

TRENDMACRO LIVE!

## On Yesterday's Elections

Wednesday, June 7, 2006

Donald Luskin

Three bellwether races in yesterday's primary elections renew optimism that the Republican party will be able to hold onto its majority status in the House of Representatives in November's general midterm elections. We have been saying since late January that the risk of the GOP's loss of House control would be an overhang on stocks this year, because it would increase risks of anti-growth protectionist and environmental legislation (see, ["Election Risk: It's Back"](#) January 26, 2006).

The corruption issue proved yesterday to have nowhere near the salience that Democratic strategists have hoped. In California's 50th congressional district, Republican Brian Bilbray beat Democrat Francine Busby by a decisive margin in a closely watched special election to replace jailed GOP congressman Randy "Duke" Cunningham. In California's 11th district, powerful House Resources Committee chair Richard Pombo -- accused of corrupt associations with lobbyist Jack Abramoff -- turned back a primary challenge from anti-corruption challenger Pete McCloskey. In the same district, Democratic primary voters rejected the hand-picked candidate of the Democratic Congressional Campaign Committee, a decorated Vietnam veteran who represented the DCCC's strategy of positioning liberal candidates with impeccable national security credentials.

Also in California -- which has historically been a bellwether for the national mood on tax policy - a ballot proposition to impose a new "millionaire's tax" to fund public pre-schools, went down to defeat by a wide margin despite backing headed by popular liberal activist Rob Reiner.

This reprieve for the Republican majority comes at a time when President Bush's approval numbers have bounced smartly from their all-time lows. That said, the Abramoff corruption scandal will continue to unfold, and Bush has yet to face the full fury of public reaction to the yet unknown dimensions of the Haditha atrocities. Thus yesterday's good news for the GOP was only sufficient to rally online political futures contracts overnight to prices indicating a 50% probability of GOP House control, up from lows of only 44% just several days ago. At the same time, the Senate control contract rallied to a 79% probability overnight, from 76% several days ago -- reaffirming that a worst-case Democratic congressional sweep in November is highly unlikely.

**BOTTOM LINE:** The worst risk of loss of GOP House control has already been taken off the table, thanks to last month's extension of the 2003 tax cuts on dividends and capital gains. Still, we think equity valuations ought to prefer a continued GOP House majority as a bulwark against populist anti-growth protectionist and environmental legislation. Stocks should be supported by yesterday's election results, in tandem with the increasing clarity with which the Fed is embracing its anti-inflation mission (see ["Bernanke Arrives"](#) June 6, 2006). **TM**

### Update to strategic view

**STOCKS:** Tuesday's primary elections suggest that the GOP will be able to hold onto its majority in the House in November. This reduction in political risk to growth, combined with growing clarity about the Fed's focus on inflation, should support our view that the steep decline in stocks has been overdone, and is a buying opportunity.