U.S. Small Caps Have Delivered Strong Returns, on Average, after U.S. Elections

Published October 17, 2024

Christopher Gannatti, CFA
Global Head of Research

Key Takeaways

- U.S. small-cap stocks could see significant movement following the 2024 election, as the renegotiation of corporate tax rates remains a key driver for this sector.
- Historically, small-cap equities have performed well in the 12 months following U.S. elections, particularly in presidential years, as seen with the WisdomTree U.S. SmallCap Fund (EES).
- Despite potential uncertainty in the upcoming election, betting against U.S. equities has often been a losing strategy, with profitable small-cap stocks historically benefiting from post-election market trends.

Small-cap stocks have a lot riding on the upcoming election.

When former President Trump was elected in 2016, there was a massive rally in U.S. small-cap stocks. One central catalyst was the U.S. corporate tax rate cut, as small-cap companies tend to have effective tax rates closest to the headline figure—at that time, 35%. Because President Trump won the election with a majority in both the U.S. House of Representatives and the U.S. Senate, he was able to lower this rate to the current level of 21%.1

Tax rates will be renegotiated next year, and small caps again will be in focus.

But we were curious if a rally in U.S. small-cap stocks happened solely in 2016 or if there is a pattern beyond just that single year.

The WisdomTree U.S. SmallCap Fund (EES)

The WisdomTree U.S. SmallCap Fund (EES) was launched on February 23, 2007. It is designed to track the total return performance, before fees and expenses, of the WisdomTree U.S. SmallCap Index.

The most well-known U.S. small-cap equity index is the Russell 2000 Index. As of September 30, 2024, 27.37% of the weight in this Index was in companies that did not deliver positive earnings over the past 12 months.2 WisdomTree's approach seeks to include only small-cap companies with positive core earnings and to also weight these stocks by their earnings, thereby lowering the overall price-to-earnings (P/E) ratio.

An index of small-cap companies with a lot of domestic earnings should be sensitive to changing tax rates.

Figure 1: Standardized Performance

Fund/Index Name	Fund Ticker Symbol	Fund Expense Ratio	Fund Inception Date	Year-to-Date	1-Year	3-Year	5-Year	10-Year
WisdomTree U.S. SmallCap Fund (NAV)	EES	0.38%	2/23/2007	7.07%	23.56%	4.51%	9.74%	9.07%
WisdomTree U.S. SmallCap Fund (MP)	EES	0.38%	2/23/2007	7.03%	23.46%	4.45%	9.73%	9.06%
S&P 500 Index				22.08%	36.35%	11.91%	15.98%	13.38%
Russell 2000 Index				11.17%	26.76%	1.84%	9.39%	8.78%

Source: WisdomTree; specifically, data is from the PATH Fund Comparison Tool, accessed as of 10/13/24. NAV denotes total return
performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results.**
Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be
worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted.
For the most recent month-end and standardized performance, click here.

In figure 2, we evaluate 3, 6 and 12 months after all of the elections, midterm and presidential, for which EES has had live performance history.

- 2008 stands out because the election itself occurred during what we now look back on as the global financial crisis of 2008–2009. It is remarkable how equity returns looked three months after the election and then how this picture had massively shifted toward an equity performance recovery merely nine months later.
- 2012, 2016 and 2020 saw some strong equity market returns, especially 12 months after the election. Notably, these were the presidential years.
- The midterm years were notably lower, return-wise.

Figure 2: Return Data for 3, 6 and 12 Months Following Elections

Election Category	Election Date	Fund/Index	President	House	Senate	3-Months	6-Months	12-Months
Presidential	11/4/2008	EES	Democrat	Democrat	Democrat	-18.40%	4.60%	25.00%
		S&P 500				-16.60%	-8.40%	6.90%
		Russell 2000				-17.40%	-6.20%	4.90%
Midterm	11/2/2010	EES	N/A	Republican	Democrat	9.90%	15.10%	3.90%
		S&P 500				9.80%	15.20%	5.80%
		Russell 2000				12.00%	20.60%	4.20%
Presidential	11/6/2012	EES	Democrat	Republican	Democrat	10.50%	16.30%	40.20%
		S&P 500				6.50%	14.50%	26.80%
		Russell 2000				10.80%	17.10%	34.90%
Midterm	11/4/2014	EES	N/A	Republican	Republican	0.10%	4.90%	0.40%
		S&P 500				2.00%	6.20%	6.70%
		Russell 2000				2.60%	6.50%	3.50%
Presidential	11/8/2016	EES	Republican	Republican	Republican	16.20%	19.60%	27.90%
		S&P 500				7.80%	13.30%	23.70%
		Russell 2000				14.10%	17.20%	25.60%
Midterm	11/6/2018	EES	N/A	Democrat	Republican	-1.80%	3.00%	2.10%
		S&P 500				-0.30%	7.50%	14.00%
		Russell 2000				-2.10%	4.60%	3.70%
Presidential	11/3/2020	EES	Democrat	Democrat	Democrat	32.10%	53.80%	65.40%
		S&P 500				14.10%	25.40%	40.40%
		Russell 2000				34.20%	41.80%	50.40%
Midterm	11/8/2022	EES	N/A	Republican	Democrat	9.20%	-5.70%	-2.60%
		S&P 500				8.00%	9.00%	16.40%
		Russell 2000				7.80%	-2.20%	-3.70%

Sources: Wikipedia for election dates and winning parties within the presidency, U.S. Senate and U.S. House of Representatives. WisdomTree for the returns; specifically, data is from the PATH Fund Comparison Tool, accessed as of 10/13/24. NAV denotes total return performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results. Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance may be lower or higher than the performance data quoted. For the most recent month-end and standardized performance, click here.**

Conclusion: The 12 Months Following U.S. Elections Have Been Largely Positive for U.S. Equities, Particularly Profitable Small Caps

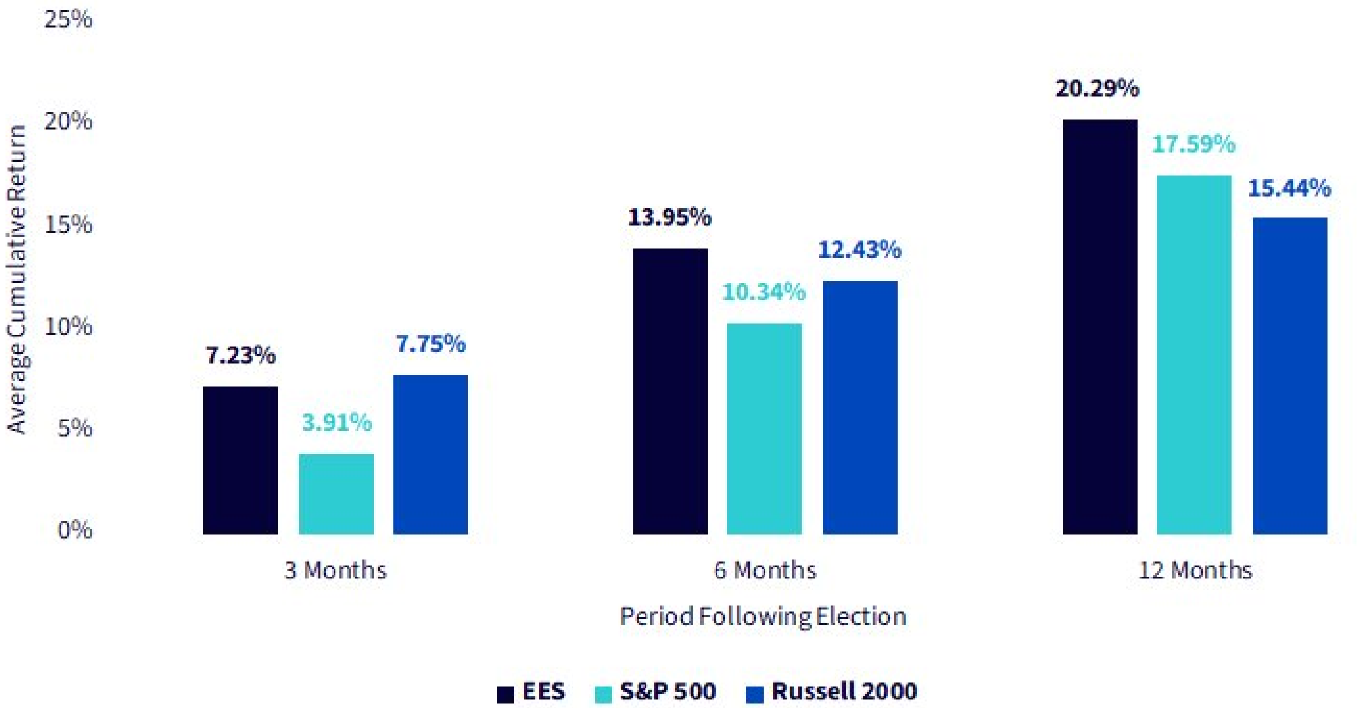
When we calculated the simple averages of the returns of the different periods shown in figure 2, we saw that, on average, looking at 12 months following the election represented the strongest overall group of returns. For most of these elections, the picture was positive. EES had a stand-out year in 2020.

The causality in any of these cases can be tricky. We mentioned 2016 because there was 1) a tax policy change discussed in the campaign and then 2) a sweep across the presidency, U.S. Senate and U.S.

House of Representatives by a single party. This allows us to at least build a narrative that can connect tax policy expectations to equity returns.

In 2020, we were in the midst of the COVID-19 global pandemic. Equity markets crashed until March 23, 2020, and then rallied significantly through the end of the year. There was a lot of fiscal and monetary stimulus being implemented during this time, so it is a bit of an outlier relative to the others.

Figure 3: Average Returns for 3, 6 and 12 Months after Elections



Source: WisdomTree; specifically, data is from the PATH Fund Comparison Tool, accessed as of 10/13/24. NAV denotes total return
performance at net asset value. MP denotes market price performance. **Past performance is not indicative of future results.**
Investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may
be worth more or less than their original cost. Current performance may be lower or higher than the performance data
quoted. For the most recent month-end and standardized performance, click here.

Now, even with all of that said, as divided as the rhetoric may sound as we approach the 2024 U.S. election, if history has been any guide, it has been a losing proposition, for the most part, to bet against U.S. equity markets.

There are never guarantees as to what we may see, return-wise, but we'd remind people that, frequently, the most likely outcome is a divided government where much of the current policy simply continues along.

1 Source: Benjy Sarlin, “Republican-led Congress passes sweeping tax bill,” CNBC.com, 12/20/17.

2 Source: WisdomTree; specifically, WisdomTree’s Fund Comparison tool within its broader PATH family of tools, with data accessed as of 10/13/24.

Important Risks Related to this Article

There are risks associated with investing, including the possible loss of principal. Funds focusing their investments on certain sectors and/or smaller companies increase their vulnerability to any single economic or regulatory development. This may result in greater share price volatility. Please read the Fund's prospectus for specific details regarding the Fund's risk profile.