

## POLITICAL PULSE

## Our Fearless Predictions

Monday, November 7, 2016

**Donald Luskin**

Clinton wins by plurality, but the GOP keeps the Senate and House, and adds governors.

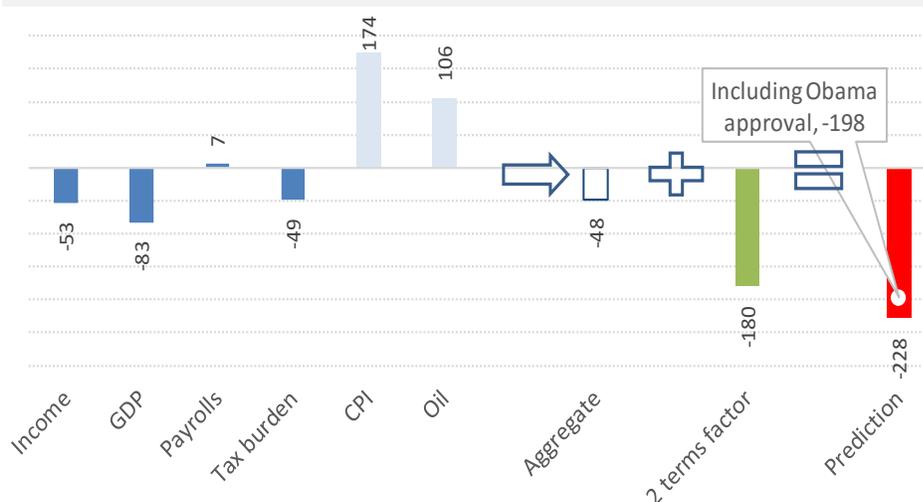
US equities, as of this writing, are breaking their nine-day losing streak, having gapped higher in futures markets last night following news that [the FBI has given Hillary Clinton an all-clear](#). *If there was a question about whether markets prefer Clinton or Donald Trump, this answers it.*

Even before this news, [most polls](#) were indicating that Hillary Clinton will win on Tuesday – as do most election models based on those polls, such as the model run by the [celebrated predictor Nate Silver](#). As of this writing [Silver gives Clinton](#) a 66.9% probability of winning.

So why would markets celebrate Clinton’s FBI news, unless they were giving Trump a much better chance than the polls and the poll-based models? Perhaps they had derived a certain skepticism from the headline a week ago on [Silver’s website](#): “**The Cubs Have A Smaller Chance Of Winning Than Trump Does**”. Or they remember that [the polls and Silver were wrong](#) on Trump in the GOP primaries. [And wrong](#) about Brexit. [And wrong](#) about the prior UK general election.

Or perhaps markets have been giving credence to models such as ours, based on fundamentals, not polls (please see the chart below) – or the models of [Yale’s Ray Fair](#), and [American University’s Allan Lichtman](#) – and

**Our election model** Electoral College votes + For incumbent party – Against



Source: Various, TrendMacro calculations

### Update to strategic view

#### US ELECTION MODEL, US STOCKS, US

**MACRO:** We expect Clinton to win, but we have very little conviction in that call, and are open to our election model having been right all along about a Trump win. If she wins, it will be by a plurality, as #NeverTrump voters go to third parties. With higher conviction we think the GOP will keep the Senate – even polls, which have appeared all year to be biased globally against conservatives, show that. We are highly confident the GOP will keep the House, but with a reduced and radicalized majority. With reasonable conviction we expect the GOP to pick up some governors. Markets may be relieved by this outcome of divided government, and indeed it will block the worst policy mistakes. But it will lead to toxicity, brinksmanship, crises and volatility (the government is funded through December 9, and the debt ceiling is suspended until next March). If Trump does win – which we don’t even remotely rule out – we expect a Brexit-like risk-off spasm.

[\[Strategy dashboard\]](#)

the rule that the incumbent party's candidate can't win [if the stock market hasn't been up](#) over the three months prior to the election – all of which are predicting a Trump win.

And we have more than a few clients who are absolutely and utterly convinced that Trump will pull an upset victory, and are taking positions in markets that reflect that expectation. Generally they are assuming, as we do, that a Trump upset would be a Brexit-like risk-off shock. Yes, these clients tend to be conservatives. But they have made fortunes for themselves and *their* clients by making smart bets – not by indulging in wishful thinking.

Now, as we approach our duty to make our final fearless predictions for the election, Job One is avoiding our own wishful thinking. There's a lot of potential for that here – we have definite personal political preferences, and yes, we would like our model to turn out to be right. That said, we can't let our desire to avoid wishful thinking limit our imagination.

Our final fearless predictions take cognizance of the powerful fundamentals that underlie our model. In portfolio-analytics terms, we think our model is capturing the factors that explain political beta. But our predictions also take cognizance of the realities on the ground that the model can't possibly capture. We have to ask ourselves, will Donald Trump turn out to be a stock with an alpha negative enough to cancel out the beta?

But how are we – how is anyone – to understand the realities on the ground through the fog of political war? Again, the polls are highly dubious. And what passes for analysis in the media is mostly propaganda (see [Sunday's lead story on the front page of the New York Times](#) claiming in the headline that Hispanic voters are turning out in droves to early-vote for Clinton, in which it's not until the 19<sup>th</sup> paragraph that any statistical evidence is given, and when it finally comes it is “an analysis by...a Democratic strategist”). Who knows what's real?

*With all that in mind, here are our final fearless predictions, with associated certainties.*

- *Clinton will win the presidency* (only 51% certainty). That's consistent with our concession a month ago that our model will likely turn out to be wrong (see [“If – When? – Hillary Wins”](#) October 10, 2016). We admit it's not exactly a “fearless prediction.” Our timid 51% certainty is meant to reflect that we still respect the fundamentals in our model, and are skeptical of the conventional wisdom in the polls and the media – but at the same time we feel overwhelmed by the lynch-mob momentum that has overtaken this election.
  - *If Clinton wins, it will be with only a plurality of the popular vote* (75% certainty). This reflects our belief that #NeverTrump Republicans will vote for third party candidates Gary Johnson or Jill Stein (national) or [Evan McMullin](#) (in Utah) rather than Clinton.

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[\[About us\]](#)

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## Recommended Reading

[The Cubs Have A Smaller Chance Of Winning Than Trump Does](#)

Rob Arthur  
*FiveThirtyEight*  
October 30, 2016

[Former CIA officer threatens to shake up White House race in Utah](#)

Demetri Sevastopulo  
*Financial Times*  
November 2, 2016

[\[Reading home\]](#)

- If Trump wins, it will be with a majority of the popular vote (75% certainty). This reflects our belief that a Trump win would be predicated on #NeverTrump Republicans having decided to #ComeHome.
- The GOP will hold the Senate if Clinton wins (60% certainty) or if Trump wins (80% certainty). It amazes us that this prediction is as

Competitive seats held by: ■ GOP ■ Dem    Polling: ← Dem ← GOP  
 Democratic path to control ■ Goal ■ '52-'08 average, president's party

### House of Representatives

Lean GOP	Young AK-AL	
	Valadao CA-21	
	Open IN-09	<b>30 to win</b>
	Young IA-03	
	Yoder KS-03	
	Open MI-01	
	Bishop MI-08	
	Paulsen MN-03	
	Open NY-22	
	Katko NY-24	
	Open PA-16	
	Love UT-04	
Toss-up	Denham CA-10	
	Knight CA-25	
	Issa CA-49	
	Coffman CO-06	
	Mica FL-07	
	Curbelo FL-26	
	Dold IL-10	
	Blum IA-01	
	Poliquin ME-02	
	Open MN-02	
	Open NV-03	
	Garrett NJ-05	
	Open NY-19	<b>Average: 8</b>
	Open PA-08	
	Hurd TX-23	
	Comstock VA-10	
Lean Dem	Jolly FL-13	
	Hardy NV-04	
	Guinta NH-01	
Likely Dem	Open FL-10	
	Open VA-04	<b>4 must hold</b>
Toss-up	Nolan MN-08	
	Ashford NE-02	
Lean GOP	Open FL-18	
Likely GOP	Open FL-02	

### Governors

Toss-up	Open IN	<span style="color: #0000c0;">←</span>
	McCrary NC	<span style="color: #0000c0;">←</span>
Toss-up	Open MO	<span style="color: #c00000;">←</span>
	Open NH	<span style="color: #c00000;">←</span>
	Open VT	<b>Tie</b>
	Open WV	<span style="color: #c00000;">←</span>

### Senate

Lean GOP	McCain AZ	<span style="color: #c00000;">←</span>
	Portman OH	<span style="color: #c00000;">←</span>
	Rubio FL	<span style="color: #c00000;">←</span>
Toss-up	Open IN	<span style="color: #c00000;">←</span>
	Blunt MO	<span style="color: #c00000;">←</span>
	Ayotte NH	<span style="color: #c00000;">←</span> <b>4 to win</b>
	Burr NC	<span style="color: #c00000;">←</span>
	Toomey PA	<span style="color: #0000c0;">←</span> <b>Average: 2</b>
	Johnson WI	<span style="color: #0000c0;">←</span>
Lean Dem	Kirk IL	<span style="color: #0000c0;">←</span> <b>1 must hold</b>
Toss-up	Open NV	<span style="color: #c00000;">←</span>

Source: Cook Political Report, RCP, US Congress, TrendMacro calculations

out-of-consensus as it is, because it is simply based on current polling (please see the chart on the previous page) which produces this result even in a global political environment in which, over and over, polls have underestimated results for conservatives or populists.

- *We may not know who controls the Senate for a month, thanks to Louisiana's unique "jungle primary" process.*  
Tomorrow's election is only an open primary between 23 candidates – unless one gets at least 50% (highly unlikely) there will be a run-off between the top two finishers on December 10. The GOP is likely to win in December, but there are credible Democratic candidates.
- *The GOP will hold the House (100% certainty).*
  - *If Clinton wins, the GOP will lose no more than eight seats (75% certainty).* This is based on the reality that there are very few competitive districts (please see the chart on the previous page), and that the coat-tails effect in presidential election years is weak – and can be expected to be weaker this year, as a Clinton win will have thwarted the electorate's taste for change (see ["Elections Have Consequences"](#) October 20, 2016). *The lost GOP members will be moderates, leaving the majority both weaker and more radical.*
  - *If Trump wins, the GOP will pick up three seats (75% certainty).* The coat-tails effect is strong enough, with a Trump win, to secure GOP districts at risk, and cause the Democrats to lose most of their four.
- *The GOP will pick up governors (65% certainty).* Democrats are defending eight of twelve statehouses – five of which are in red states. Polling – which, again, has been underplaying conservative and populist probabilities – supports a GOP pick-up (please see the chart on the previous page).
  - *If Clinton wins, the GOP will pick up one governor (60% certainty).*
  - *If Trump wins, the GOP will pick up three governors (75% certainty).*
- Putting it all together, we expect divided government – in Washington, a Democratic president and a Republican Congress, and at the state level, more GOP governors.
- *As a first-order approximation, that's not a big deal for markets – at least not immediately. Arguably there could even be a sense of relief that the uncertainty of a populist Trump administration will have been avoided – as today's market action would seem to suggest. It means markets can expect there will not be any major misguided economic policy initiatives that could get rushed through a compliant Congress.*
- But looking deeper and longer-term, it means pro-growth economic policy won't happen either. That's not a change from the status quo.
- The change is that we would have an angry and isolated Nixonian President who will not accept that she has no mandate, and who therefore will too strongly use and likely exceed executive authority,

worsening the already toxic, sentiment-depressing and growth-suppressing environment in Washington.

- There will be more government shutdowns (current government funding runs out on December 9), more debt ceiling crises (the current suspension of the debt ceiling ends next March). Endless corruption investigations. Deeper erosion of respect for institutions.
- *That's a recipe for intermittent bouts of volatility like we had in the similar political environment of 2011 to 2013.*

*What if our predictions are wrong? Then it could indeed be a big deal for markets.*

- *If Trump wins, we would expect a convulsive Brexit-like response in markets* (see, among many, [“Elections Have Consequences”](#) October 20, 2016).
- We predicted, even before the Brexit referendum, that a post-“leave” market correction would be a big buying opportunity (see [“Brexit: Opening Pandora’s Brox”](#) May 23, 2016), and indeed it was. It’s not so simple to make the same call for a Trump win. It will depend critically on (1) our being right that the GOP will hold the Senate in order to implement his pro-growth tax cuts and regulatory reforms, and on (2) Trump’s signaling that he will not follow his most disruptive protectionist impulses. *We will have to live headline-by-headline and make the call in real-time. But if we had to make it today, we would say buy the dip.*
- *If Clinton wins, and it turns out to be a lot more of a sweep than we expect – that is, some strong combination of Democrats taking the Senate, the GOP holding the House but with a substantially reduced majority, the GOP losing governors – this would be the configuration that maximizes toxicity and, therefore, future volatility. It’s hard to say whether markets would twig to this immediately, but giving them credit for being far-seeing, we would expect optimistic reactions like today’s to erode, and for the correction from the mid-August all-time highs in stocks to deepen and lengthen.*

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## **Bottom line**

We expect Clinton to win, but we have very little conviction in that call, and are open to our election model having been right all along about a Trump win. If she wins, it will be by a plurality, as #NeverTrump voters go to third parties. With higher conviction we think the GOP will keep the Senate – even polls, which have appeared all year to be biased globally against conservatives, show that. We are highly confident the GOP will keep the House, but with a reduced and radicalized majority. With reasonable conviction we expect the GOP to pick up some governors. Markets may be relieved by this outcome of divided government, and indeed it will block the worst policy mistakes. But it will lead to toxicity, brinkmanship, crises and volatility (the government is funded through December 9, and the debt ceiling is suspended until next March). If Trump does win – which we don’t even remotely rule out – we expect a Brexit-like risk-off spasm. ▶