

POLITICAL PULSE

If – When? – Hillary Wins

Monday, October 10, 2016

Donald Luskin
Have markets stopped worrying about Trump, only to start worrying about Clinton?

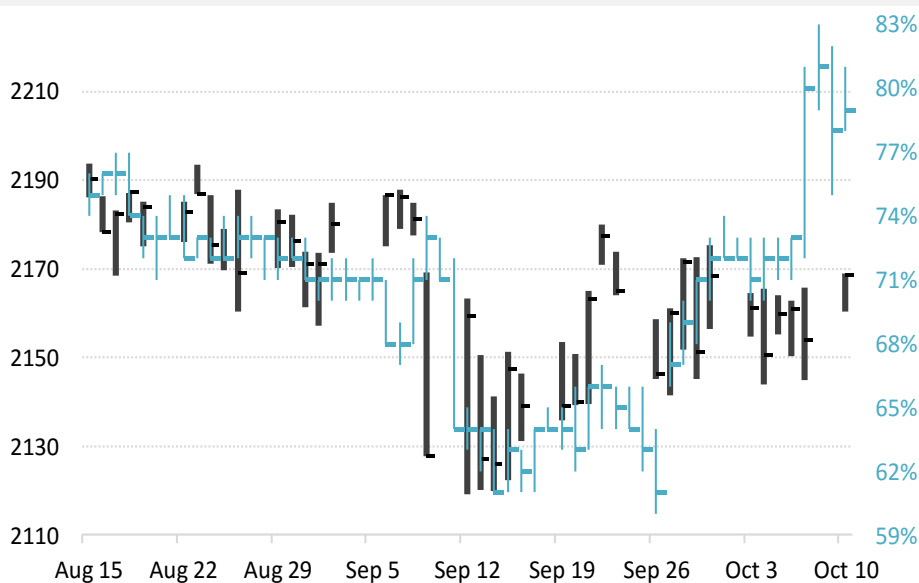
In our view Donald Trump [got the best of last night's debate](#). *But if market reactions during the span of the debate are any indication, it didn't matter – equity futures, and futures on the election outcome, were unchanged.*

We thought the first debate was a tie (see [“On the First Presidential Debate”](#) September 27, 2016). But in its aftermath, Trump stumbled terribly. In the second debate, Job One for Trump was to win back the confidence of his campaign ecosystem, and reassure his wavering base. *This he did, but all that accomplishes is to pull him out of free-fall. Now he has less than a month to turn around, gain elevation and fly to victory.*

As the clock runs out on Trump, we are concerned by the way markets are behaving.

- Since the all-time high for US equities on August 15, stocks have been tightly correlated with Clinton's probability of election (please see the chart below) – *falling* when her probability *fell* (and Trump's

— S&P 500 from Aug 15 all-time high As of this writing at 9:50 ET
 — Market-implied probability of Clinton election


 Source: Bloomberg, [PredictIt](#), TrendMacro calculations

Update to strategic view
ELECTION MODEL, US STOCKS, US BONDS:

We think Trump won the debate. That stabilizes his candidacy, but leaves less than a month to actually win, and it's getting increasingly unlikely. The broken correlation between stock prices and the probability of a Clinton victory points to markets beginning to fear her, possibly driven by the spectacle of last week's populist lynching of Trump, which was egged on by the establishment to which he is an existential threat. The modal outcome now is probably President Clinton, GOP House, Dem Senate, and liberal Supreme Court. But with the electorate's appetite for change thwarted, Clinton will be damaged goods, and the GOP House will be further radicalized. Continued "secular stagnation" with high risk premia, adequate but unspectacular equity returns and low bond yields is the base case, but political toxicity lowers that baseline and leads to potential shocks. If elected, Clinton would be a one-term president, likely undone by an attack on her left, clearing the way for a GOP president in 2020.

[\[Strategy dashboard\]](#)

- rose), and *rising* when her probability rose (and Trump's fell).
- *Last week, when Trump was damaged by media firestorms concerning his tax returns and remarks about women, that pattern reversed.* Clinton's probabilities rose, but stocks fell (again, please see the chart on the previous page).
 - *Why?*
 - Obviously, it could be that last week's poor performance by stocks had nothing to do with the election at all. Maybe markets have just written off Trump entirely, and all the risks that would attend a Trump win, and moved on to other things to worry about such as [hard-Brexit](#) or the [hawkish Fed](#).
 - Fine. *But indulge us for a moment in wondering whether last week markets went from building in a Trump-risk premium to, instead, realizing that they ought to be building in a Clinton-risk premium.*
 - We have assumed that markets are comfortable with Clinton as the "devil you know," and fear Trump as a Brexit-like leap into the populist unknown (again, see "[On the First Presidential Debate](#)").
 - The attacks on Trump last week for his entirely legal [tax filings](#) and his entirely commonplace [locker-room braggadocio](#) – and the orgy of outrage about them, *faux* and otherwise, mostly *faux* – have a distinctly populist odor about them, if not the stench of the lynch mob.
 - It's gotten so bad that Bloomberg – *Bloomberg!* – ran a story, and deemed it worthy of highlighting in its daily digest of top stories, that actor [Robert De Niro had denounced Trump](#).
 - There's rich irony here, to be sure. This particular populist lynch mob is being directed against a populist at the behest of the establishment.
 - Make no mistake about it. Trump is an existential threat to elite global institutions – including, not insignificantly, the Republican party – not only because some of his policies might threaten their interests, but mostly because he has thrust himself to within grasp of the very top of the power-pyramid without their blessing. [Rudolph Giuliani was right](#) on Saturday when he said, emerging from a meeting at Trump Tower, "This is basically the insiders against the outsiders."
 - What worries us here is that, while we vehemently disagree with some of Trump's signature policy thrusts, particularly protectionism, we nevertheless have seen him as an aspirational and liberating force. We thought that, for all his faults, he might reinvigorate the "[animal spirits](#)" of the American economy in a way that we haven't seen since the high hopes of the dot-com era died in the ashes of 9-11 (see "[Trump May Be First Since Reagan To Unleash America's Animal Spirits](#)" March 19, 2016).
 - *To have this aspirational and liberating force crushed – by a lynch mob egged on by the elites – makes us worry that the entrepreneurial energies of the economy are likely to become even dimmer in the future. Remember, entrepreneurship is a fundamentally outsider activity, which is always opposed by incumbent insiders. Trump is being made an "example" of what happens to uppity outsiders.*

Contact TrendMacro

On the web at
trendmacro.com

Follow us on Twitter at
twitter.com/TweetMacro

Donald Luskin
Chicago IL
312 273 6766
don@trendmacro.com

Thomas Demas
Charlotte NC
704 552 3625
tdemas@trendmacro.com

Michael Warren
Houston TX
713 893 1377
mike@trendmacro.energy

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Recommended Reading

[Presidents, Vice Presidents, and Death: Closing the Constitution's Succession Gap](#)
Akhil Reed Amar
Yale Law School Faculty
Scholarship Series
January 1994

[The Crisis of Masculinity](#)
Maggie Gallagher
National Review
October 7, 2016

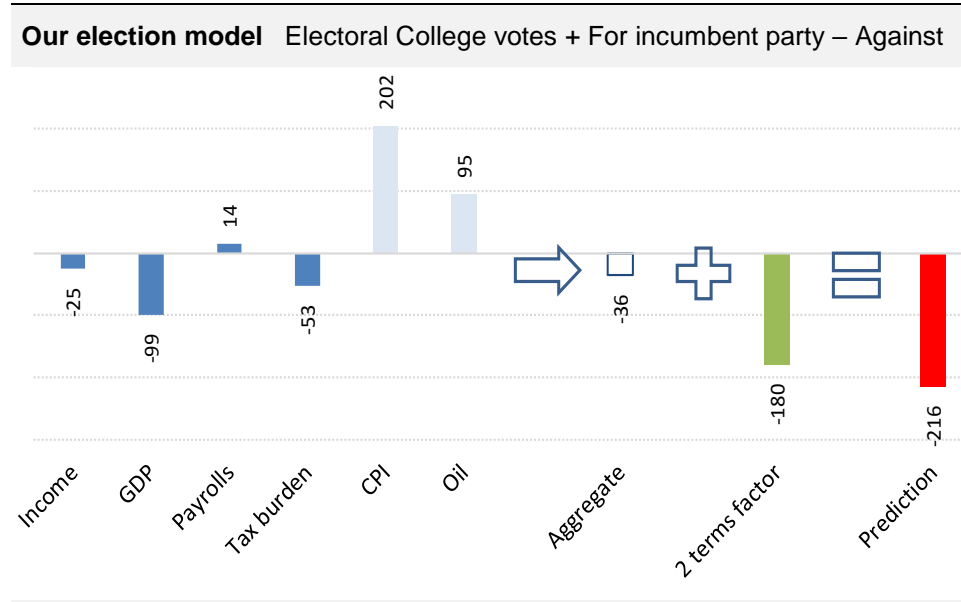
[Why Does This Happen on My Vacation? \(The Trump Tapes\)](#)
Scott Adams
Scott Adams' Blog
October 8, 2016

[Few Believe Fed Chairman Is Independent of Obama](#)
Rasmussen Reports
October 7, 2016

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Let's set these subjective thoughts aside for one moment, and just look at the more immediate and practical implications for the economy and markets if – when? – Hillary Clinton wins the presidency.

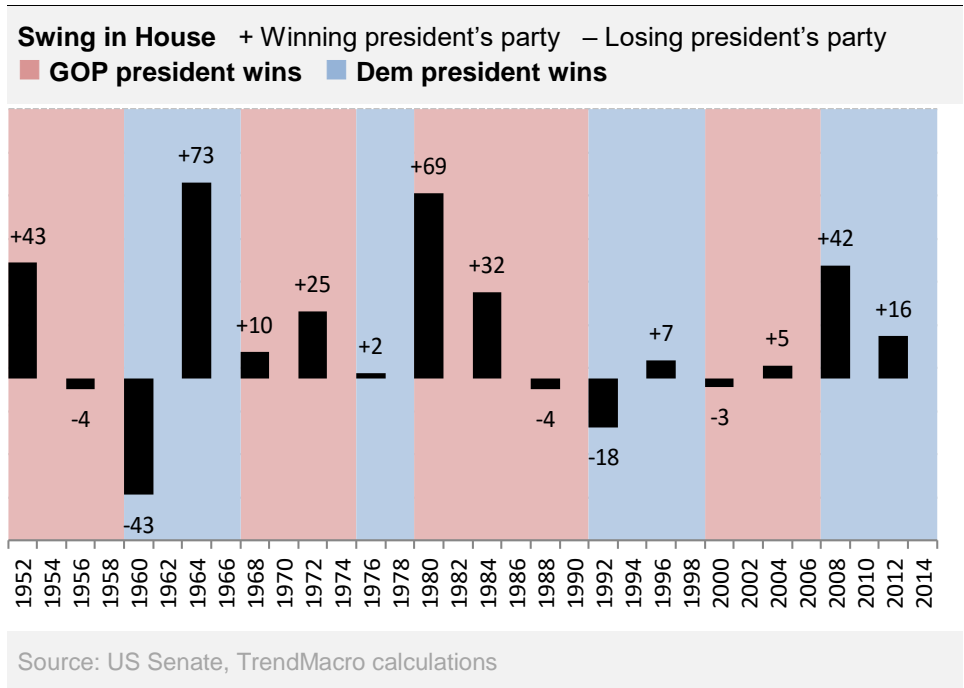
- There is economic policy-risk with Clinton that could damage growth, just as there would be with Trump. It's just in different domains. And there's more of it, in our view.
- Obviously the big risk with Trump is protectionism, at least if you go by his populist talk. With Clinton a comparable-magnitude risk is [her policy](#) to increase regulatory burdens until there won't be "many places in America where fracking will continue to take place" – again, if you go by her populist talk.
- While Trump wants to cut taxes – especially, to reduce the punitive and globally uncompetitive corporate tax rate – Clinton wants to raise taxes across the board. She supports expanding Obamacare, union card-check, carbon taxes, college subsidies – and a raft of Democratic wish-list items, all of which would only heap costs, burdens and imbalances on the American economy.
- Some of this can be accomplished, to some extent, by executive order or regulatory fiat. But much of it would require the cooperation of Congress, so if Clinton wins the presidency, congressional control will make all the difference.
- Even if Clinton wins by a wide margin in the Electoral College, we doubt this will be a "wave" election that realigns partisan power. This particular election is a referendum on individual presidential candidates, not parties. And our election model shows clearly that the non-incumbent party – the GOP – should, by all historical precedent, win (please see the chart below).



Source: Various, TrendMacro calculations

- If it loses, it's because of a flawed individual. So we doubt that the GOP will lose control of the House of Representatives, even if Clinton wins the presidency.

- The GOP majority in the House is now 59 seats, so it would take a loss of 30 seats to cede control. There *is* a well-documented “coat-tails effect.” But since 1952, such a large partisan shift has happened in only two presidential election years – 1964 and 1980, two classic “wave” elections (please see the chart below).
- And note that the coat-tails effect was absent in 1988, the anomalous year in which George H. W. Bush became the only candidate in the post-war era to earn three consecutive terms for his party. We will have much more to say on that important pattern later.



- This year, accomplishing a 60-seat swing, requiring 30 seats to switch from GOP to Democratic, the GOP would have to lose (a) *all* 7 GOP seats currently already “leaning” or “likely” Democratic according to [the Cook Political Report](#), plus (b) *all* 14 “toss-ups,” and (c) 9 of 12 “leaners” – (d) *all without* picking up a single of the 3 Democratic “toss-ups” and 4 Democratic “leaners.”
- The Senate is more at risk, even if Trump wins. Today the GOP controls the Senate by a narrow margin of 8 seats – so losing 5 would cede control if Trump wins, and losing only 4 would cede control if Clinton wins (because the vice president breaks ties in the Senate). The 34 senators of the “class of 2010” are in play, 24 held by the GOP and only 10 held by Democrats. Two GOP seats already “lean” Democratic. After that, to lose control, the GOP would have to lose only 2 (or 3) out of 6 “toss-ups” and 2 “leaners,” assuming it didn’t pick up the single Democratic “toss-up.”
- So even if the GOP keeps House control under a Clinton presidency, the Supreme Court would be in play with a Democratic Senate (the House does not have to approve nominees to the Court). The balance of power on the court already hangs on filling Antonin Scalia’s vacant seat.

- While we have sympathy for many liberal elements in the *social* domain, such things are not our focus here. In the *economic* domain, we fear that a liberal majority on the court would only further entrench the over-reaching regulatory power of government, and the further erode property rights.

It would seem that the single most likely outcome – the modal outcome in this distribution – would be a Clinton presidency with a GOP House and a Democratic Senate, and a liberal Supreme Court.

- It could be far worse, were the Democrats to control the House, too. But even with a GOP House, it's no set-up for better growth. *As a first approximation, it suggests four more years of so-called “secular stagnation.” That would mean the continuation of high equity risk premia, associated with adequate but unspectacular equity returns, and low bond yields.*
- Upside game-changers that could come into play in the intermediate term are the two megatrends we have often highlighted – (1) the return of oil prices, sustainably and profitably, to the historic range of \$15 to \$35 in today's dollars, assuming Clinton doesn't outlaw fracking (see ["Just-In-Time Energy"](#) April 27, 2015); and (2) the deployment of Chinese savings into out-bound foreign direct investment, assuming Clinton allows it to find its way to America (see ["More Anbang For the Buck"](#) April 13, 2016).

That looks a lot like the “muddle along” or “four more years” or “the devil we know” scenario that we had assumed would cause markets to prefer a Clinton presidency. But now let's go back to the beginning, taking into account of what seems like the market's re-appraisal of Clinton in light of the lynching that Trump has had to endure last week.

- Let's start with the basic political forces in play here, using our election model as a lens for examining them.
- Even if our model proves to be wrong this time around – for the first time in any election from 1952 – we can learn from its core driver: the pattern that, with one exception in that period – the election of 1988 – neither party has ever held the presidency for more than two terms. The enduring power of this pattern – *indeed, its special power this year, revealed in a strong preference for change everywhere in the world* – can be seen in the fact that a figure as unlikely as Trump could get as far as he has.
- *That means that if Clinton wins, we will have to live with the consequences of a powerful appetite in the electorate for change having been thwarted.*
- *Because of this – and, we think, especially because of the brutal lynch-mob manner in which it is being accomplished – Clinton will assume the presidency as damaged goods. She will both be loathed by those she steam-rolled, and be a disappointment to those whose populist passions she inflamed.*
- And if the GOP holds the House, probably with a slightly narrower majority, its populist wing will be even angrier than it already is. The

toxicity of the political environment, believe it or not, will get even worse.

- This is a recipe not just for gridlock, but for ongoing brinksmanship that could play itself out in investigations, impeachment proceedings (the Democratic Senate would not convict, but the GOP House could still indict) and debt-ceiling crises.
- This, in turn, would fan the flames of social incoherency that we've already seen emerging this year in increased urban violence (see ["DisTrumption: What I Saw In Chicago"](#) March 14, 2016). We suppose "animal spirits" have to find their outlet somewhere.
- *So the baseline thesis of ongoing "secular stagnation" would have to be shifted lower, and seen as subject to shocks. It's painful to imagine growth in America even slower than it has been the last seven years.*

All this means that Clinton will likely be a one-term president, as was George H. W. Bush, the only other modern president to have caused his party to hold the presidency for more than two terms.

- Bush failed to earn a second term, and a fourth for the GOP, despite the power of running as an incumbent – a success factor with a nearly perfect record since 1892. The appetite for change that he thwarted in his first election caught up to him in his second, with an attack on his right flank by H. Ross Perot. Without carrying a single state in 1992, Perot probably threw the election to Bill Clinton. For Hillary Clinton, the attack will come from her left, probably in the person of Elizabeth Warren.
- *It's too soon to recalibrate our election model for 2020. But if Clinton wins in 2016, we know what it will predict. History is quite clear on this. And we'll be putting all our chips on it. The only question is whether the GOP president elected that year will be Pence or Ryan.*

Bottom line

We think Trump won the debate. That stabilizes his candidacy, but leaves less than a month to actually win, and it's getting increasingly unlikely. The broken correlation between stock prices and the probability of a Clinton victory points to markets beginning to fear her, possibly driven by the spectacle of last week's populist lynching of Trump, which was egged on by the establishment to which he is an existential threat. The modal outcome now is probably President Clinton, GOP House, Dem Senate, and liberal Supreme Court. But with the electorate's appetite for change thwarted, Clinton will be damaged goods, and the GOP House will be further radicalized. Continued "secular stagnation" with high risk premia, adequate but unspectacular equity returns and low bond yields is the base case, but political toxicity lowers that baseline and leads to potential shocks. If elected, Clinton would be a one-term president, likely undone by an attack on her left, clearing the way for a GOP president in 2020. ▶