ElectionWatch 2024

Early expectations

4 October 2023

Chief Investment Office GWM
Investment Research

UBS

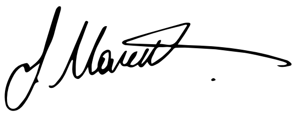
Dear reader

Congress averted a shutdown on Saturday with the enactment of a continuing resolution (CR) to fund the government for another 45 days. The new deadline for the enactment of a federal budget has been pushed to 17 November. The CR passed both chambers on a bipartisan basis but omitted additional money for border protection and aid for Ukraine, which remain contentious policy issues. The campaign season is underway, but deferral of final action on the budget will preoccupy members of Congress for another month.

The election campaign was overshadowed this week by a motion in the House of Representatives to "vacate the chair." The unprecedented removal of Kevin McCarthy (R-CA) as speaker in a roll-call vote on Tuesday is expected to lead to time-consuming negotiations over the election of new GOP leadership in the House and could result in additional delays in enacting a budget for fiscal year 2024.

While the lower chamber of Congress attempts to get its own house in order, the candidates for president will continue their quest for the nomination. In this edition of *ElectionWatch 2024*, we offer four tips on how to navigate the upcoming campaign (jump to page 4). The contest is likely to be more rancorous than usual, so keeping a long-term perspective will be critical. We also share a historical perspective on the budget stalemate (jump to page 6) and conclude our inaugural report with a review of policies that are expected to become more important areas of debate in 2024 (jump to page 7).

Regards,



Solita Marcelli
Chief Investment Officer Americas
Global Wealth Management

UBS Trending: What to know before the 2024 presidential election

The 2024 presidential election is more than a year away. However, it's never too early to keep an eye on how it could impact policy and investments.

Watch the video discussion ›

Editor-in-chief
Tom McLoughlin

Authors
Solita Marcelli
Tom McLoughlin
Nadia Lovell

Contributors
Brad Ball
Kevin Dennean
Jay Dobson
Nathaniel Gabriel
Kathleen McNamara
Eric Potoker
Jon Woloshin

Contributors outside CIO
Shane Lieberman

Editors
Abe De Ramos
Mark Boehme

Design
Cheryl Seligman

Project management
John Collura
Matt Siegel
Allie Gorin

Cover photo
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Election basics

Figure 1

Key dates in the 2024 election

Iowa Republican caucus	15 January
Super Tuesday	5 March
Republican National Convention	15–18 July
Democratic National Convention	19–22 August
Election Day	5 November

Jan	Feb	Mar	Apr	May	Jun	Jul	Aug	Sep	Oct	Nov	Dec
1	1	1	1	1	1	1	1	1	1	1	1
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15	15	15	15	15	15	**15**	15	15	15	15	15
16	16	16	16	16	16	**16**	16	16	16	16	16
17	17	17	17	17	17	**17**	17	17	17	17	17
18	18	18	18	18	18	**18**	18	18	18	18	18
19	19	19	19	19	19	19	**19**	19	19	19	19
20	20	20	20	20	20	20	**20**	20	20	20	20
21	21	21	21	21	21	21	**21**	21	21	21	21
22	22	22	22	22	22	22	**22**	22	22	22	22
23	23	23	23	23	23	23	23	23	23	23	23
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30		30	30	30	30	30	30	30	30	30	30
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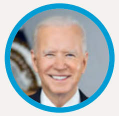
Figure 2

Who is running for president in 2024?

Declared candidates listed in alphabetical order by last name within each political party

Democrats **Republicans**



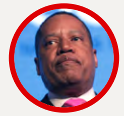
Joe Biden
President (incumbent)
80 years old | Delaware

Ryan Binkley
Businessman and pastor
55 years old | Texas

Doug Burgum
Governor (ND)
67 years old | North Dakota

Chris Christie
Former Governor (NJ)
61 years old | New Jersey

Ron DeSantis
Governor (FL)
45 years old | Florida



Larry Elder
Radio host
71 years old | California

Robert F. Kennedy Jr.
Attorney
69 years old | New York

Nikki Haley
Former Governor (SC)
51 years old | South Carolina

Will Hurd
Former US Representative (TX)
46 years old | Texas

Asa Hutchinson
Former Governor (AR)
72 years old | Arkansas

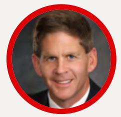
Perry Johnson
Businessman
75 years old | Michigan

Mike Pence
Former Vice President
64 years old | Indiana

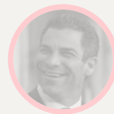
Marianne Williamson
Author
71 years old | Iowa

Vivek Ramaswamy
Entrepreneur
38 years old | Ohio

Tim Scott
US Senator (SC)
58 years old | South Carolina



Corey Stapleton
Former Secretary of State (MT)
56 years old | Montana



Francis Suarez
Mayor of Miami
45 years old | Florida

Donald Trump
Former President
77 years old | Florida

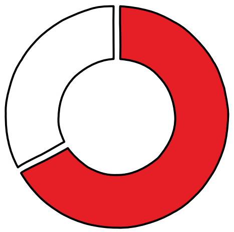
Democrat (running) Democrat (withdrew) Republican (running) Republican (withdrew)

Candidate photos: Adam Schultz/White House (Joe Biden); Gage Skidmore, distributed under a CC BY-SA 2.0 license (Ryan Binkley, Larry Elder); Office of the Governor, State of North Dakota, distributed under a CC BY-SA 4.0 license (Doug Burgum); Office of U.S. Health Secretary (Chris Christie); Office of Congressman Ron DeSantis (Ron Desantis); U.S. Department of State (Nikki Haley); Office of Congressman Will Hurd (Will Hurd); Arkansas National Guard (Asa Hutchinson); Gage Skidmore, distributed under a CC BY-SA 3.0 license (Perry Johnson, Robert F. Kennedy Jr., Vivek Ramaswamy); D. Myles Cullen/White House (Mike Pence); Renee Bouchard/U.S. Senate Photographic Studio (Tim Scott); Adcreative, distributed under a CC BY-SA 4.0 license (Corey Stapleton); Carlos Fyfe/White House (Francis Suarez); Shealah Craighead/White House (Donald Trump); David Livingston/Getty Images Entertainment via Getty Images (Marianne Williamson)

Four tips for navigating the upcoming campaign

For all the talk about a disenchanted and polarized public, Americans have taken an increasingly active interest in national elections. After decades of diminished turnout, the past three election cycles (2018, 2020, and 2022) have drawn record numbers of voters. Two-thirds of eligible voters turned out for the last presidential election in 2020—the highest participation rate in more than a century.[1] And while midterm elections usually generate less interest, the turnout rate in 2018 (49%) was the highest since 1914. The midterm election in 2022 was almost as impressive at 46%.

Americans appear increasingly engaged, passionate in their beliefs and policy preferences, and anxious to express themselves at the ballot box. Presidential elections, in particular, have become more closely contested, with fewer landslides. The last candidate to win at least 54% of the popular vote was Ronald Reagan in 1984. Of course, the Electoral College will choose the president based on the tallies from each state, and the margins of victory within the Electoral College are often much wider than the popular vote totals.[2]



Two-thirds of eligible voters turned out for the last presidential election in 2020—the highest participation rate in more than a century.[1]

This brings us to the inevitable reminder that US presidents are elected by voters in a handful of states where the contest is closest. Next year will be no different. Voters in a small number of states, such as Arizona and Wisconsin, among others, are the ones most likely to dictate the outcome. As the election campaign gets underway, we are obliged to offer our readers a few survival tips on withstanding the inevitable onslaught of campaign commercials and incessant media coverage.

Remember, it's still early

Despite a persistently low public approval rating, President Joe Biden has reiterated his intent to seek his party's nomination again. Registered Democrats appear ambivalent about a second Biden term, and, as a recent CNN poll suggested, two-thirds of voters who lean Democratic would prefer a different nominee due to concerns about the president's age and health. However, a quixotic challenge by Robert F. Kennedy Jr. has failed to gain much traction. So, barring deterioration in the president's health, Biden is well positioned to receive the nomination next summer.

The Republican Party faces a choice: whether to nominate a former chief executive whose own low approval rating rivals the sitting president's, or to seek a new nominee. Donald Trump holds a commanding lead in the polls, but it is still too early to conclude he will receive his party's nomination. Second acts in politics are fairly common, but only one former president—Grover Cleveland—managed to win back the presidency after a previous defeat.

Much will depend on the initial contests, beginning in Iowa on 15 January. The Iowa caucus has a distinctly unimpressive record of predicting the eventual Republican nominee, but a second-place performance by a dark-horse candidate can alter the momentum heading into the succeeding primaries.[3] Those contests are still months away and will be affected by more immediate issues being debated in Congress this autumn.

Take the early polling data with a grain of salt

The polling industry was subjected to severe criticism after failing to predict the palpable surge in support for Donald Trump in 2016. A variety of explanations were offered, including the concept of the "shy Trump voter" who provided pollsters with expected but misleading answers to leading questions. Critics also cited the prevalence of respondents who "leaned Democratic" and the practical challenges imposed by the use of mobile phones.

[1]Pew Research Center, "Republican Gains in 2022 Midterms Driven Mostly by Turnout Advantage," 12 July 2023
[2]Two states—Maine and Nebraska—allocate some of the Electoral College votes based on the winner of congressional districts.
[3]Mike Huckabee, Rick Santorum, and Ted Cruz won the caucuses in 2008, 2012, and 2016, respectively, but failed to receive the GOP nomination. George H.W. Bush lost to Bob Dole in 1988 but went on to win the nomination and the presidency. Ronald Reagan lost to George H.W. Bush eight years earlier but went on to win the nomination and the presidency.

Recent academic research has unearthed another perplexing problem with survey data. In the absence of a financial incentive or another inducement to reply frankly to questions from pollsters, respondents are more inclined to provide answers that correspond to their own personal biases. The risk is particularly acute when questions about economics are preceded by questions about politics.[4]

With few exceptions, national polls should be treated with particular skepticism. In the US, we elect presidents based on electoral votes. A Democrat running up the margin of victory in Oregon, or a Republican doing so in Oklahoma, is less impactful than winning a swing state by the narrowest of margins.

Beware partisan bias, which can distort investment decisions

The notion that political affiliation has a direct impact on one's level of optimism regarding the future direction of the economy is supported by ample academic research.

> While policies can affect the performance of individual asset classes in the short run, longer-term portfolio construction is best treated as an **apolitical exercise**.

Individuals generally have a more positive assessment of current economic conditions when the White House is occupied by a president of the party they support.[5] The partisan bias exerts significant influence on survey measures of economic expectations, and this bias appears to be increasing substantially over time.[6]

A perception that the economy is improving—or deteriorating—can affect investment decisions in a way that can impair investment returns. Investors who share an affiliation with the political party in office are more likely to believe that financial assets are undervalued and respond accordingly by increasing their allocation to equities. Conversely, investors disappointed with the outcome of an election often adopt a risk-off strategy and take refuge in fixed income securities.[7] While that type of impulse may be less costly when yields are high, as they are today, it runs the risk of distorting longer-term asset allocations.

Professional money managers are also susceptible to this type of confirmation bias. Mutual fund managers appear more likely to allocate assets to firms managed by individuals with a similar party affiliation, and demonstrate greater partisan bias in their asset allocation decisions when the political party they support holds power.[8] Hedge fund managers that are on record as having donated to Democratic candidates in the 2008 election outperformed their GOP-donating peers in the months following the ballot. Eight years later, Republican households were more likely to increase their exposure to investments poised to benefit from economic growth following Trump's election, thereby improving returns.[9]

Separating one's own political beliefs from longer-term asset allocation is the overriding lesson from these examples. The American economy is remarkably resilient. While individual fiscal and regulatory policies can affect the performance of individual asset classes in the short run, longer-term portfolio construction is best treated as an apolitical exercise.

Take the spitefulness of presidential elections in stride

The upcoming election has the potential to be among the most acrimonious on record. There is no love lost between the two leading candidates, and our political parties vehemently disagree on fundamental fiscal, regulatory, and social policies. Take comfort in the fact that incendiary speech is nothing new to US politics. John Adams was called a "repulsive pedant" and "hideous hermaphrodite" by Thomas Jefferson's campaign. The Adams campaign responded in kind, calling Jefferson a "godless atheist" and circulating a rumor that he had died during the campaign. The severity of personal attacks has ebbed and flowed in the succeeding two centuries. Adams and Jefferson ultimately reconciled, so there is always hope for a kinder and gentler reconciliation of our political differences.

[4] John G. Bullock, Alan S. Gerber, Seth J. Hill, Gregory A. Huber, "Partisan Bias in Factual Beliefs about Politics," National Bureau of Economic Research, May 2013

[5] Larry M. Bartels, "Beyond the running tally: Partisan Bias in Political Perceptions," *Political Behavior*, 24:2 (2002), 117–150. As cited by Atif Mian, Amir Sufi, and Nasim Khoshkhou in "Partisan Bias, Economic Expectations, and Household Spending," *The Review of Economics and Statistics*, Vol. CV, No. 3, May 2023

[6] Atif Mian, et. al., "Partisan Bias"

[7] See UBS Chief Investment Office ElectionWatch, "More clarity, more uncertainty," 20 March 2020. In that report, we cited Maarten Meeuwis and Jonathan Parker, et al., "Belief Disagreement and Portfolio Choice," National Bureau of Economic Research, Working Paper 2510, September 2019; Yosef Bonaparte and Alok Kumar et al., "Political Climate, Optimism, and Investment Decisions," University of Miami, 26 February 2012; Marian Moszoro, "The Party Politics of Stock Market Investing," George Mason University, 25 March 2019; and Harrison Hong and Leonard Kostovetsky, "Red and Blue Investing," Princeton University, March 2010.

[8] M. Babajide Wintoki and Yaoyi Xi, "Partisan Bias in Fund Portfolios," *Journal of Financial & Quantitative Analysis*, 10 January 2019

[9] Marian Moszoro, "Political Cognitive Biases Effects on Fund Managers' Performance," George Mason University, SGH Warsaw School of Economics, 28 May 2020

A heads-up on the shutdown

The United States Congress enacted the Congressional Budget and Impoundment Control Act in 1974. In doing so, Congress reasserted its constitutional authority over the federal budget, which had waned over time as the executive branch of government exercised more influence on federal spending in the postwar period. Among its myriad provisions, the act established a new fiscal year to begin on the first day of October rather than July. The intent was to provide more time for new members of Congress to familiarize themselves with the federal budget and to reach agreement on policy priorities.

At least that was the idea. As the accompanying table indicates, Congress often failed to meet its new deadline. As we discussed in a recent report on the prospects of a shutdown, the practical impact of operating without budgetary authority was insignificant until 1980.[1] Federal employees reported to work, as usual, on the assumption that policy differences in Congress would be resolved and payroll deferrals would be remedied. US Attorney General Benjamin Civiletti issued a formal legal opinion to the contrary in 1980, which raised the stakes for any shutdown. He concluded that the existing law prohibited federal agencies from incurring financial obligations once their authority to expend appropriations lapsed.[2] Subsequent interpretations of the AG's original opinion made provision for the retention of federal employees engaged in the protection of life and property.

Initially, the AG's opinion exerted pressure on Congress to avoid the adverse political consequences of shutting down the government and furloughing hundreds of thousands of federal employees. However, there has been a noticeable uptick in the willingness of one political party or the other to use the threat of a shutdown to extract policy concessions.

> There has been a noticeable uptick in the willingness of one political party or the other to use the **threat of a shutdown** to extract policy concessions.

All of which brings us to the current stalemate. Congress averted a shutdown last weekend by passing a continuing resolution for another 45 days, but the GOP majority is perilously narrow. In the wake of the enactment of the CR, a motion was introduced by a rump caucus of Republicans to remove Kevin McCarthy from the speaker's chair, followed by a roll-call vote of the entire House. McCarthy was removed by a vote of 216–210.

The unprecedented action will likely lead to a chaotic week of negotiations within the Republican conference to identify a successor. In the meantime, Rep. Patrick McHenry will serve as speaker pro tempore.

Once the new leadership roster is determined, the House will resume negotiations over the budget, with border security and military assistance for Ukraine posing two of the biggest obstacles to adoption by the middle of November.

Figure 3

Previous instances of budgetary lapses

Final date of budgetary authority	Start date of budget impasse	Date of funding restoration	Duration of budgetary stalemate in days
30 Sep 1976	1 Oct 1976	11 Oct 1976	10
30 Sep 1977	1 Oct 1977	13 Oct 1977	12
31 Oct 1977	1 Nov 1977	9 Nov 1977	8
30 Nov 1977	1 Dec 1977	9 Dec 1977	8
30 Sep 1978	1 Oct 1978	18 Oct 1978	17
30 Sep 1979	1 Oct 1979	12 Oct 1979	11
20 Nov 1981	21 Nov 1981	23 Nov 1981	2
30 Sep 1982	1 Oct 1982	2 Oct 1982	1
17 Dec 1982	18 Dec 1982	21 Dec 1982	3
10 Nov 1983	11 Nov 1983	14 Nov 1983	3
30 Sep 1984	1 Oct 1984	3 Oct 1984	2
3 Oct 1984	4 Oct 1984	5 Oct 1984	1
16 Oct 1986	17 Oct 1986	18 Oct 1986	1
18 Dec 1987	19 Dec 1987	20 Dec 1987	1
5 Oct 1990	6 Oct 1990	9 Oct 1990	3
13 Nov 1995	14 Nov 1995	19 Nov 1995	5
15 Dec 1995	16 Dec 1995	6 Jan 1996	21
30 Sep 2013	1 Oct 2013	17 Oct 2013	16
19 Jan 2018	20 Jan 2018	22 Jan 2018	2
8 Feb 2018	9 Feb 2018	10 Jan 2018	1
21 Dec 2018	22 Dec 2018	25 Jan 2019	34

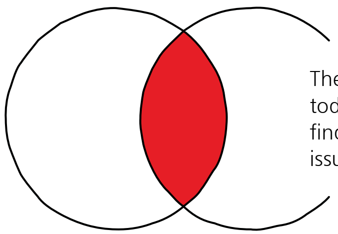
Source: UBS

[1] UBS Chief Investment Office, "The impact of a government shutdown," 1 September 2023
[2] Opinion of the US Attorney General of the United States, 4A Op. O.L.C. 16 (1980). The AG's opinion was clarified during subsequent administrations to allow some essential services to remain open. See 31 U.S.C. Section 1342, as amended, which states: "An officer or employee of the United States Government…may not accept voluntary services…or employ personal services exceeding that authorized by law except for emergencies involving the safety of human life or the protection of property."

Policies and priorities in the 2024 election

Bipartisan legislation is always possible in a divided government, but the elected representatives from America's two major political parties have become far more ideologically cohesive within their own party in recent decades, which makes crossing the aisle in support of bipartisan legislation more challenging. Fifty years ago, there were 144 Republican members of the House who were less conservative than the most conservative Democrat. There were also 52 House Democrats whose voting record was less liberal than the most liberal Republican.[1] This type of ideological overlap is nonexistent today, which makes finding common ground on divisive social and fiscal issues ever more challenging.

The paradox of the nonaligned voter eager for compromise is a contributing factor in the ideological drift to the left and the right. As Fig. 4 illustrates, the percentage of Americans who self-identify as politically independent has increased markedly in the past two decades.[2] The increase in nonaligned voters has come at the expense of both Republican and Democratic parties, whose membership rolls have correspondingly declined. As a plurality of Americans disengage from active participation in an organized political party, those who remain active at party conventions and caucuses encounter less ideological diversity and are more likely to espouse rigid political views. Once elected, those in office may be more reluctant to compromise for fear of being branded nonconformist.[3]



The lack of **ideological overlap** today across political parties makes finding common ground on divisive issues ever more challenging.

The two political parties are nearly evenly divided in the current Congress, with Republicans and Democrats controlling the House and the Senate, respectively, by exceptionally narrow margins. While the rules of the Senate generally require a degree of bipartisanship to advance legislation (budget reconciliation excepted), there is more latitude to pass bills in the House by a simple majority. However, the GOP majority in the House is the fifth-smallest in history, which compounds the challenges faced by the new future speaker (Fig. 5, next page). The GOP's narrow control of the chamber has allowed the conference's most conservative members to exercise outsize influence, with the recent dustup over the enactment of a budget for fiscal year 2024 being a case in point.

Enacting substantive legislation in an election year is always difficult, but the absence of goodwill between the two parties creates additional obstacles. The national election is still 13 months away, and a great deal of water still needs to flow

Figure 4

Shifts in political party affiliation

Percent (%) of respondents answering to survey question, "Do you consider yourself a Republican, Democrat, or Independent?"

	Republican	Independent	Democrat
2023 Aug 1–23	25	47	26
2022 Aug 1–23	24	43	30
2021 Aug 2–17	28	40	29
2020 Aug 31–Sep 13	29	40	30
2019 Aug 1–14	27	40	29
2018 Aug 1–12	28	43	27
2017 Aug 2–6	28	41	28
2016 Aug 3–7	27	38	31
2015 Aug 5–9	27	41	31
2014 Aug 7–10	26	40	31
2013 Aug 7–11	24	43	31
2012 Aug 20–22	28	41	31
2011 Aug 4–7	24	42	34
2010 Aug 5–8	29	40	30
2009 Aug 31–Sep 2	28	36	35
2008 Aug 7–10	31	32	35
2007 Aug 13–16	28	40	30
2006 Aug 18–20	33	32	34
2005 Aug 22–25	29	34	35
2004 Aug 9–11	36	29	34

Source: Gallup

[1] Drew DeSilver, "The polarization in today's Congress has roots that go back decades," Pew Research Center, 10 March 2022
[2] Gallup, "Party Affiliation," August 2023, based on voter surveys over two decades
[3] UBS *ElectionWatch*, "Challenges mount, but delegates count," 11 March 2016

under the proverbial bridge before the presidential candidates are obliged to announce specific policy priorities. While some items must be addressed in the 118th Congress, including a quinquennial agriculture bill and an annual defense bill, many other issues will be deferred until after the election.

We expect Congress to address the expiring provisions of the Tax Cuts and Jobs Act (TCJA) in 2025. The TCJA temporarily reduced marginal income tax rates for most individuals and doubled the amount of the standard deduction. It also doubled the amount of the child tax credit and increased the thresholds at which the credit was phased out. The estate tax exclusion was also doubled. Many of these changes are scheduled to revert to prior levels beginning on 1 January 2026.

The debate will be highly contentious. Republicans are expected to try and make the tax cuts permanent. Democrats are likely to focus on raising tax rates within the highest marginal income brackets. The outcome is uncertain, and much will depend on the degree of control exercised by one party or the other, but some provisions are likely to survive regardless of who controls the gavel in each chamber. For example, a limit on state and local tax deductions probably will persist, albeit with a higher cap. Meanwhile, temporary tax cuts become entrenched with each passing year and are difficult to reverse. The variable will be the degree to which tax cuts, once made permanent, cover individuals with higher incomes. Here, we examine selected policy areas with greater specificity.

Figure 5

Republican majority's margin in 118th Congress is tied for fifth-closest ever

House majority party margins by seat and percentage-point advantage

Congress	Majority party		Minority party		Total voting members	Margin (seats)	Margin (in percentage points)
65th Congress (1917–19)	217	(D+others)	215	(R)	432	2	0.46
72nd Congress (1931–33)	219	(D)	214	(R)	434	5	1.15
19th Congress (1825–27)	108	(pro-Adams)	105	(pro-Jackson)	213	3	1.41
31st Congress (1849–51)	112	(D)	108	(Whig)	230	4	1.73
83rd Congress (1953–54)	221	(R)	211	(D)	433	10	2.30
107th Congress (2001–02)	221	(R)	211	(D)	434	10	2.30
118th Congress (2023–24)	**222**	**(R)**	**212**	**(D)**	**434**	**10**	**2.30**
117th Congress (2021–22)	222	(D)	211	(R)	433	11	2.53
30th Congress (1847–49)	116	(Whig)	110	(D)	228	6	2.63
51st Congress (1889–91)	169	(R)	160	(D)	329	9	2.73

Note: The GOP margin of control has declined to nine seats since the beginning of this Congress, when one seat was vacant.
Source: Pew Research Center, UBS

Fiscal sustainability

Key driver: The increasing federal deficit

Our early take: According to the Congressional Budget Office, federal debt held by the public is projected to rise from 98% of GDP in 2023 to 118% in 2033. Growth in mandatory spending on entitlement programs and higher rates of interest on the national debt are expected to increase the debt-to-GDP ratio to 195% by 2053.

More than three-quarters of the federal budget consists of mandatory spending, national defense outlays, and interest payments on the national debt. Meaningful reductions to these line items are highly unlikely. Democrats were unable to enact significant tax increases while they controlled both houses in the last Congress, while Republicans have not yet been able to address the rising cost of federal transfer payments. The 2024 campaign will feature persistent and acrimonious debates over fiscal policy but will not alter the general trajectory of the deficit until a crisis takes hold.

Municipal securities

Key driver: Tax exemption

Our early take: Public interest groups, ranging from the Government Finance Officers Association to the Conference of Mayors, have been obliged to remind Congress periodically that most non-defense-related infrastructure in the US is financed by states and local governments. Tax exemption lowers the cost of capital for these borrowers, but it comes at a cost to the federal government in the form of forgone tax revenue. The tax benefits are skewed to individuals with higher incomes, which makes them a target for progressive lawmakers. This tax exemption ranks 16th in the top estimated federal tax expenditures over five years, at roughly USD 180.7bn, according to the staff of Joint Committee on Taxation.[4]

As the next Congress reconvenes in January 2025, both parties will be focused on passing a major tax bill. We expect all tax expenditures—including municipal tax exemption—to be actively debated. While some constraints may be imposed, which could include the loss of tax exemption for new-issue private activity bonds, we believe there is enough support in Congress to retain the exemption for most types of municipal securities. To the extent that additional constraints are enacted, we would expect Congress to grandfather outstanding tax-exempt securities.

State and local tax (SALT) deductions

Key driver: The SALT deduction was capped at USD 10,000 per year through 2025.

Our early take: The TCJA imposed a USD 10,000 per year cap on a taxpayer's ability to deduct state and local taxes on federal tax returns. To the extent that all expiring provisions of the TCJA are made permanent, the cap on SALT deductions would persist. However, a complete repeal is unlikely because it would result in a more substantial reduction in federal tax revenue and would be opposed by members of Congress who believe that an unlimited deduction represents a subsidy to states with higher rates of taxation. Other opponents of an unlimited deduction point out that the benefit of an unlimited deduction skews to the more affluent. We expect Congress to address the cap, but an increase in the maximum deduction is a more likely outcome than a complete elimination of the cap.

Estate tax exclusions

Key driver: The federal estate tax exclusion is at an all-time high but is scheduled to decline at the end of 2025.

Our early take: The TCJA more than doubled the inflation-adjusted estate tax exclusion, which rose from approximately USD 5.5mn in 2017 to roughly USD 12.9mn in 2023. The exclusion will be cut in half, adjusted for inflation, in 2026 if Congress does not act. We expect Congress to address this issue, but absent a unified government under GOP control, the size of the exemption would likely decline in 2026.

Real estate

Key driver: 1031 exchanges

Our early take: Section 1031 now applies only to exchanges of real property. Exchanges of personal or intangible property are no longer exempt from treatment as a gain or loss under the Internal Revenue Code. We place a low probability on the restoration of personal or intangible property as eligible exchanges for 1031 treatment. In addition, previous Democratic administrations have discussed further limitations and potential eliminations of the entire 1031 program. In the event of full Democrat control of Congress and the White House, it is possible this topic could be revisited.

Business tax

Key driver: Phase-out of bonus depreciation

Our early take: The TCJA extended bonus depreciation rules that were set to expire at the end of 2019 and increased the deductible amount to 100%. However, the law also provided for a phasing-out of the accelerated depreciation beginning in 2023. Barring a change in law, the bonus percentage will decline by 20% each year through 2027. There appears to be bipartisan support to slow down or eliminate the phase-out, but a legislative vehicle through which to do so has not been identified. In the absence of any action before 2025, we expect Congress to address the issue at that time.

Industrials

Key driver: Defense spending and supplementals

Our early take: The debt ceiling agreement stipulated that the defense budget can rise by only 3.3% in FY24 and 1% in FY25—a sizable step-down from FY23 growth. This is seen by many in Congress as shortchanging military preparedness amid a precarious geopolitical backdrop, but loud voices on both sides would prefer to see spending reduced. Given the ongoing war in Ukraine and elevated tensions with China, we expect these numbers to be the floor, not the ceiling. However, the timing and size of new supplementals will depend on the voting power of the vocal opposition. Aside from the absolute level of spending, passing an annual budget and authorizing funds will be important for defense contractors' cash flows. Operating under a continuing resolution for an extended period could become increasingly disruptive.

[4] Staff of the Joint Committee on Taxation, "Estimates of federal tax expenditures for fiscal years 2022–2026," 22 December 2022

Inflation Reduction Act

Key driver: Maintenance of existing provisions

Our early take: The Inflation Reduction Act (IRA) and its generous tax credits are accelerating investment in green and blue hydrogen, sustainable aviation fuel, carbon capture, and electric vehicles—a rising tide that lifts the value chain, many of which are large industrial and material companies. We do not believe the core of the IRA will be renegotiated, as much of the investment is taking place in red states, and incentives are spurring global participants to focus investment in the US. However unlikely it may be, should provisions of the IRA be called into question, rates of return on certain projects may no longer be worthwhile. The success of the IRA also likely means that tax credits on offer could cost the government significantly more than initially contemplated. If budget hawks gain influence, the uncapped nature of the tax credits may be reassessed.

Energy

Key driver: Regulatory burden and prices at the pump

Our early take: Energy policy is a recurring issue in election years. Though we expect some candidates to talk about trying to weaken provisions in the IRA and increase US fossil fuel production, we do not believe either topic has much policy potential. US crude oil and natural gas production continues to grow slowly, and the IRA is driving renewable project developments (and jobs) in red and blue states across the country. The key issue to watch during 2024 will be oil prices. Higher oil prices could drive gasoline and diesel prices in 4Q23 and 1H24 higher than they were a year ago (and thereby influence inflation). A release from the Strategic Petroleum Reserve is possible, but with potential negotiations for a US-Saudi Arabia bilateral deal in early 2024, this appears less likely in the first half of next year.

Financials

Key driver: Banking system stability

Our early take: Elections inevitably lead to headline and regulatory risks for the financial sector. A third—legislative risk—seems remote given a divided Congress, and the 2010 Dodd-Frank Act already covers a lot of ground. That said, there could be changes with broad implications such as market structure reforms promoted by the SEC and credit card interchange controls advanced by Congress.

We would expect the Biden administration to continue to impose rules and interpret regulations that raise banks' compliance and capital costs. A Republican candidate would be more likely to support some deregulation and tailoring of existing rules and regulations that could simplify the oversight of banks and lower compliance and capital costs. It is too early to determine which of the two outcomes is more likely.

Healthcare

Key driver: Medicare drug pricing regulation and legislation

Our early take: Overall, we expect only a modest impact from any healthcare proposals discussed in the upcoming presidential election. We expect President Biden to tout Medicare drug pricing negotiation provisions included in the IRA and advocate for additional pricing reforms, both in Medicare and in the commercial/employer market.

Given the challenges faced by Democrats in the past two congresses, we do not expect additional drug pricing reforms to gain much traction in a closely divided Congress. Republicans are unlikely to sponsor major healthcare policy initiatives during the upcoming election, and appear to have little appetite to roll back the IRA's drug pricing provisions, but will focus attention on rising healthcare costs.

Technology and communication services

Key driver: Privacy, trade, and geopolitics

Our early take: From bipartisan clamoring to rein in "Big Tech" to increasing restrictions on chips and chip equipment shipments to China, technology has been front and center in both domestic policy and international relations for much of the past five years. The 2024 election cycle will see more of the same.

We believe there will be four pivotal issues that presidential candidates address: 1) the perception of outsize market power of large technology companies and the associated impacts on competition, politics, and society; 2) a continued focus on restricting mergers and acquisitions by large technology companies; 3) bilateral relations with China; and 4) the risks, threats, and opportunities of artificial intelligence.

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