

## MORGAN STANLEY GWMG ASSET ALLOCATION and INVESTMENT STRATEGY

## Investment Strategy for a Post Election Environment

## Election Year Insights

Year	Total Eligible Voters (in MM)	Total Voters (in MM)	Total Voters as % of Eligible Voters	Rep. / Dem. Electoral Votes
1996	196.5	96.3	49.0%	159/379
2000	205.8	105.4	51.3%	271/266
2004	221.3	122.3	55.3%	286/251



Years of Presidential Cycle	Average S&P 500 % Chg. (Without Dividends 1945-Q3 '07)				
	Q1	Q2	Q3	Q4	Year
Year 1	-0.3	1.8	0.0	3.2	5.2
Year 2	1.0	-2.0	-1.0	6.8	4.3
Year 3	7.1	5.3	1.9	2.8	18.0
Year 4	1.2	3.0	0.7	3.5	8.6
All Years	2.3	2.0	0.3	4.1	9.0

Source: www.archives.gov

Source: Standard &amp; Poor's Equity Research

## General Guidelines

## • Historical Party Performance

	S&P 500		U.S Long-Term Gov't. Bond Total Return	Small Stocks vs. S&P 500
	Price Return Over Entire Term (1901-2000)	Relative Compound Ann. Return (1901-2000)		
Democratic Administration	66.0%	6.7%	2.7%	8.2%
Republican Administration	44.7%	4.6%	7.9%	-3.5%

- **Impact of Recession?** When the economy has been in or entering a recession during past presidential elections (1920, 1932, 1944, and 1960), the S&P 500 has fallen -3% on average and the incumbent party has lost 3 of the 4 contests.
- **Pharmaceuticals and Biotech have consistently underperformed in election years** (+8% vs. +13% annual average overall), but tend to bounce back strongly in the first year of the new presidential term (because investors tended to become overly pessimistic on the Healthcare outlook as the election race was unfolding).
- **Own Defense in an election year.** Defense stocks have outperformed the market by +19% over the last 8 election years irrespective of the party in power. Morgan Stanley Equity Research recommends being overweight Defense stocks and underweight Aerospace stocks in the 2008 election year.

## White House Republican Victory

- Potential Beneficiaries may be found in companies, exchange traded funds, closed-end funds, and open-end funds focused on the following sectors:

- Asset Managers
- Brokers/Investment Banks
- Coal
- Credit Card Companies
- High Dividend Yielding Companies
- Large Cap Pharmaceuticals
- Managed Care, Oil & Gas
- Student Loan Providers

## White House Democratic Victory

- Potential Beneficiaries may be found in companies, exchange traded funds, closed-end funds, and open-end funds focused on the following sectors:

- Biofuels
- Generic Drug Companies
- Geothermal
- Healthcare IT
- Hospitals
- Medicaid Companies
- Natural Gas Companies
- Solar Power Companies
- Wind Power Companies

## Important Themes and Considerations

- **U.S. Foreign Policy:** is likely to focus on: (i) maintaining its military, economic, and financial position; (ii) repairing or strengthening diplomatic ties with America's close allies; and (iii) preventing nuclear proliferation, failed nation-states, genocide, and the escalation of armed conflict.
- **Healthcare and Retirement:** Legislative initiatives may attempt to bring about: (i) drug re-importation; (ii) Medicare-negotiated drug discounts; and (iii) stricter drug approval policies.
- **Environmental and Emissions Standards and Alternative Energy:** Short-, intermediate-, and long-term investor psychology and capital market conditions are likely to be affected by the 111<sup>th</sup> Congress' stance toward, regulation of, and/or taxation of selected industries.
- **Key Issues:** Assuming that the national political will finds meaningful expression in the elections and effective sponsorship can emerge, legislative initiatives may be formulated to address such key issues as: Energy, Education, Intellectual Property, Immigration, Infrastructure, National Broadband, and Technology.
- **Intrade** (<http://www.intrade.com>): Shows real-time market-based odds of political outcomes.
- **Iowa Electronic Markets** (<http://www.biz.uiowa.edu/iem/>): Futures markets where contract payoffs are determined by the popular vote cast in the 2008 U.S. Presidential Election.

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