RBC Global Asset Management

Making sense of elections' potential impact on investments

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Elections around the world generate headlines and attention, but their relevance to investors is more nuanced. While the elections themselves can impact some investments, it's what happens after that is of more consequence. The policies that flow from a new government are what has the power to reshape economies and markets.

"It's a critical year for elections: over 1.5 billion people will vote in elections this year in more than 50 countries," says Graham Stock, senior sovereign strategist with RBC Global Asset Management (GAM). "Generally speaking though, it's been a question of continuity — we haven't seen big shifts in those elections," he adds, noting that the market reactions have been limited to a country's own, without any real contagion.

The big election: the U.S.

The 2024 U.S. election is the one to watch in terms of its potential to affect trade and global economic trends.

Tariffs are a key policy area that could go in very different directions depending on who becomes the next president of the U.S. "That's probably our biggest concern right now as it relates to U.S. fixed income market," explains Charlie Whinery, portfolio manager with RBC GAM. "As [Donald] Trump has said, he wants a 10% tariff on everybody and 60% on China, and you never know with him if it's bluster or a strategy. But were that to happen, we worry that that's inflationary, that puts the Fed back on a hold and that creates a weak setup for fixed income." Although the equity markets might respond positively in the short term, it's nevertheless a concern there too, he adds. Meanwhile, big government spending is nearly guaranteed regardless of who wins the election, so it's less of a wildcard in terms of its potential impact on inflation.

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Whinery predicts that a divided U.S. Congress is the most likely outcome. Additionally, he believes a Republican-led U.S. Senate is more probable, while the U.S. House will likely follow the top of the ticket. "We view [Kamala] Harris as continuity and maybe some things change around the margins, but largely with a divided Congress, she'll be a little bit handcuffed. Whereas with tarrifs, Trump can just move unilaterally and it will be difficult to slow him down," says Whinery to sum up the situation. In any case, the U.S. election and the country's subsequent economic policies — alongside the outlook for Europe and China — are key factors that investors should be watching closely in the coming year.

Elections abroad

There have already been a number of major elections around the world, some with surprising results. Narendra Modi in India, where he and his party were expected to win in a landslide and consolidate even more power, ended with a weaker majority. Similarly, in South Africa, the ANC had its lowest election results since apartheid, and had to form a coalition with other partners.

Zooming in on Latin America, Stock notes that "there's always political risk [there], and sometimes it's around election time, and sometimes it's just a change in social and economic conditions that is leading to volatility that could result from changes in government." Next year, elections in Ecuador and Argentina will deliver verdicts on the two countries' current administrations. In both cases, re-election of the incumbents would contribute to more investor confidence.

Notably, there is a global move — including in emerging markets — toward more central bank independence, "or at least autonomy," as Stock points out. "When you're targeting inflation more explicitly using a policy rate, you depend on your credibility, and it's very hard to have credibility if you're at the beck and call of the president or the finance minister. So most countries have now moved to a system where there's some degree of independence and where there's more transparency as well," he explains.

And that's part of a larger question around the resiliency and stability of institutions. In some regions, like the European Union, the larger political structures are blunting whatever policy differences there may be between a member country's government and the opposition. "We've had elections in countries where we get quite a radical shift in the identity of the president, but actually the institutions are an effective control against that," notes Stock. "Colombia is a good example of that. Gustavo Petro has quite radical ideas, but there are limits on what he can do with his representation in Congress." Venezuela, on the other hand, is an example where democracy and institutions have deteriorated, and the government did not respect the election's results earlier this year.

Sovereign credit ratings are another area that's not directly affected by an election, but rather, by subsequent policy changes. Widening budget deficits, for example, are usually seen as problematic, especially if debt levels are already high.

"So elections do matter, but so far we haven't had any that have been ground-shaking in terms of their impacts," says Stock.

As for countries not subscribing to the traditional democratic election model, they can in theory have good outcomes. China, notably, has delivered remarkable gains in living standards. But in general, not asking people what they want does tend to result in frustrations, disappointment, and suboptimal policy outcomes.

Lessons from prior election cycles

One important lesson from past elections is to evaluate polling data more thoughtfully. While the data can be used as one input for forecasting outcomes, we still need to actively consider alternative results. And a general principle to hedge against binary results is to identify asymmetric outcomes and to focus on the larger expected moves.

Still, there's no one-size-fits-all approach to analyzing elections, warns Stock. "The important thing as a sovereign analyst, is to understand the structural factors driving the electorate's choices," he adds. "What is it that's likely to be a key factor in the election? Is there frustration with the incumbents, which might be their fault or it might be an unfortunate side effect?" The restrictions in response to the COVID-19 pandemic, for example, were not popular, making it harder for incumbents to win elections. The rising costs of living are another such area.

"And it's important to look down-ballot as well. It's not just about the government or the president that's elected," notes Stock.

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