election, for example, was won by just 40,000 votes cast in three states.

This year, the battleground states are Nevada, Arizona, Wisconsin, Michigan, North Carolina, Georgia, and Pennsylvania. Pennsylvania, a moderate state winnable by either candidate, is deemed to be a must win on the road to the White House. Ms. Ellefritz notes that winning the Keystone State and its current 19 electoral votes (down from 20 after the 2020 census), has been a necessary win in each of the most recent presidential races.

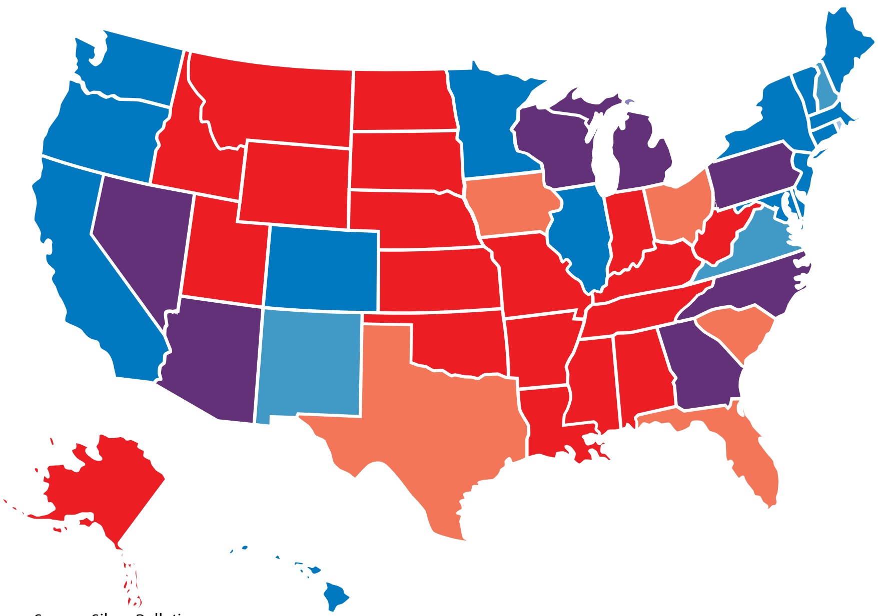
Each of the battleground states are currently polling within the margin of error for both candidates (Chart 3) which will undoubtedly lead to fierce battles, intensive advertising, and a lot of stump speeches for residents' hearts and minds. On this front, the substantial increase in donations to the Democratic campaign since Biden's exit are important, given the short, intense race to the finish line, funding and infrastructure, especially in battleground areas will be vital.

**Chart 3: Battle Ground States**




Source: Real Clear Politics

**Chart 4: The Path Through the Electoral College**



| | Segment Total | Party Total | Road to 270 |
|---|---|---|---|
| Safe Democrat | 181 | 226 | +44 |
| Lean Democrat | 45 | | |
| Battleground | 93 | | |
| Lean Republican | 106 | 219 | +51 |
| Safe Republican | 113 | | |

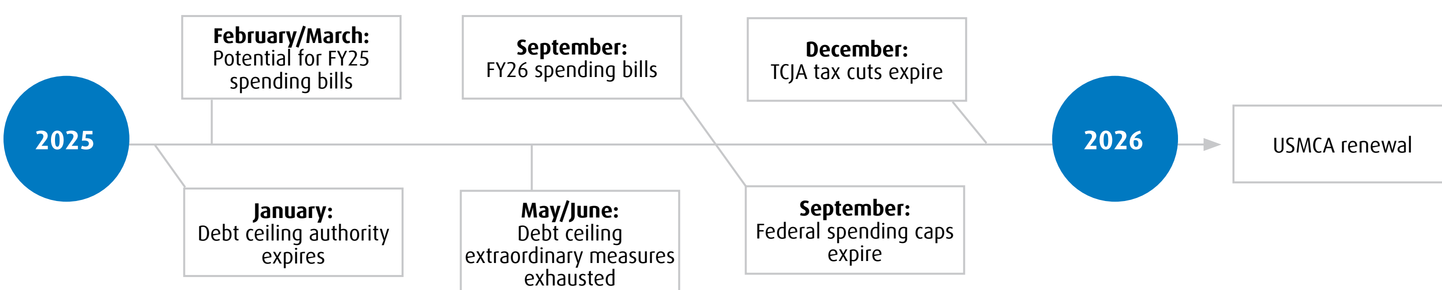
Source: Silver Bulletin

While the bulk of the attention has zeroed in on the presidential race, the composition of the Senate – where one-third of the seats are in play – is also critical to watch. Key administration cabinet posts, as well as many agency and ambassadorial posts, all require Senate approval. If Senate control is different than the party occupying the White House (gridlock) the cabinet confirmation process, and governing in general, can be slow or derail campaign promises and agendas.

As is the case in every election year, 100% of the House of Representatives is also on the ballot. In recent periods, the House has been nearly evenly divided making it tough to govern as assembling a winning coalition to get legislation passed has been challenging. The ability to successfully navigate the policy debates on tap in 2025 and 2026 (Chart 5) will be critical to how the U.S. economy evolves in the years ahead.

**Chart 5: The Legislative Horizon- 2025 and 2026**

**Looking Ahead:** How functional Congress and its leadership will be tested early and often in 2025, as major legislative milestones loom on the horizon.



## Policy Backdrop

When dissecting differences in policy positions, it is important to remember that much of the rhetoric that makes today's headlines are *campaign promises*. Turning those promises into legislative action is an entirely different game. The founding fathers built many, *many* checks and balances into the system for a purpose.

With that caveat, one of the most obvious points of difference between the two candidates relates to tax policy. It is important to reiterate that tax policy is squarely in the purview of *Congress* not the Executive branch. During our recent update call, BMO U.S. Wealth Chief Investment Officer Dr. Yung-Yu Ma, outlined core attributes of both candidates plans. He noted that Vice President Harris' plans are focused on creating a "Care Economy," and propose such steps as increasing child tax and earned income credits; expanding access to, and attributes of, the Affordable Care Act; removing taxes on tips; and installing credits for small business formation and first-time home buyers. To offset the cost of much of this, current Harris proposals suggest raising the top corporate tax rate, removing the cap on Social Security and Medicare taxes, increasing the capital gains tax rate and taxing share buy backs, as well as potentially removing the step up at death. **According to Dr. Ma, such moves, were they all to pass, would likely be viewed as moderately stimulative to the economy but potentially negatively by markets, given the increase to corporate and capital gains taxes.**

Former President Trump's stated plans are to make permanent many of the tax cuts first put in place with his signature Tax Cuts and Jobs Act (TCJA) of 2018. In addition to lowering the highest individual marginal tax rates and corporate tax rates, the TCJA increased the standard deduction and child tax credits, while putting caps on mortgage and other deductions, making it less preferential for individuals to itemize deductions (the so called "SALT" deductions). Many of the reductions in personal taxes expire at the end of 2025, though the Trump campaign has stated a desire to make them permanent[3]. Further, he has floated the idea of no tax on tips or Social Security payments and has put forth a desire to lower the overall corporate tax rate even further. **Dr. Ma noted that if all of former President Trump's proposals pass, markets would most likely view them in a neutral light. While investors would theoretically cheer a further reduction in corporate tax rates, the increase in fiscal deficits due to lower income receipts could conceivably worry others, most particularly the fixed income markets.**

Some estimates suggest that the combined cost of Trump's tax proposals could add up to $4 trillion to U.S. debt over the subsequent decade if enacted, while Vice President Harris' proposals would add up to $2 trillion.[4]

Another key point of policy debate relates to tariffs. Unlike tax policy, which is largely the purview of Congress, the Executive branch does hold substantial sway over tariffs. Should former President Trump regain the White House, they would definitely be back on the table – and, in short order. Trump has asserted an intent to impose 60% across the board tariffs on all goods coming from China, as well as noting a desire to impose 10-20% across the board tariffs on all imported goods to encourage domestic manufacturing and "Made in America" purchases. **Dr. Ma believes that given former President Trump's prowess as a negotiator these are likely opening bargaining positions that would ultimately be scaled back. According to BMO Wealth Management's analysis, even a 10% across the board tariff on all imported goods would only add 50 to 60 basis points to the overall inflation rate spread across two years (25-30 bps per year).** Despite the relatively benign long run, potential impact, markets could react negatively in the short run by reacting to headlines and negotiations as details were sorted out. Tariff policy as it relates to other key trading partners including Mexico – which is now the #1 U.S. trading partner – and the EU would undoubtedly be front-and-center of a second Trump term.

Other key policy issues that will be under the microscope in coming weeks as the election nears include:

- **Geopolitics and Foreign Policy** – for wars in Ukraine, the Middle East, support of Taiwan, and the approach to NATO and other EU efforts;
- **Funding the Government** – and how to pay for any special credits and spending, including dealing with entitlement spending;
- **Immigration** – security and tariffs at both borders, as well as H-B1 and other programs; and
- **Debt and Deficits** – no matter what the post-election composition, keeping the government open and figuring out how to pay for existing obligations, as well as any new ones put forth by a new set of legislators, will be a non-negotiable priority.

Some of these already have deadlines attached due to sunsetting of prior law. Others, including geopolitics and debt/deficits could conceivably be forced by markets, geopolitical tensions and/or economic unknowns.

## Economic Cycle – Current and Prospective

As noted by Stéphane Rochon, Equity Strategist and Managing Director for BMO Private Wealth Canada, **"The economic cycle always trumps the political cycle." And the present economic cycle continues to display durability as the unwinding of pandemic-era supply chain, employment, consumption, and production disruptions settle into new post-pandemic norms.** Inflation globally has come down markedly, even if in many places it is still not quite at the target core rate desired by Fiscal Policy leaders. The Bank of Canada and EU have already cut rates and the U.S. Federal Reserve began its own cutting path with a larger than originally expected 50 basis point cut to the policy rate at the culmination of its FOMC meeting on September 18.

In the U.S., the supportive impacts of trillions of dollars in fiscal stimulus packages (Inflation Reduction Act, CHiPs Act, Infrastructure Investment and Jobs Act) and the hundreds of billions being spent to build out artificial intelligence are helping support employment and business activity. Importantly, they are also having a favorable impact on productivity growth. Additionally, as pointed out by Dr. Ma (September – October Market Insights: Some (re)assembly required), **S&P 500 earnings growth remains positive and is set to accelerate in the coming quarters.**

## Portfolio Implications

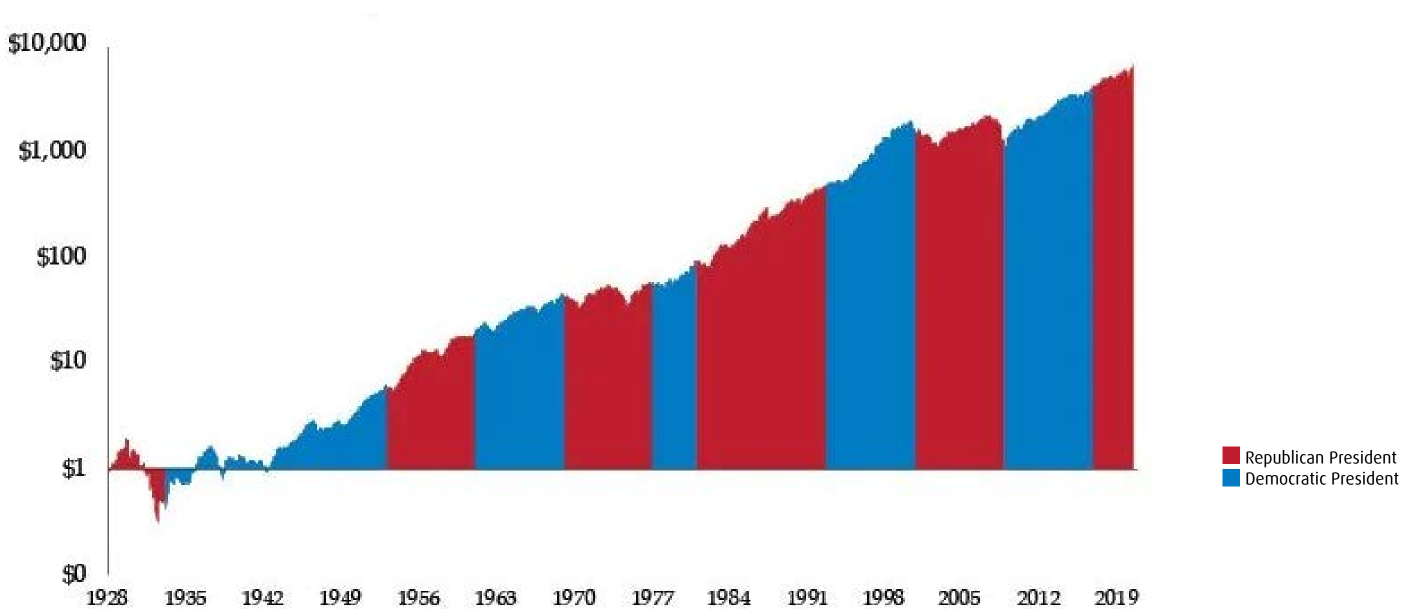
During our call, Brent Joyce, Chief Investment Strategist for BMO Private Investment Counsel, urged listeners to "keep politics out of your portfolio," as well as to keep emotions at bay despite the zigs and zags of headlines. **Trying to incorporate political outcomes into investment portfolios based on polling and predictions brings risks, but little benefit. Furthermore, with the race extremely tight, multiplying probabilities on top of probabilities yields a margin of error too great to contemplate, making changes to portfolios that can be sized meaningfully enough to deliver an impact on a risk-adjusted basis.**

Within just a few months we will have clarity on a number of issues including the path and an outline of central bank actions, the composition of the House, Senate and White House and another earnings season put to bed. As Chart 6 demonstrates below, markets have adjusted and persevered, irrespective of which party was in the White House. As long-term investors, it is important to keep a sense of balance and perspective as we focus on the next generation, not the next election.

Please speak to your BMO Private Wealth professional if you have questions, or would like to discuss your portfolio.

**Chart 6: Market Performance and the U.S. Presidency**

S&P 500 Total Returns: 1928 - 2023




Source: Standard and Poor's

[1] The panel convened on September 16, 2024, and included: Michael Miranda, Head of Investments for BMO North American Private Wealth; Ashley Ellefritz, Head of U.S. Government Affairs, BMO Financial Group; Dr. Yung-Yu Ma, Chief Investment Officer, BMO U.S. Wealth; Stéphane Rochon, Equity Strategist & Managing Director, BMO Private Wealth Canada; and Brent Joyce, Chief Investment Strategist, BMO Private Investment Counsel (Canada).

[2] 41 Million Members of Gen Z Will Be Eligible to Vote in 2024 | CIRCLE (tufts.edu)

[3] Tax Cuts and Jobs Act - Wikipedia

[4] How the Plans of Kamala Harris and Donald Trump Could Affect the Deficit (investopedia.com)

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