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Evolution of Industry Momentum Factors Following the 2025 U.S. Midterm Elections: Analysis of Structural Differentiation and Policy Sensitivity

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Abstract

Even though the United States election finished in 2024, the first half of 2025 is critical for the incoming administration's policies to transition from anticipation to action. In light of this, this essay predicts that during the first half of 2025, high-momentum sectors will exhibit substantial structural divergence. This disparity reflects the market's perceptions about different industries' ability to respond to policy changes. This article's key statistic is a 9-day momentum factor, which captures short-term trend performance across sectors. With statistically significant t-test results, it explores the sectors with the greatest difference in policy events and creates discrete event analysis windows based on policy types. Finally, the findings reveal that policy events exacerbate the disparities in momentum between industries. Furthermore, the disparity is systematic, involving both the nature of the industry and the policy's content. Building on these findings, it discusses five critical policies and the underlying variables that contributed to this outcome. It concludes that, while policy serves as an external catalyst for divergence, the primary cause of this divergence is changes in industry sensitivity.

Keywords

U.S. presidential election, policy impact, momentum effect

1. Introduction

Momentum in finance refers to the persistence of asset price trends: failing assets continue to decrease, while high-performing assets tend to rise. This phenomenon contradicts the weak-form market efficiency hypothesis, which asserts that market prices accurately reflect all available information about the price of securities, including trading volumes, short-selling amounts, margin financing amounts, and stock transaction prices. It is recognized as a classic market oddity. Long-term research has revealed that the momentum effect is resilient across asset classes and economies, and it persists in huge markets.

The momentum effect has been studied since Jegadeesh and Titman (1993) built a momentum portfolio by "buying strong stocks and selling weak stocks" using historical data from the US stock market (Efficiency, 1993). Over the following three to twelve months, they discovered notable positive excess returns, proving that the market exhibits delayed price movements (Efficiency, 1993). On a sector level, Moskowitz and Grinblatt (1999) expanded on this study. They discovered that sector momentum was more reliable and predictive than stock-level momentum using sector-level return data, suggesting that sector rotation is a major

factor in stock momentum Exchange-traded funds (ETFs) and empirical trading applications have been included in research more and more in recent years. Sector ETFs were used by Vanstone et al. (2021) to create momentum strategies, showing that (Vanstone et al., 2021).

Over time, portfolios continuously produced strong excess returns that were highly replicable. Yang and Shi (2023) greatly improved returns and Sharpe ratios by combining factor models with fundamental analysis to screen momentum and risk-adjust portfolios. This suggests that in order to improve performance in the actual world, momentum techniques can be optimized through information improvement. Using the U.S. presidential elections as an exogenous variable, Amburgey (2025) revealed that policy changes increased momentum divergence in sectors including energy, clean energy, and military in response to significant policy or public crisis shocks. This suggests that policy risk exacerbates the consequences of sector rotation. When Patel et al. (2025) looked at industries during times of increased health policy uncertainty, he discovered that the manufacturing of pharmaceuticals and medical devices performed the best, while coal, real estate, and building materials did the worst .

Similarly, Patel et al. (2025) revealed that climate policy events help the clean energy sector; but, when policies reverse or uncertainty grows, the sector experiences increased volatility and falling performance, with responses differing by sub-sector .

However, while recent empirical studies have begun to bridge policy, momentum, and cross-industry gaps, research has yet to thoroughly characterize the common characteristics of top-performing and bottom-performing industries. Few studies have coupled structural variables like volatility, trade volume, industry sensitivity, or connectivity with momentum performance for testing purposes. Furthermore, most research concentrates on a single policy area or industry, with little cross-industry and cross-policy comparisons. These are still promising areas for further investigation.

This article aims to better understand how policy promotes momentum divergence across industries by analyzing significant U.S. industry ETF data and using metrics such as mean difference, range, and dispersion. It identifies the impact of policy on sector differentiation, which helps investors anticipate industry changes (Bannigidadmath and Powell, 2025).

2. Organization of the Text

2.1 Methodology

This study uses daily return data from ETFs in U.S. sectors such as Communication Services, Energy, Financials, Industrials, Technology, Consumer Staples, Health Care, and Consumer Discretionary from January 1, 2025, to July 31, 2025. A momentum indicator is designed to capture momentum shifts across all sectors.

First, a rolling 9-day return period was used as a momentum indicator to assess the market performance of sector ETFs across different policy contexts and time horizons.

The yield calculation method is as follows-

$$M_{\mathrm{t}} = \frac{P_{\mathrm{t}}}{P_{\mathrm{t-9}}} - 1 \tag{1}$$

M_t means yield, and t represents the current time, $t-9$ referring to the time nine days prior, with -1 converting the ratio to a percentage.

Next, directly calculate the momentum indicator sequences for all industries and conduct horizontal comparisons across sectors. To reflect the degree of divergence among industries, two types of structural divergence indicators are introduced:

(1) Average difference: Measures the average absolute difference in momentum performance across industries, reflecting overall disparities between sectors;

$$\mathrm{MAD} = \frac{1}{\mathrm{n}} \sum_{\mathrm{i=1}}^{\mathrm{n}} |\, \mathrm{M_i} - \bar{\mathrm{M}}| \tag{2}$$

MAD is average deviation. $\bar{M}$ denotes the average return over the period, where M_i represents the return on day i.

(2) Range — The difference between the maximum and minimum values, measuring the extreme divergence in sector performance.

$$R = \max(M_1, M_2, \ldots, M_n) - \min(M_1, M_2, \ldots, M_n) \quad (3)$$

In this formula, $\max(M_1, M_2, \ldots, M_n)$ denotes the maximum return among all returns, while $\min(M_1, M_2, \ldots, M_n)$ denotes the minimum return among all returns.

Methodologically, the study first identified significant policy event dates in the first half of 2025 (e.g., fiscal stimulus packages, energy policy changes, technological regulatory measures), and then created dynamic event windows around these timepoints. These dynamic frames were changed based on event density and market reaction speed in order to capture short-term policy impacts more effectively. Within each event window, the trend changes of the blue and red dashed lines were calculated individually and compared to other time periods.

Following that, independent samples t-tests were used to determine the significance of divergence indicators within and outside event windows, as well as whether policy events had a significant impact on the degree of momentum divergence across sectors.

$$t = \frac{\bar{X}_1 - \bar{X}_2}{\sqrt{\frac{s_1^2}{n_1} + \frac{s_2^2}{n_2}}} \quad (4)$$

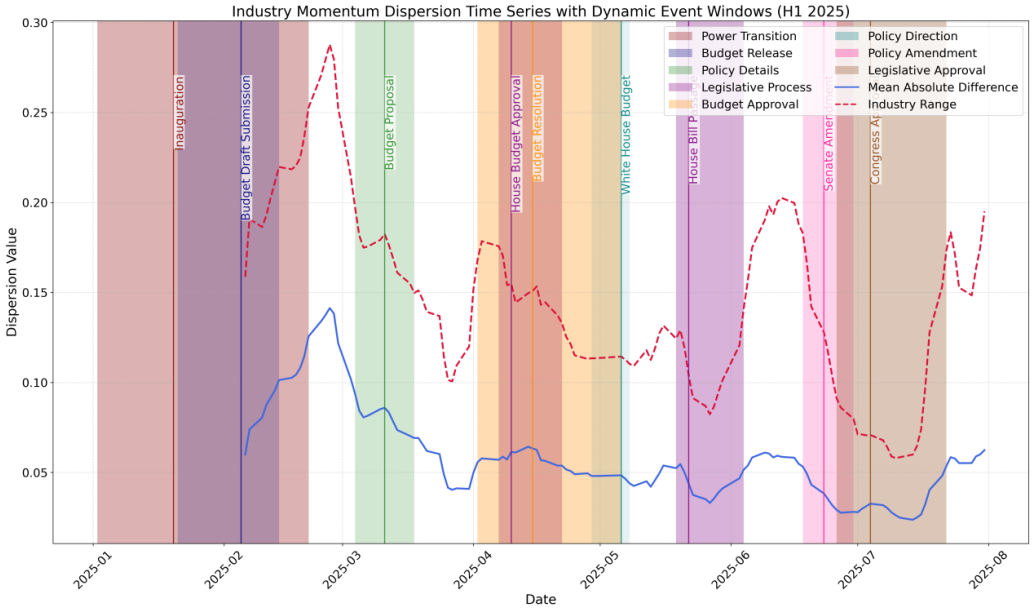
wheretis the t-test statistic,$\bar{X}_1$ and $\bar{X}_2$are the means of the two sample groups, s_1^2 and s_2^2 are their respective variances, and denote the sample sizes.

Finally, we do a thorough examination of the best and worst-performing industries during major events. These methodologies allow us to not only monitor the divergence trajectories of general and extreme industries but also measure the actual impact intensity of policy events. This strengthens the credibility of our findings, providing empirical support for the notion that "policy plays a role in driving momentum divergence across industries."

3. Results

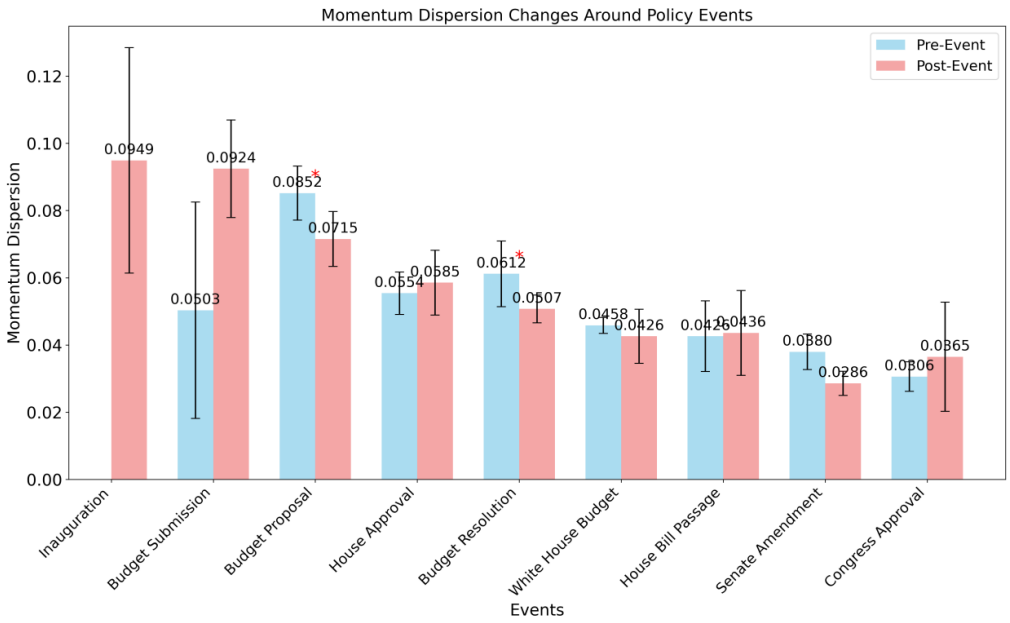
First, we evaluate the dispersion of sector momentum across time (Figure 1). The horizontal axis depicts time, and the vertical axis shows dispersion values, which reflect the degree of variation in sector momentum returns. Sector momentum differences were largely steady throughout most periods, while dispersion measures fluctuated significantly during specific policy event intervals. The average absolute difference (blue line) depicts the overall amount of sector divergence, whereas the range (red dashed line) shows the widest disparity between the strongest and weakest sectors. Colored bars show the time of event impacts. Both metrics reveal synchronized rises at important junctures, indicating that policy actions had a considerable impact on sector divergence.

Figure 1: Time Series of Industry Momentum Dispersion and Dynamic Event Window



To uncover the many mechanisms by which policy events generate sector divergence, this paper studies both the general trend in momentum dispersion and the quantitative comparison of specific events, demonstrating statistical variations in dispersion before and after each event (Figure 2). The horizontal axis reflects several policy event categories, while the vertical axis depicts the industry's average momentum dispersion prior to and following each event. Precise numerical comparisons for each event are completely displayed, with statistical significance indicated by error bars and asterisks, allowing for comparisons of impact intensity across events.

Figure 2: Changes in Dispersion Around Policy Events



To evaluate the impact of policy events on industry momentum divergence, this study employed t-tests on important event windows, as indicated in Table 1. Most event windows had t-values larger than 2, with some exceeding 4, indicating that industry divergence was substantially stronger during these times than in non-event periods. This discovery closely corresponds to the divergence peaks shown in Figure 1 and confirms the group comparison conclusions in Figure 2. The results confirm that policy announcements cause firms to diverge, whereas inaugurations and budget blueprint approvals significantly increase sector momentum dispersion (Figure 2).

Table 1: T-Test Results for Each Event

Event	Date	Type	T-Value
Presidential Inauguration	2025-01-20	Power Transition	4.939
President Submits Budget Draft	2025-02-05	Budget Release	2.645
Presidential Budget Proposal	2025-03-11	Policy Refinement	1.263
House Passes Budget Blueprint	2025-04-10	Legislative Process	7.575
Congressional Budget Resolution	2025-04-15	Budget Approval	-0.067
White House Releases Budget	2025-05-06	Policy Direction	2.682
House Passes Bill	2025-05-22	Legislative Process	1.433
Senate Amends Bill	2025-06-23	Policy Revision	-0.646
Congress Passes Bill	2025-07-04	Legislative Adoption	2.829

This article examines the microstructure of sector divergence by focusing on five important policy events and identifying the best and worst-performing sectors within each event window (see Table 2). During the presidential inauguration, the energy and communication services sectors outperformed, reflecting market confidence in the new administration's industrial goals. In contrast, the discretionary consumer and information technology sectors trailed, showing investor pessimism about consumer spending and the regulatory prospects for technology. When the President released his draft budget, fiscal spending supported the energy and communications industries, which continued to lead, while the consumer and technology sectors received little support. Subsequently, following the House passage of the budget blueprint, the previously leading communications and energy sectors corrected, while the industrial and consumer staples sectors demonstrated considerable resilience. When the White House unveiled its budget, the general market reaction was mild, with energy and consumer staples up slightly. Finally, when Congress passed the law on July 4th, the financial and technology sectors profited the most from enhanced policy certainty, while the energy and industrial sectors suffered relative losses.

Table 2: Industries with the Best and Worst Performance Corresponding to Significant Events

Event	Top-performing sector 1	Top-performing sector 2	Worst-performing sector 1	Worst-performing sector 2
Presidential inauguration	Communication services	Energy	Non-essential consumer goods	Technology
The President submits a draft budget	Communication services	Energy	Non-essential consumer goods	Technology
House of Representatives passes budget blueprint.	Industry	Consumer Staples	Technology	Energy
White House Releases Budget Consumer Staples	Energy	Consumer Staples	Industry	Healthcare
Congress Passes Bill Financials	Financials	Technology	Energy	Industry

4. Conclusion

This study looks at the performance and internal divergence of major US industry ETFs in the first half of 2025 through the lens of momentum factors. The findings show that industries did not have consistent, persistent advantages overall, but rather significant structural differences between sectors. The technology and discretionary consumer sectors maintained strong momentum, but energy and other conventional industrial sectors faced intermittent drops. This phenomenon demonstrates that the effectiveness of high momentum factors differs by industry. Its endurance is determined not only by broad market trends but also by macroeconomic policy contexts and the structural peculiarities of the industries themselves.

This study examines investors' varying risk and growth expectations for diverse sectors in the face of policy shocks such as election uncertainty and tariff variations. These distinctions are quickly reflected in capital markets, resulting in diverse trends within high-momentum businesses. In conclusion, the momentum effect is not evenly distributed, but it is strongly related to an industry's policy sensitivity and market expectations.

The study also includes limitations, such as a brief research period and an examination limited to the industry ETF level. Future research could look at longer time horizons, use micro-level company data, and draw on existing literature to better understand the dynamic link between macroeconomic policies and financial markets.

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Conflicts of Interest

The authors declare no conflict of interest.

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