

POLITICAL PULSE

## Mid-term Cliffhanger

Wednesday, September 24, 2014

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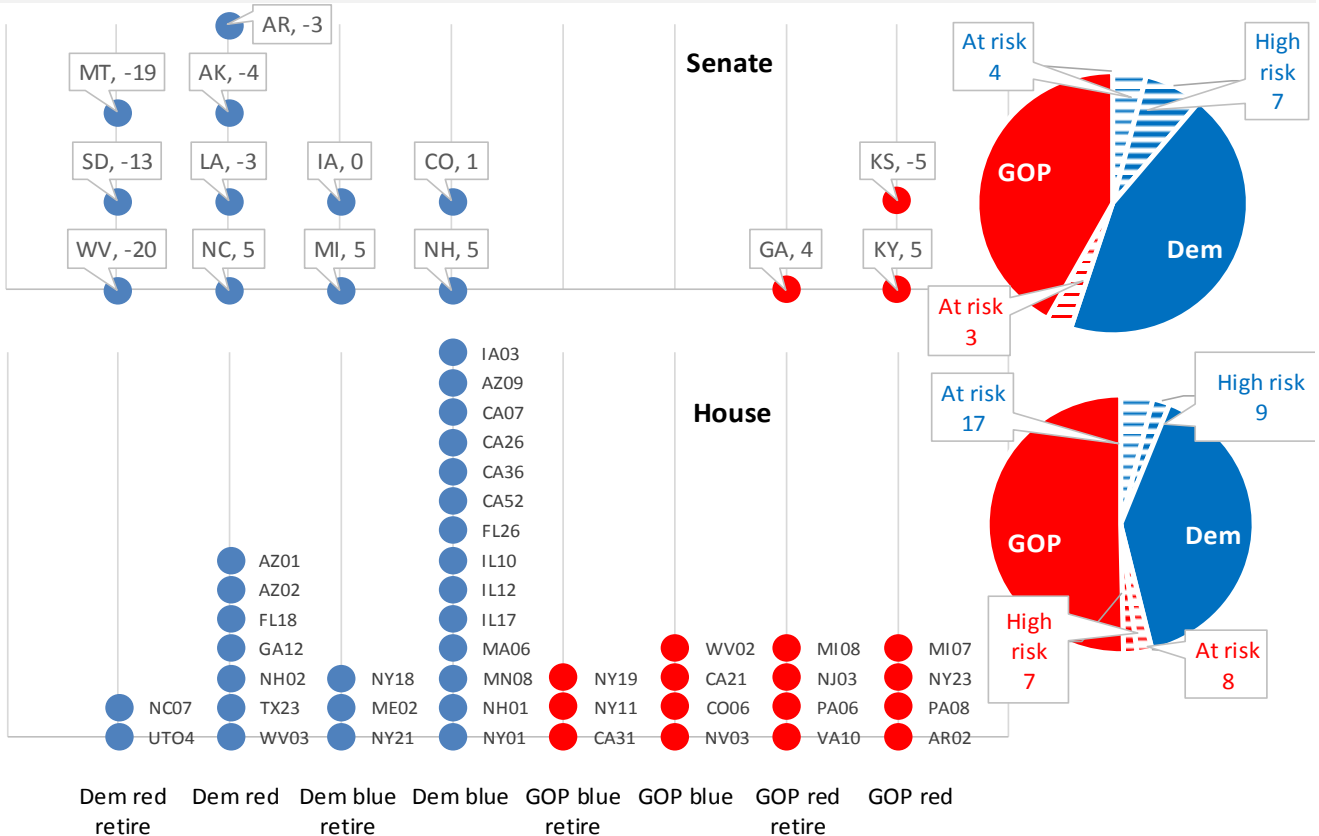
41 days till we may have to wait 32 more days to know who controls the Senate.

We have been saying since last year's government shutdown that the GOP would keep House control and take Senate control in the 2014 mid-terms (see ["On the Shutdown and Debt Limit Deal"](#) October 17, 2013). This would open the door to a modest but positive pro-growth shift in economic policy, and some alleviation of uncertainty as partisan discord within a divided congress would be mooted. *We think some of the risk-off tone in markets this week is due to new dangers to this outcome. So where do we really stand, with the elections just 41 days away?*

**Update to strategic view**

**US MACRO, US STOCKS:** The economy and the equity market eager for certainty are being frustrated by the mid-term elections...  
*[continued on next page]*

**Competitive 2014 congressional races by current party occupant ● Dem ● GOP**  
**Senate: poll advantage for incumbent party**



Source: Cook Political Report, RealClearPolitics, TrendMacro calculations

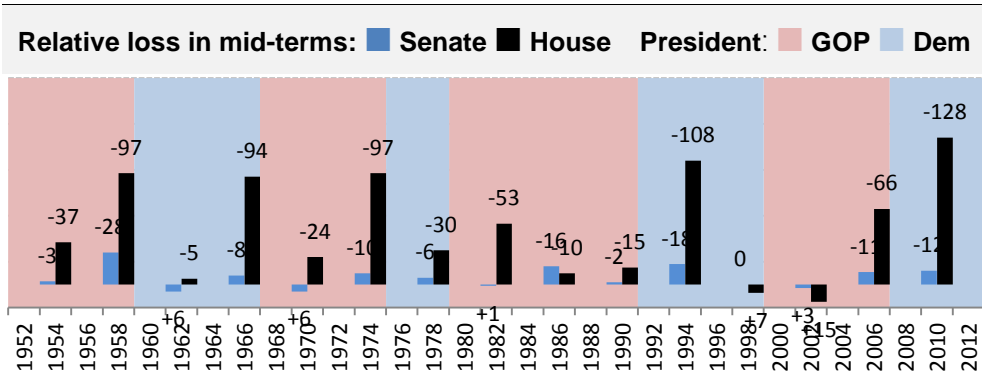
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- The GOP comes into this election with a very reliable historical law operating in its favor. There is a strong tendency for the party that does not occupy the White House to make congressional gains in mid-terms (please see the chart below). The president's party has only made mid-term gains in both the House and the Senate twice in the last century -- 1934 and 2002, both years in which the president was unusually popular. Obama's low approval and high disapproval utterly rules out such an outcome in November.
- Durable historical patterns like this formed the core of our presidential election model, which correctly predicted Obama's 2012 victory within six electoral college votes (see "[TrendMacro's Election Model](#)" September 28, 2012 and "[On the 2012 Election](#)" November 7, 2012).

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...which, by the polls, point to a very narrow probability that the GOP will gain Senate control -- from which limited but positive pro-growth policy initiatives would flow. We continue to think that the strong patterns of US political history point to a GOP majority of two seats. But it could be narrower than that -- and there are two contingencies that could keep the outcome from being known until December: a likely run-off in Louisiana, and if independent Orman is the winner in Kansas, his decision on which party he will caucus with.

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Source: House and Senate clerks, TrendMacro calculations

- By any analysis, the House is a lock for continued GOP control, and Republicans stand to gain only a handful of additional seats (please see the chart on the previous page) -- both thanks to effective gerrymandering by both parties.
- The Senate will surely swing toward the GOP -- the only question is whether the GOP can take control. We have been saying in client conversations that the GOP can win a two-seat majority -- that's still our call, but it must be recognized that there are numerous razor-close races involved here.

Here's how it lays out for the Senate, all based on the latest polling (again, please see the chart on the previous page):

- Democrats have to defend 11 seats in competitive races, while the GOP only has to defend three.
- The GOP will surely win three open seats in red states currently occupied by Democrats -- Montana, South Dakota and West Virginia.
- The GOP will likely win three seats in red states in which the Democratic incumbent is on the ballot -- Arkansas, Alaska and Louisiana.
- The GOP is at little risk in Georgia, a red state where it is defending an open seat, and in Kentucky, another red state, where Senate Minority Leader Mitch McConnell is defending his seat.
- So that's six -- enough for the GOP to earn a one-seat majority.

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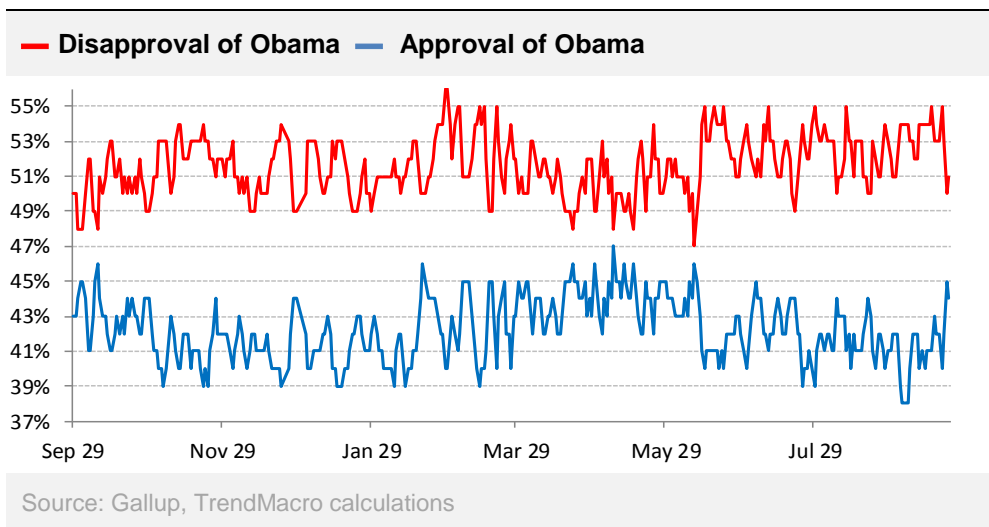
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- The problem for the GOP is Kansas, a red state in which the GOP incumbent Pat Roberts trails his independent opponent Greg Orman in the polls, with no Democrat on the ballot. If Roberts loses, there would be a 50/50 tie in the Senate, which would be broken one way or the other by Orman's decision on which party he would caucus with.
- Orman is hard to pin down -- he uses his partisan independence as a brand promise in lieu of particular policy commitments. He [describes](#) himself as "fiscally responsible and socially tolerant." He has had prior affiliations with both parties, but in recent years he has been more associated with Democrats, having narrowly decided against a 2008 Senate run as a Democrat.
- As to which party he might caucus with as a tie-breaker, [he says](#) "I will work with the other independent Senators to caucus with the party that is most willing to face our country's difficult problems head on and advance our problem-solving, non-partisan agenda." But remember that the other independent Senators are Vermont's Bernie Sanders, [an avowed socialist](#), and Maine's Angus King -- both caucus with Democrats, and both support Obamacare."
- Orman goes on to say, "Both Harry Reid and Mitch McConnell have been too partisan for far too long to earn my vote for majority leader." He prefers "responsible leaders from both sides like Democrat Heidi Heitkamp and Republican Lisa Murkowski who are willing to cross party lines to vote for what is right."
- Framed that way, this could get quite interesting -- if Orman is sincere, he would put McConnell and Reid into a contest to show which would be more selfless, with the one who sacrifices his own ambitions earning the majority for his party.
- Meanwhile, Roberts is portraying Orman as a Democrat in disguise -- and the Roberts campaign has now become the object of intense assistance by the national party. Despite the fact that Orman is up 5% in the most recent polling, it's far from a foregone conclusion that he can really win.
- All that said, there are five other competitive races that Democrats must defend which we haven't mentioned so far -- and none that must be defended by Republicans.
- In North Carolina, a red state, incumbent Kay Hagan has, at the moment, come from behind to lead in the polls.
- There are two blue states in which the GOP is contending for open seats currently occupied by Democrats -- Iowa and Michigan. In Iowa, the GOP is tied. It trails in Michigan.
- There are two blue states in which the incumbent Democrat is on the ballot -- Colorado and New Hampshire. In both states the GOP trails in the polls -- but in Colorado quite narrowly, and in New Hampshire the deficit is shrinking.
- All the GOP has to do is win one out of five of these races and lose all the rest and Kansas becomes less critical -- hence our adherence to our view that the GOP will take Senate control.
- For what it's worth, "prediction markets" agree -- the [Iowa Electronic Markets](#) have the probability of Democrats losing Senate control at about 75% -- and the [Irish bookies](#) have it at 65%.

Believing as we do in the durable patterns of political history, the determining issue here is Obama's popularity. Mid-terms are low turn-out elections -- the key is always for the party that doesn't occupy the White House to mobilize partisan dissatisfaction and frame the election as a protest against the president.

- Obama's approval gap -- the deficit between voter approval and disapproval -- has been fairly consistent over the last year (please see the chart on the following page).
- We think there is some risk that, as the mid-term election approaches, Obama's approval gap will shrink as he becomes increasingly identified with an assertive response against the Islamic State in Iraq and Syria.
- To be sure, last year he was stumbling over his own ["red line"](#) in Syria and just [two weeks ago](#) he confessed ["We don't have a strategy yet"](#) for ISIS.
- Now we're bombing ISIS in Syria -- as Obama bragged yesterday, ["on my orders"](#) -- and today the partisan *New York Times* is dutifully trumpeting [on its front page](#) that we've taken out a terrorist unit planning attacks against the US.
- Against this news backdrop, Obama's approval gap has narrowed over the past week (please see the chart below). Even though it seems he has been dragged against his will into this more aggressive posture in the Middle East, we know from when the US first invaded Iraq in 2003 that George W. Bush's approval increased substantially -- at least in the short term. Intentional or not, this could prove to be a ["wag the dog"](#) moment for Obama that might tip one or more close calls in the Senate in the Democrats' favor.



- At the same time, the concerted move against ISIS is exerting downward pressure on global oil prices, pulling them back from what had been shaping up to be a growth-chilling tipping point (see ["The Stench of CrISIS"](#) June 25, 2014) -- which gives voters slightly less to protest about on November 4.

It would be good for growth and good for equity markets not only to have a

GOP majority that could implement -- despite Obama's veto pen -- some measure of pro-growth policy in energy and deregulation. And having the election settled would, itself, be a positive development in that it would alleviate yet another instance since the end of the Great Recession of "regime uncertainty."

- The problem is, right now -- our optimistic prediction notwithstanding -- the mid-term election is something of a toss-up.
- Indeed, even after election night on November 4, we may have to wait another month to find out which party controls the Senate.
- In Louisiana, the November 4 election is in fact an "open primary," in which two Republicans and the incumbent Democrat are running. It is highly unlikely that any of the three candidates will get the 50% vote required to avoid a run-off on December 6. Then, the two candidates would be incumbent Mary Landrieu and the leading GOP challenger Bill Cassidy. The Republican is favored in the polls now, in that hypothetical two-way run-off, by 6% -- but be that as it may, GOP control may not be official until that second election.

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### **Bottom line**

The economy and the equity market eager for certainty are being frustrated by the mid-term elections which, by the polls, point to a very narrow probability that the GOP will gain Senate control -- from which limited but positive pro-growth policy initiatives would flow. We continue to think that the strong patterns of US political history point to a GOP majority of two seats. But it could be narrower than that -- and there are two contingencies that could keep the outcome from being known until December: a likely run-off in Louisiana, and if independent Orman is the winner in Kansas, his decision on which party he will caucus with. ▶