

POLITICAL PULSE

Trump's the One

Wednesday, May 4, 2016

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It could be yuge. It could be hahrible. But we predict The Donald will be the next president.

The black swan has landed. After winning Indiana, Donald J. Trump, barring assassination or some other mishap, is going to be the GOP candidate for the presidency. As economic strategists and as citizens – in both capacities we favor pro-growth and pro-freedom policy – *we look at Trump with both hope and horror, and what emerges from that duality will be very consequential for markets* (see [“2016: Two Charts, Six Words, One Man”](#) December 31, 2015). But as people who earn their living in the prediction business, we are thrilled at having been virtually unique among strategists last year, telling clients when Trump was seen as little more than a joke-candidate, that he would make it all the way (our first written report on this was [“Trumped!”](#) December 14, 2015). *And now we're going to double-down: for better and for worse, we predict Donald J. Trump will be the next president.* Politics first, then we'll discuss market implications.

- We think the key political variable now is how the GOP responds to the game-theoretic challenge it faces, which is something like a [prisoner's dilemma](#) in which a choice must be made between loyalty and defection. *With the electoral horse-race over for now, in-or-out decisions by GOP luminaries will rule the headlines.*
- Republicans looking ahead to having to run down-ticket from Trump in November must decide whether to distance themselves from him – to spare themselves the spillover from his high negatives – or to embrace him, and latch onto his momentum.
- We think politicians tend to follow [minimax](#) strategies – that is, they seek to minimize their maximum loss. Here it's hard to know what that even is. Trump has high negatives, but so does Hillary Clinton.
- *And face it: Trump is a demonstrated winner. He is a force of nature. There are risks, but when a tiger is on the loose, the safest thing to do is jump on his back, grab his ears, and try to ride him.*
- And though Trump is on many levels an existential affront to the establishment, any Republican running against him would deprive himself of the benefits of staying fully attached to the party.
- Thus the tweet last night from Republican National Committee Chair Reince Priebus, trying to set the tone:



Reince Priebus ✓ @Reince · 7h

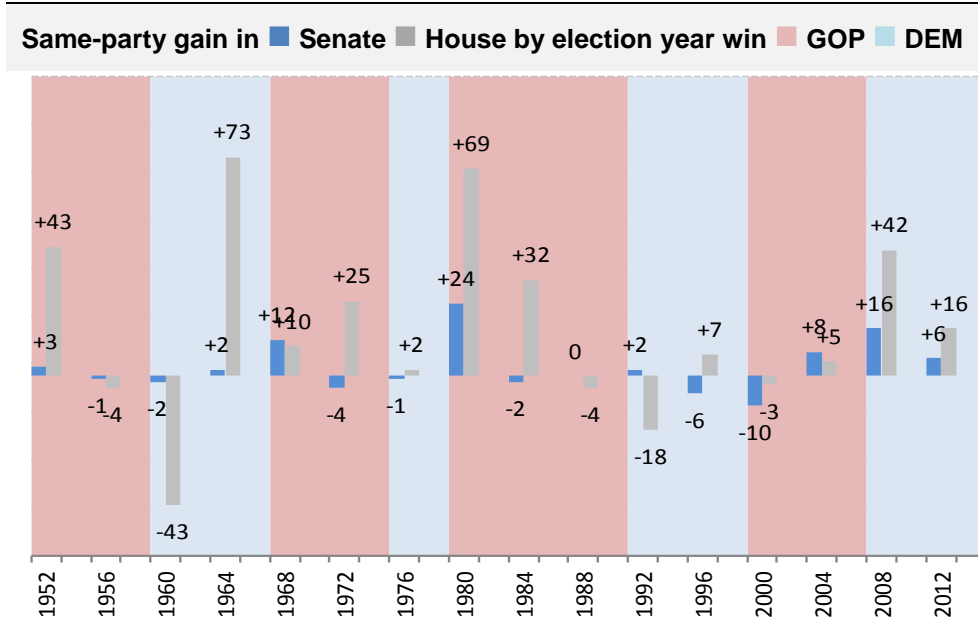
.@realDonaldTrump will be presumptive @GOP nominee, we all need to unite and focus on defeating @HillaryClinton #NeverClinton

Update to strategic view**US ELECTION MODEL, US FED, US EQUITIES:**

Trump, barring mishap, is the candidate. We predict he will win the general election. The next phase politically is to see how the GOP establishment deals with the game-theoretic decision of either riding the Trump tiger, or fighting it. We think the logic of minimax points to lining up behind Trump. But there are major uncertainties for markets here, perhaps motivating the present correction in equities – uncertainty if he will win or lose, with each possibility leading to its own different world of further uncertainty. One thing for certain: this puts the Fed on hold at least until December.

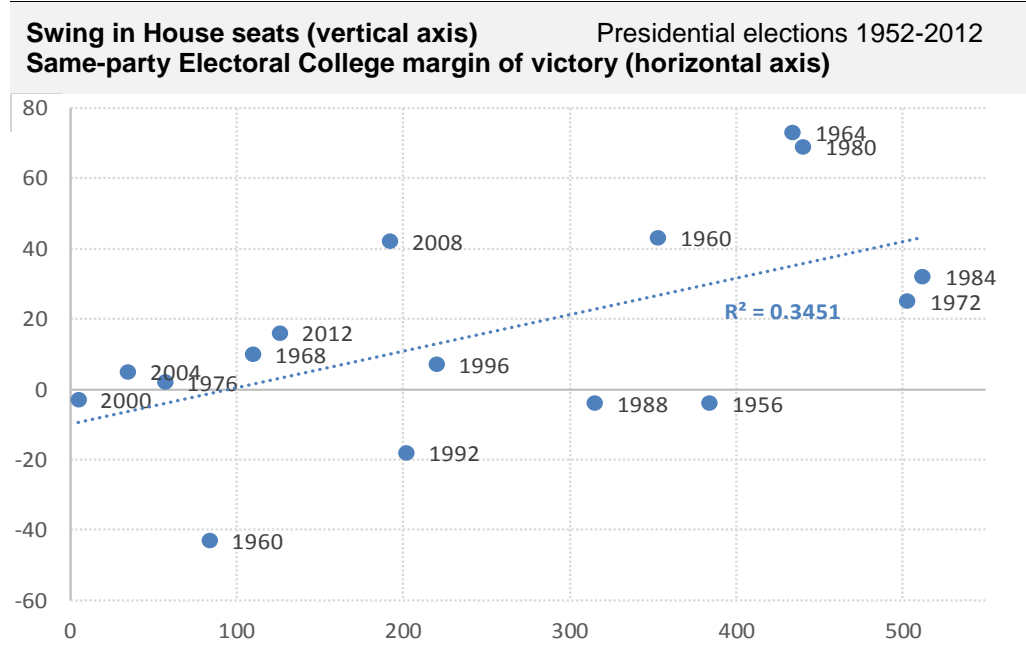
[\[Strategy dashboard\]](#)

- Down-ticket candidates need to realize that the “coat-tails effect” – the tendency for the party that wins the White House to make gains in the House and Senate too – is historically very strong and fairly reliable, especially for the House (please see the chart below). So in this sense the smartest thing a GOP candidate for congress can do to promote himself will be to promote Trump.



Source: US Congress, National Archive, TrendMacro calculations

- Historically, the bigger the margin in the Electoral College for the presidential winner, the bigger the gains for the same party in the Senate and the House (please see the chart below, and the chart at the top of the following page).



Source: US Congress, National Archive, TrendMacro calculations

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Recommended Reading

[Price drift before U.S. macroeconomic news: private information about public announcements?](#)

Alexander Kurov, Alessio Sancetta, Georg Strasser and Marketa Halova Wolfe
ECB Working Paper Series
 May 2016

[The Four Corners of the Gop \(Trump Owns Three of Them\)](#)

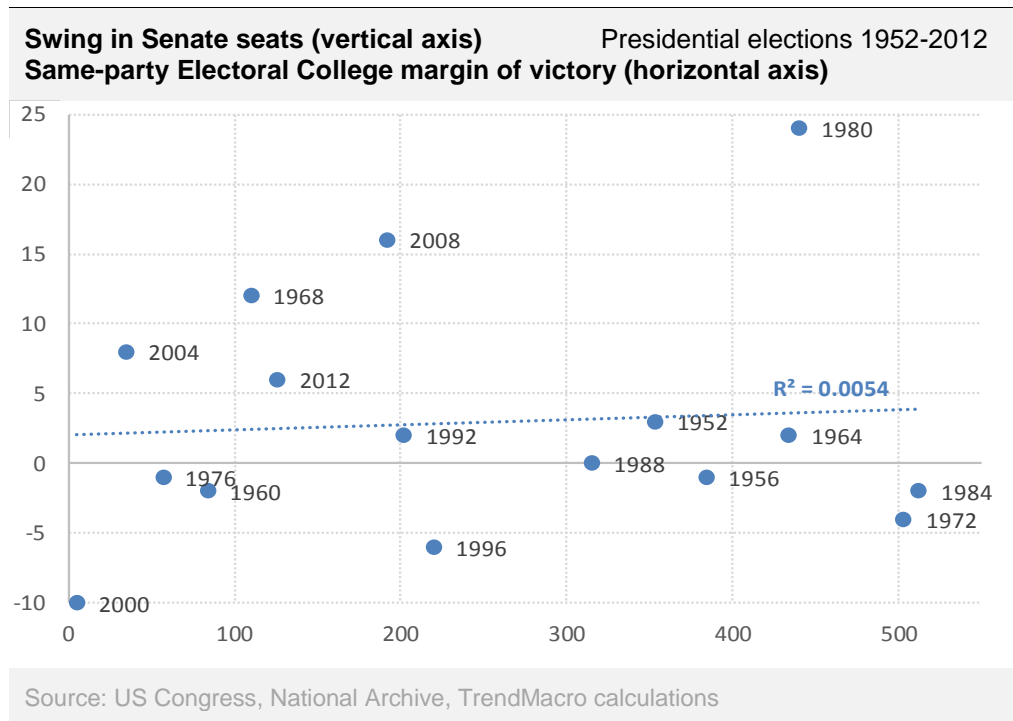
David Wasserman
FiveThirtyEight
 April 26, 2016

[Donald Trump will get more primary votes than anyone in history \(because more people are voting\)](#)

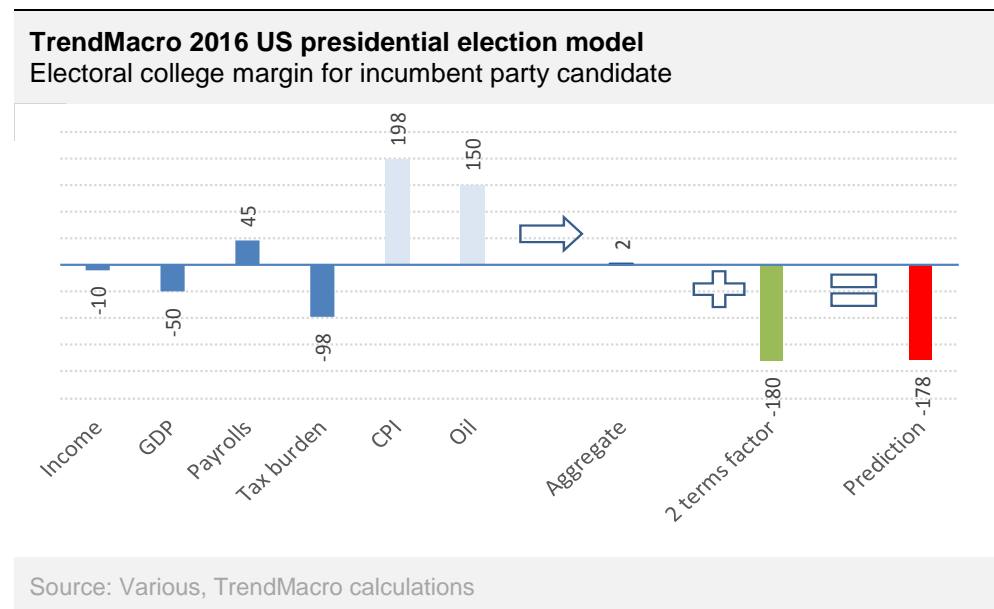
Philip Bump
The Fix
 April 27, 2016

[\[Reading home\]](#)

- The correlation is stronger in the House, but present to some extent for the Senate, too.

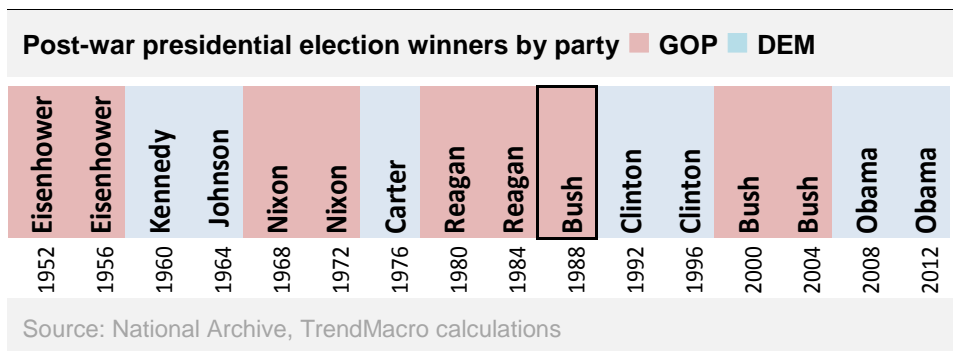


- While Trump is a most unusual candidate, he is running with a favorable background environment. Our quantitative election model (see ["Modeling the 2016 Presidential Election"](#) November 12, 2014) is currently saying that the GOP candidate (the model knows nothing of Trump specifically) would win by 178 electoral college votes if the election were held today (please see the chart below).
- Our model correctly predicted in real-time Obama's 2012 victory, getting it within just four Electoral College votes (see ["On the 2012 Election"](#) November 7, 2012). In back-test, the model has correctly



called every election since 1952.

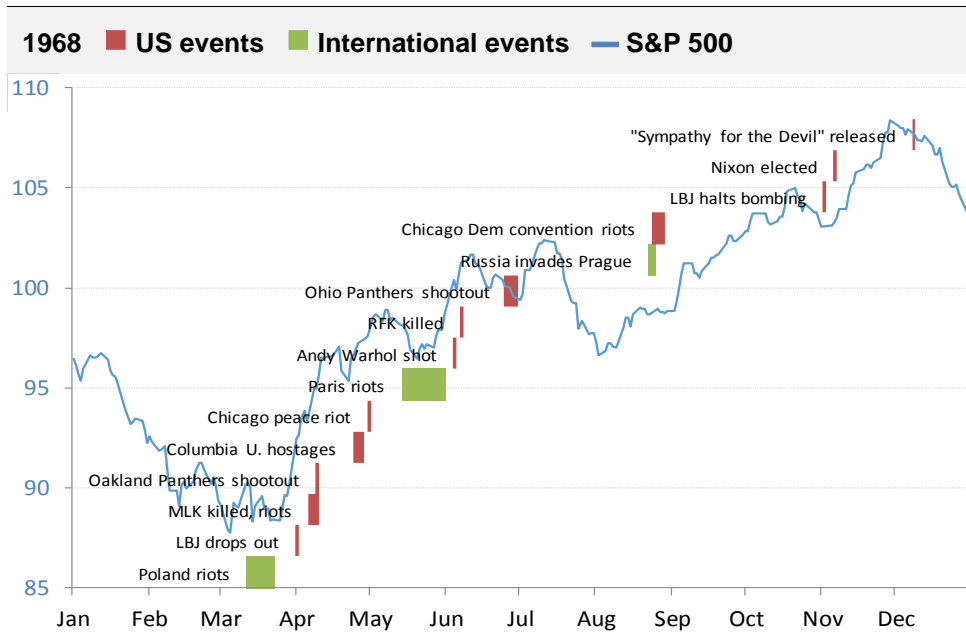
- The model sees the present configuration of the economic variables it uses as a tie, favoring neither party.
- We think that as the economy only slowly emerges from the mini-recession caused by too-low oil prices (see [“Have We Suffered Enough?”](#) February 26, 2016), the general economic backdrop won’t be much different on election day.
- But we do think oil prices will be higher, and that will tend to move the model further in favor of the GOP (see [“Oil’s Bull Market in a Month”](#) March 15, 2016).
- The tie-breaker in the model, which gives the election to the GOP despite no decisive advantage from the economy, is the “dummy variable” that takes account of the fact that, historically, it is almost impossible for either party to retain the White House for more than two terms (the only exception in the post-war record is the election of 1988 – please see the chart below).



Now we’ll turn to market implications.

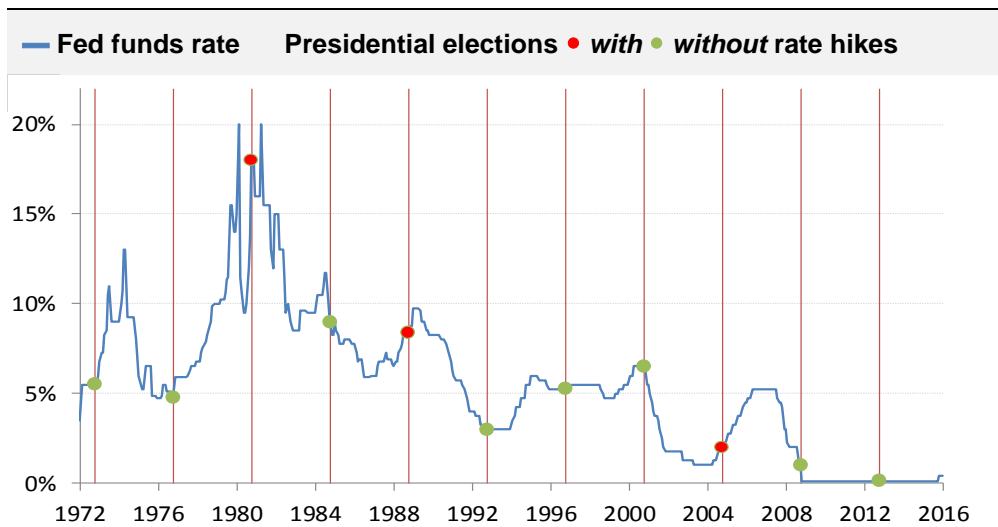
- With the Fed (see [“On the April FOMC”](#) April 27, 2016), too-low oil prices (see [“On the Doha Oil Freeze Failure”](#) April 17, 2016) and China (see [“More Anbang For the Buck”](#) April 13, 2016) now sidelined as major risks for markets, the presidential election is our biggest worry.
- We can’t rule out that the correction in equity markets of the last week or so has been a response to the consensus suddenly [moving from denial to acceptance](#) of what we’ve said all along, that Trump will be the GOP candidate.
- But after the rapid run-up from the mid-February bottom, we don’t think a correction even particularly requires any explanation. And despite the deep denial of the political class, we don’t see how hard-nosed self-interested markets could not have seen the Trump tiger coming. And we don’t see how markets would have preferred Ted Cruz, or a brokered convention bringing forth an unelected white knight.
- That said, perhaps there is some shock of recognition here – recognition that, win or lose, Trump’s candidacy carries special risks.
- During the election, there is the possibility that violent anti-Trump protests will create an atmosphere of instability and uncertainty – though, as we have noted, in the tumultuous year of 1968, beset by

assassinations and violent protests world-wide, stocks rallied consistently (please see the chart below, and [“DisTrumption: What I Saw In Chicago”](#) March 14, 2016).



Source: Bloomberg, Wikipedia, TrendMacro calculations

- One benefit of any pre-election uncertainty is that it surely sidelines the Fed, at least until December. Even in ordinary elections, the supposedly independent Fed has only three times in more than four decades hiked rates leading into elections (please see the chart below, and [“On the April FOMC”](#)).
- In this case especially, Chair Janet Yellen might wish to hedge her bets, just in case Trump wins. [Trump has said](#) he wants no more rate hikes, and warned he would likely replace Yellen.
- *If Trump loses the election* – especially if his opponent is able to portray him as a madman, and he loses by a landslide as Barry



Source: Federal Reserve, TrendMacro calculations

Goldwater did in 1964 – then the “coat-tails effect” would likely lead to the GOP losing both the Senate and the House. This would usher in two years of one-party rule, like 2009-2010, unleashing a flood of hastily-conceived large-scale policy initiatives that would surely be bad for certainty, and very likely bad for growth.

- *If Trump wins the election* – who knows? Uncertainty abounds. He has no policy record as an elected official.
- *We think markets ought to be very cautious of his nativist anti-trade and anti-immigrant rhetoric.* If he carries out the worst of his threats, there would be a serious blow to global growth (see [“Trumped!”](#) December 14, 2015).
- That said, the rise of Trump does point to a need for economically sophisticated people to re-examine some of their unquestioned assumptions about trade and globalization. [Serious non-politicized academic research](#) is now showing that US adaptation to trade-shocks is slower than expected, and represents a cost of globalization that offsets more of its gains than previously realized. [Research is also showing](#) that the inability to adapt to globalization leads to political radicalization.
- *Looking in other areas, though, there are some elements both of Trump’s policies and Trump’s persona that could be very pro-growth* (see [“Sympathy for the Donald”](#) March 2, 2016).
- On the policy side, most salient for us is that he advocates [slashing and simplifying personal and corporate tax rates](#).
- *But beyond any policy positions, we continue to believe that Trump’s persona – for all the bluff, bluster and boorishness – is aspirational for many Americans. It has been decades since a presidential candidate has come forward with an optimistic vision for the American economy, and the potential for individuals to find joy and build wealth by participating in it. The economy moves on “animal spirits” – and we think a major source of the Trump tiger’s power is that he promises to liberate America’s inner animal.*

There is a great deal of multi-layered uncertainty here. There is uncertainty as to whether Trump will win or lose the general election. If Trump loses, we’re in one world of uncertainty. If he wins, we’re in another different world of uncertainty. Markets have cleared a lot of hurdles this year – but now these uncertainties are staring us in the face. Small clues as to how they will resolve will have a lot of decision leverage.

Bottom line

Trump, barring mishap, is the candidate. We predict he will win the general election. The next phase politically is to see how the GOP establishment deals with the game-theoretic decision of either riding the Trump tiger, or fighting it. We think the logic of minimax points to lining up behind Trump. But there are major uncertainties for markets here, perhaps motivating the present correction in equities – uncertainty if he will win or lose, with each possibility leading to its own different world of further uncertainty. One thing for certain: this puts the Fed on hold at least until December. ▶