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How Will US Elections Affect Markets?

Morningstar index behavior in 2016 and 2020 is interesting to examine, but the honest answer is: who knows?

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It's often said that politics and investing don't mix, but that's not because political dynamics have no impact on financial markets. Taxing and spending, policy and regulation—these are all important variables that can affect stocks, bonds, currencies, and commodities.

But politics are just one of the many forces that move asset prices. Markets have thrived (and sometimes crashed) under administrations of all stripes. Plus, the emotions intertwined with political beliefs present behavioral challenges, undermining the type of rational, coolheaded decision-making that investing demands. Then there's the fact that political forecasting is tricky business. Predicting the reaction to elections ratchets up the degree of difficulty.

Those caveats won't stop us from contemplating the investment implications of US presidential elections in November 2024, principally by examining the behavior of various Morningstar benchmarks in the previous election years of 2016 and 2020. After all, this year's race offers the unique scenario of two candidates who have won before—unless the winner is somehow not named Trump or Biden.

Key Takeaways

- We shouldn't assume the presidential election of 2024 will cause unusual levels of volatility in the equity market. Overall, 2016 was actually less volatile than 2015. Brexit prompted a bigger market reaction by the US equity market than the 2016 presidential election, but the nearly forgotten flash crash of August 2015 saw a larger one-day decline. All pale in comparison to the gyrations of March 2020, during the pandemic panic.
- Small-cap value stocks rallied after both Trump's election in 2016 and Biden's in 2020, before large growth reclaimed its dominant position over the US equity market. Counterintuitively, technology ended up as the best-performing equity sector under Trump, and energy stocks have done best under Biden.
- When comparing US equity and bond market performance under the past four presidential administrations, we see that stocks did best under Trump and performed the worst under Bush. Equity returns under Obama were also very strong, and stocks have posted solid gains under Biden. Bonds did best under George W. Bush. The broader context is critical to examine, of course.
- Though the (presumed) candidates in 2024 are familiar, market behavior in 2024 will likely differ from 2016 or 2020. Circumstances have changed, and markets learn from the past.

Another "Trump Bump"?

As of late March 2024, Donald Trump led all presidential opinion polls tracked by 538, which is a political analysis and blogging platform. His prospects this year are far better than they were before the 2016 hustings. In 2016, Hillary Clinton was given a 71.4% chance of winning the presidency by 538's preelection forecast.

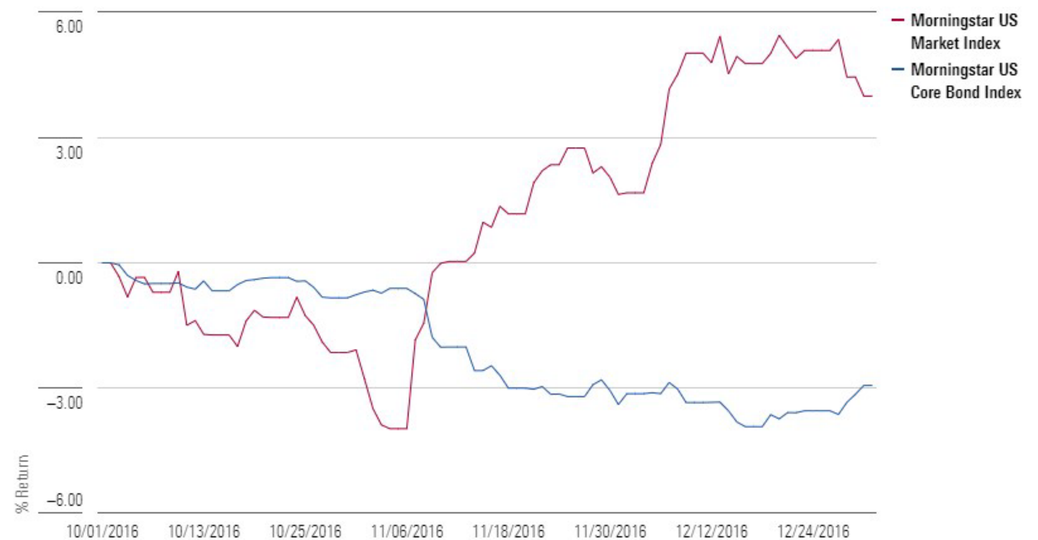
Despite this, market volatility in 2016 was actually lower than in 2015, measured by the standard deviation of daily returns. In election year 2016, the US equity market saw some large movements in daily returns, but not hugely unusual, as displayed in Exhibit 1. We found that on 20 separate trading days in 2016, the Morningstar US Market Index recorded returns in the top- or bottom-fifth percentile of daily returns for the previous 10 years, essentially the same number as in 2015. The biggest daily move of 2016 was prompted by Brexit in late June, when the United Kingdom's vote to exit the European Union surprised and unsettled markets. In 2015, the August flash crash accounted for the largest bump.

Exhibit 1 The Morningstar US Market Index Experienced Roughly the Same Number of Large Daily Moves in 2016 as in 2015

Source: Morningstar Direct. Black bars represent the top and bottom fifth percentile of daily returns for the 10-year trailing period through 2016.

Interestingly, the market fell in the runup to the 2016 election as Trump's prospects improved, only to soar after Trump won. Nov. 8, 2016, was a surprise for many. Clinton took the popular vote, but the Electoral College delivered the presidency to Trump. As displayed in Exhibit 2, the Morningstar US Market Index climbed after the election and finished the quarter up 4%—the so-called Trump Bump. The bond market wasn't as pleased by Trump's victory, as displayed by the Morningstar US Core Bond Index's postelection decline.

Exhibit 2 Fourth-Quarter 2016 Saw a Trump Bump for Equities, but a Bond Market Decline



Source: Morningstar Direct. Gross returns in USD displayed. Data as of Dec. 31, 2016.

The overall market direction, as well as market leadership, reversed after the 2016 elections. By the time of Trump's election, large-cap growth stocks had been on top for several years. The FANG acronym—for market leaders Facebook, Amazon.com, Netflix, and Google—was created in 2013. These highly profitable secular growth businesses were thriving amid a subdued economy and low interest rates.

Trump had campaigned on tax cuts, regulatory rollbacks, infrastructure spending, a protectionist trade policy, and economic growth above 4% (the US economy never grew more than 3% per year during the Obama years). Meanwhile, Trump's relationship with Silicon Valley was uneasy at best.

The market initially interpreted the 2016 election results as a boon for economically sensitive, domestically oriented companies in sectors like energy, basic materials, and financial services. Stocks like US Steel and Oasis Petroleum soared while Big Tech retreated. In what was referred to as a "postelection whipsaw," the Morningstar Small Value Index paced the market, as displayed in Exhibit 3.

Exhibit 3 US Small-Cap Value Stocks Were the Biggest Perceived Beneficiaries of Trump's 2016 Election

Morningstar US Market Barometer 2016

		Value	Core	Growth
	US Market 12.44%	20.79	14.20	3.16
Large	11.18	18.91	13.75	1.79
Mid	14.39	25.21	12.40	6.46
Small	20.25	27.96	23.63	9.61

Source: Morningstar Direct.

These same expectations also help explain the bond market's reaction to Trump's victory. The prospect of fiscal stimulus, in the form of higher infrastructure spending and tax cuts, heightened fears of inflation and interest-rate hikes. Existing bonds sank on the expectation of higher future yields.

What about global markets? Among the 45 equity markets that Morningstar indexes tracked in 2016, Russia was the big winner and Mexico the big loser following Trump's election, as displayed in Exhibit 4. The ruble gained and share prices on the Moscow Exchange rallied postelection, in response to the victory of a candidate who said he'd "get along very well" with Putin. By contrast, Mexico's stock exchange and currency declined sharply. Trump had a long history of disparaging Mexico and the US trade policy toward it. [1]

1 See: https://time.com/4473972/donald-trump-mexico-meeting-insult/

Exhibit 4 Russian Equities Soared and Mexican Stocks Plunged After Trump's 2016 Election

Source: Morningstar Direct. Gross returns in USD displayed. Data as of Dec. 31, 2016.

Ultimately, market expectations around the Trump presidency reset. Parts of Trump's campaign platform, such as infrastructure spending, failed to advance. Large-growth stocks resumed their dominance of the US equity market. In fact, in 2017, FANG was expanded to FAANG to include Apple. Technology was by far the best-performing equity sector under the Trump presidency. Technology stocks have also performed well under the Biden presidency thus far.

This rotation back to large-growth and technology-sector leadership in 2017 is instructive. Markets learn and adapt. If Trump wins again in November 2024, we shouldn't assume another small-value rally or bond market decline. A US president doesn't implement policy by fiat. Congress owns taxing and spending authority, while the Federal Reserve is an independent institution that oversees monetary policy.

Still Ridin' With Biden?

The 2020 US presidential election took place against the backdrop of an unprecedented shock. The so-called pandemic panic roiled markets in March 2020, as the coronavirus' arrival in the US prompted societal lockdowns. This made 2020 more than twice as volatile of a year for US equities than 2019.

Daily fluctuation data displayed in Exhibit 5 shows that 2020 was significantly bumpier than 2019, but the pandemic, not the election, was the biggest driver. We found that on 62 separate trading days in 2020, the Morningstar US Market Index recorded returns in the top- or bottom-fifth percentile of daily returns for the previous 10 years. In 2019, there were just 11 big swings. Most of 2020's biggest moves

came in March, though the pandemic continued to roil the US equity market into September and October.

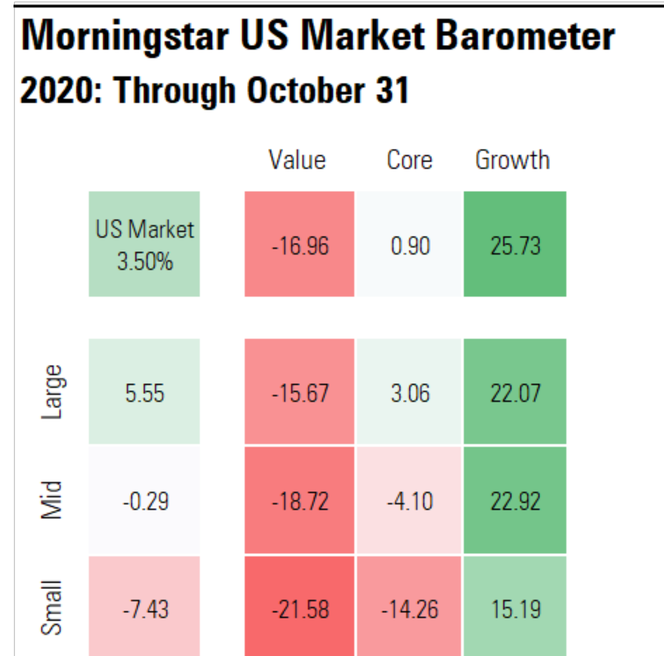
Exhibit 5 The Morningstar US Market Index Experienced a Significantly Higher Number of Large Daily Moves in 2020 than 2019—Because of the Pandemic

Source: Morningstar Direct. Black bars represent the top- and bottom-fifth percentile of daily returns for the 10-year trailing period through 2020.

Aside from causing volatility, the pandemic also served to amplify large-growth's primacy. As a result of lockdowns, society became wholly reliant on technology for work, school, and shopping. FAANG evolved to become FAAGM, with Netflix swapped out for Microsoft.

Meanwhile, 2020's economic losers clustered on the value side of the Morningstar Style Box and lower down on the capitalization spectrum. The energy sector was hit by falling demand; shockingly, oil futures went negative in April 2020. Banks battled low interest rates and loan losses. Commercial real estate suffered from people working from home. A new acronym, BEACH—booking, entertainment, airlines, cruises, and hotels—was coined for the market's pandemic victims. The gap between US growth and value stocks in the first three quarters of 2020 was the largest since the peak of the dot-com bubble in 1999.

Exhibit 6 The Pandemic Market Saw Growth Trounce Value and Small Beat Large



Morningstar US Market Barometer

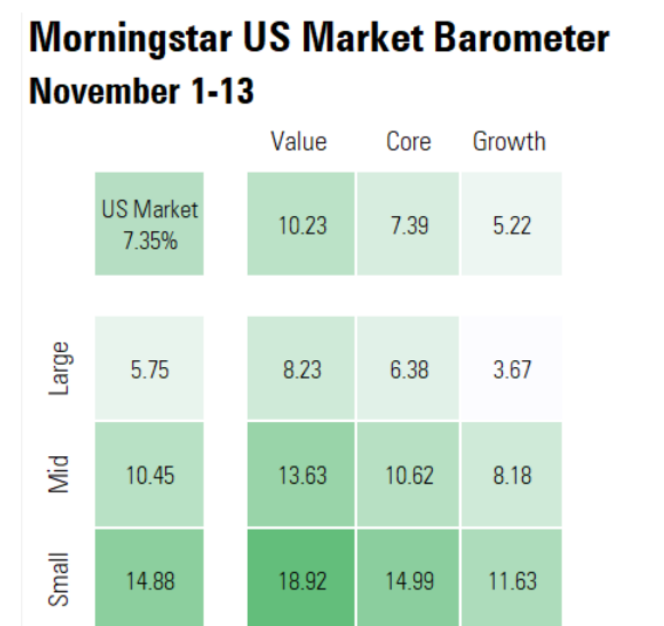
2020: Through October 31

		Value	Core	Growth
	US Market 3.50%	-16.96	0.90	25.73
Large	5.55	-15.67	3.06	22.07
Mid	-0.29	-18.72	-4.10	22.92
Small	-7.43	-21.58	-14.26	15.19

Source: Morningstar Direct.

The direction of the market then reversed around the November election that saw Biden prevail.

Exhibit 7 November 2020 Saw the US Equity Market Surge, Led by Small-Value Stocks



Morningstar US Market Barometer

November 1-13

		Value	Core	Growth
	US Market 7.35%	10.23	7.39	5.22
Large	5.75	8.23	6.38	3.67
Mid	10.45	13.63	10.62	8.18
Small	14.88	18.92	14.99	11.63

Source: Morningstar Direct.

The market ticked up after the election and continued rallying for the remainder of the year (and into 2021). Small-value stocks skyrocketed, just as they had after Trump's election. Again, the market was expecting stimulus from a new administration—the so-called reflation trade.

The rally wasn't just about the election, though markets were clearly relieved to see the end of a divisive campaign, and a clear winner. Pfizer and BioNTech unveiled highly encouraging results for a covid-19 vaccine on Nov. 9, raising hopes of the pandemic’s end. Not only did Pfizer, the fifth-largest constituent of the Morningstar US Value Index, take off, but so did the shares of many economically sensitive companies. Moderna's announcement of successful vaccine results one week after Pfizer further bolstered expectations that the BEACH stocks would be released from their pandemic hell.

The Morningstar Small Value Index had a very good year in 2021, but so did large growth. Then came a sharp market decline in 2022, prompted by generationally high inflation and sharp interest-rate hikes. The recovery that began in the fourth quarter of 2022—also spanned 2023 (with some bumps) and has continued into 2024—has largely been fueled by enthusiasm around artificial intelligence. The "Magnificent Seven" (Alphabet, Amazon.com, Apple, Meta Platforms, Microsoft, Nvidia, and Tesla), the latest iteration of FANG, is leading once again. Interestingly, though, the best-performing equity sector under the Biden presidency has been energy (led by oil and gas stocks), which is surprising given the administration's focus on renewables. High oil prices after Russia's invasion of Ukraine and pandemic-related supply/demand imbalances have contributed.

Who's Better for Markets?

Returns for the broad US equity and bond markets under the past four presidential administrations reveal a mixed picture. According to the tally in Exhibit 8, equity investors fared best in the Trump years and worst under George W. Bush. Equity market returns were very strong under Obama and have been solid under Biden so far. Bond investors, however, have suffered under Biden and long for the George W. Bush years. Of course, the broader context is critical to examine.

Exhibit 8 Among the Past Four Presidential Administrations, US Equity Market Returns Were Best Under Trump

Administration	Morningstar US Market Index - Annualized Return %	Morningstar US Core Bond Index - Annualized Return %
G.W. Bush (2001-08)	-2.3	5.8
Obama (2009-16)	14.8	3.8
Trump (2017-20)	16.3	4.9
Biden (2021-24*)	11.2	-3.4

Source: Morningstar Direct. Time frames above cover investment returns. *Market returns under Biden are as of March 31, 2024.

George W. Bush presided over a miserable era for US equities, despite massive tax cuts passed under his administration. The bursting of the dot-com bubble that began in early 2000 (under Clinton) was followed by the 9/11 attacks and recession in 2002. The market recovered in 2003 and enjoyed several good years, led by old-economy sectors (energy was the best performer). Value beat growth and small

beat large. Then, in 2007, came the financial crisis that made 2008 one of the worst years ever for investors. Bond investors fared well under Bush, however. Rates were cut in response to the economic troubles in the early 2000s and then again in 2007-08.

Barack Obama's administration started with the massive stock market recovery of 2009, which continued through 2010. Equities had a rough year in 2011 thanks to the European debt crisis, and then there was a congressional battle over the debt ceiling that contributed to an unprecedented downgrading of the US sovereign credit rating. But 2012 saw a bounceback, and by 2013, the FANG acronym was born. Communication services was the best-performing sector under Obama, with stocks like Time Warner Cable and DISH Network as the big winners. Growth beat value under the Obama years, though small caps outperformed large caps.

Donald Trump's numbers do not include the rally sparked by his election because he wasn't inaugurated until January 2017, but they do span three great years for stocks: 2017, 2019, and 2020. The tax cuts passed by Congress in late 2017 undoubtedly gave a boost to the market. Yes, the pandemic panic saw stocks plunge in early 2020, but they came roaring back that same year thanks to fiscal and monetary stimulus. Technology was the best-performing sector under Trump, with stocks like Apple, Adobe, and Nvidia soaring. Growth led value; large led small. The bond market benefited from interest-rate cuts in both 2019 and 2020.

Joe Biden's first year in office, 2021, was a great year for equities. Then both stocks and bonds crashed in 2022 because of the stubbornly high inflation and the sharpest interest-rate hikes in a generation. The recovery that started late that year, and continued through 2023 and the first quarter of 2024, was fueled by enthusiasm for AI and a surprisingly robust economy. Just as during the Trump years, technology stocks have performed well. But so too has the traditional energy sector, which is surprising given the administration's focus on renewables.

What Will the Rest of 2024 Bring?

One clear lesson from the past is that elections don't take place in a vacuum. Politics sit alongside many other variables—macro and micro, fundamental and technical, foreign and domestic—which affect asset prices. The pandemic was a far bigger driver of markets in 2020 than elections were, for example.

Another lesson is that initial reactions don't always persist. The small-value rallies of both 2016 and 2020 eventually faded, as large-cap growth stocks resumed their dominance. Earnings and cash flows are ultimately bigger drivers of markets than politics.

Finally, we shouldn't assume that market behavior in 2024 will resemble that of 2016 or 2020. The candidates might be the same, but the context differs. The expectations that powered the small-value rally of 2016 won't be the same should Trump prevail in November, especially given US equity market behavior under the Trump presidency. Markets know that campaign rhetoric is one thing; what actually happens under an administration is quite another. M

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