TrendMacrolytics

Donald Luskin, Chief Investment Officer
David Gitlitz, Chief Economist
Thomas Demas, Managing Director

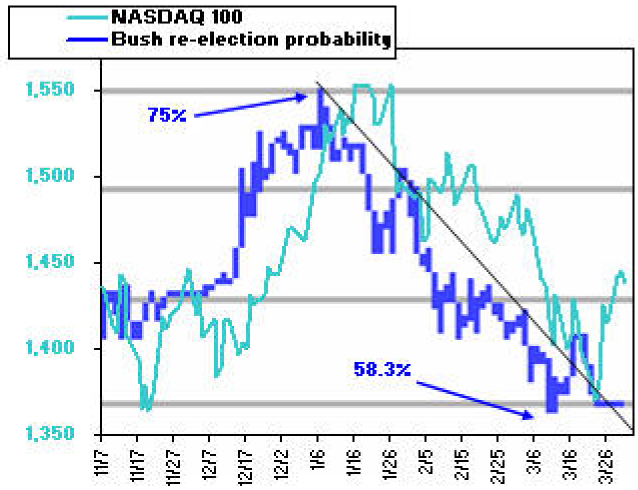
MACROCOSM

More At Stake Than Jobs

Thursday, April 1, 2004

Donald Luskin

Bush (and the market) survived Richard Clarke. Now for tomorrow's payroll jobs number.



The probability of **George W. Bush's** re-election has stabilized at 60%, as measured by the political futures contracts traded on **Tradesports.com**. The sharp year-to-date downtrend in Bush's chances seems to be broken. To be sure, it's been with a whimper, not a bang -- but broken nevertheless. As we forecasted two weeks ago, it's been enough to sustain a strong rally in the NASDAQ, which represents the growth-sensitive sectors of the economy most attuned to the risks to the extension of Bush's pro-growth tax policies (see "The Bush Breakout" March 19, 2004).

The stabilization of his re-election probabilities, and his continued moderate strengthening in convention opinion polls, suggest the exhaustion of public interest in his opponent's messages. To put it another way, that Bush has been able to stabilize in the face of intense media carpet-bombing triggered by **Richard Clarke's** accusations of negligence on counterterrorism may mean that Bush has hit bottom. In a winner-take-all event like a presidential election, hitting bottom at 60% probability is a very good thing. Certainly the NASDAQ seems to think so.

While all eyes are properly on tomorrow's payroll jobs numbers for what they imply for **Fed** policy, their market impact may be greater in terms how they will influence Bush's prospects. The failure of officially measured growth in payroll jobs during this economic recovery has been a key weapon for the **Democrats** to sow dissatisfaction with Bush, by creating the public perception that an otherwise booming economy is not, in fact, recovering at all (see "Tough Time for Tech" March 8, 2004). Though this perception is false in our opinion -- being the joint result of political engineering and a deeply flawed statistical process -- it could nevertheless determine the election, and the course of the stock market.

The payroll jobs numbers may be an element in a market process once described by **George Soros** as "the theory or reflexivity." The idea is that financial markets not only reflect economic activity, in some cases they also determine it. In such cases there can develop a self-reinforcing positive-feedback loop between the market and the economy. For example, say a speculator believes a particular country's currency is too strong in light of that country's economic weakness. The speculator shorts the currency, which itself contributes to the country's further weakness -- which causes the speculator to short even more currency...and so on.

We may be in a "reflexive" situation today if we are correct that the stock market would prefer to see George Bush re-elected. If Bush's chances diminish, the market will fall. The very fact that the market fell will deepen fears about the economy, and make Bush's re-election chances fall even further...and so on. It could work in reverse, too. Say tomorrow a big payroll jobs number helps to catalyze public appreciation that the reality of economic recovery is actually excellent. That will help Bush's re-election chances, which will boost the market. The fact that the market is up will further boost Bush's re-election chances...and so on. No doubt Soros, who has taken an active role in the campaign to defeat Bush, has thought of this. TM