

POLITICAL PULSE

## Many A Slip

Friday, October 1, 2004

Donald Luskin

### Bush missed the whisper number last night. Time to start whispering about October 8.

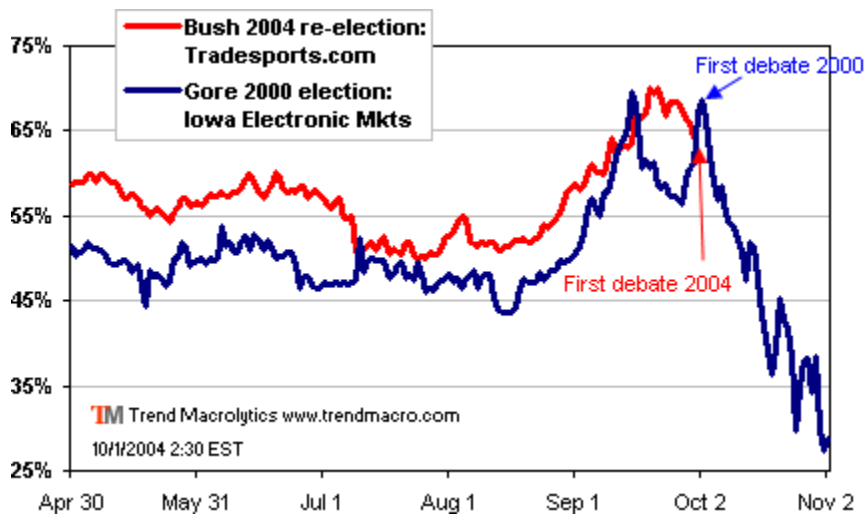
We have now passed through the first of several critical risk gates on the way to the election -- the first presidential debate. Admitting that it takes several days to see how events like this end up resonating in the public consciousness, at the moment our sense is that it was not decisive one way or the other.

Not unlike when a company announces earnings, the reaction to a presidential debate is largely a function of expectations. Setting expectations nice and low is an art at which **George W. Bush** is a master. So all week **GOP** surrogates have been talking up what a great debater **John Kerry** is, so when the relatively inarticulate Bush turns in a merely adequate performance, he'll be seen as a big winner. But we're not confident that they got away with it this time. In an iterated game, one can only get away with playing the same strategy so many times before the opponent -- or in this case, the audience of voters -- catches on. Also, despite the last week of admiration for Kerry's debating skills, GOP surrogates have spent the last two months talking up what a pompous phony he is, and luxuriating in Bush's accelerating momentum coming out of the conventions. Finally, at what may have been the mistaken insistence of GOP strategists, the first debate was focused on foreign affairs and homeland security -- areas in which voters give Bush an edge, and thus expect him to perform especially well.

We commented last week that the debate had become a paradoxical game between two underdogs (see "[Bush Out of Whack](#)" September 22) -- but in retrospect, for all these reasons, this now seems like a best-case view for Bush. Perhaps the reality is that the "whisper number" had him as the favorite. And relative to *that* level of expectations, our view is that Bush's performance last night wasn't good enough -- and Kerry's wasn't bad enough -- to provide a decisive and market-moving result. Bush was Bush, and Kerry was probably a little better than Kerry. For both men, the debate seemed like a case of linguistic deflation -- too few soundbites chasing too many minutes of airtime. In terms of issues, it's hard to believe that any undecided voter would be moved one way or the other by anything of substance said last night. But in the game theory of expectations, Kerry probably came out a bit on top.

This is borne out by the futures contracts on Bush's re-election probabilities, traded online at [Tradesports.com](#). Always a reliable indicator of which direction the polls will swing over the next several days, the futures dropped after the debate -- from an intraday high of 69.9% yesterday before the debate, to an intraday low this morning of 61.6%.

Here we are, then, still unable to rule out the risk of a repeat of 2000, when **Al Gore** enjoyed the same advantage in the polls that Bush has recently enjoyed -- only to lose it all by screwing up the debates. But let's think one move ahead in game theoretic terms. Perhaps it's the case that last night's negative surprise for Bush is exactly what's required to sufficiently lower expectations for the *next* debate, which will set up Bush for a decisive win from his preferred



position as underdog. All the preconditions will be right: Bush will come in the "loser" of the first debate, and the subject will be domestic affairs -- a subject area where Kerry has a much stronger standing in the polls.

And then there's something else that could come into play in the second debate. It will be held on the evening of October 8, the same day that the last jobs report will

be issued before the election. And this will be no ordinary jobs report. This will be the annual "benchmarking" revision, where the estimated payroll jobs numbers of the entire previous year are subject to revision. Typically, the estimated jobs numbers seem to systematically lag the business cycle, so that revisions in soft years tend to be downward, and revisions in strong years tend to be upward. We've just come through a very strong year by almost any measure, and based on historical experience there's no reason why the revision couldn't be as great as, say, 500 thousand jobs. Even a revision that big would only be a small down payment on closing the unprecedented gap between payroll jobs measured by the establishment survey (showing only about 600 thousand jobs created since the recession trough) and jobs measured by the household survey (2.6 million created). So it's possible that Bush could walk into the second debate -- the one focused on the economy -- with this recovery not looking so jobless after all, and with Kerry deprived of a key rhetorical weapon.

1979	447	1992	-59
1980	-63	1993	263
1981	-349	1994	747
1982	-113	1995	542
1983	36	1996	57
1984	353	1997	431
1985	-3	1998	44
1986	-467	1999	258
1987	-35	2000	468
1988	-326	2001	-123
1989	47	2002	-203
1990	-229	2003	-122
1991	-640		

If we are correct in our interpretation of last night's debate, and of the potential for the second debate, then we wouldn't expect to see a big reaction in markets, one way or the other, in the next several days. It's encouraging to see the stock market opening higher this morning. As we noted last week, the stock market has rallied from the lows it made on August 12, the same day the Bush futures contracts made *their* lows -- but the market has failed to rally in commensurate magnitude with Bush's rising probabilities. The market seems to have already discounted the risk that there can be many a slip between the cup and the lip -- and the election. Last night was probably one of them, but it seems the market had that priced in. Stocks remain so overwhelmingly undervalued here, we don't see a lot of room on the downside. And we continue to believe that if and when the election catalyzes strongly in favor of Bush -- possibly as soon as the second debate on October 8 -- the deep risk premium in equities will be released very dramatically. **TM**