

TRENDMACRO LIVE!

On the Mid-Term Elections

Wednesday, November 7, 2018

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A major risk-event has passed. The animal spirits of growth live on, in the Senate at least.

The mid-term elections turned out precisely as we predicted (see [“Mid-terms: Animal Spirits on the Ballot”](#) September 11, 2018). As of this writing at 8:00 am EST, with 3 Senate races still not called (and assuming the GOP wins the November 27 Mississippi run-off) it looks like the GOP gained 3 seats on net, through the flip of the 4 red state Democrats (FL, IN, MO and ND), and the loss of the lone blue state Republican (NV) – a sweep of all the incumbents we identified as vulnerable. With 20 House races still not called, we estimate the GOP has lost 31 seats on net, giving Democrats control by a narrow 17-seat majority (the third narrowest in the post-war era – the present GOP majority is 45). The GOP took more than half its losses in fragile swing districts that voted Democratic in 2016, while failing to flip Democratic seats in districts that voted GOP in 2016 (please see the table on the following page). The GOP held onto governorships in three upset races in swing states where they had been sharply behind in the polls – Ohio, Florida and Iowa, while losing three others that voted for Trump in 2016. *This is a slightly more GOP-friendly outcome than we think markets were expecting, but generally it is in-consensus: keep the Senate, lose the House.*

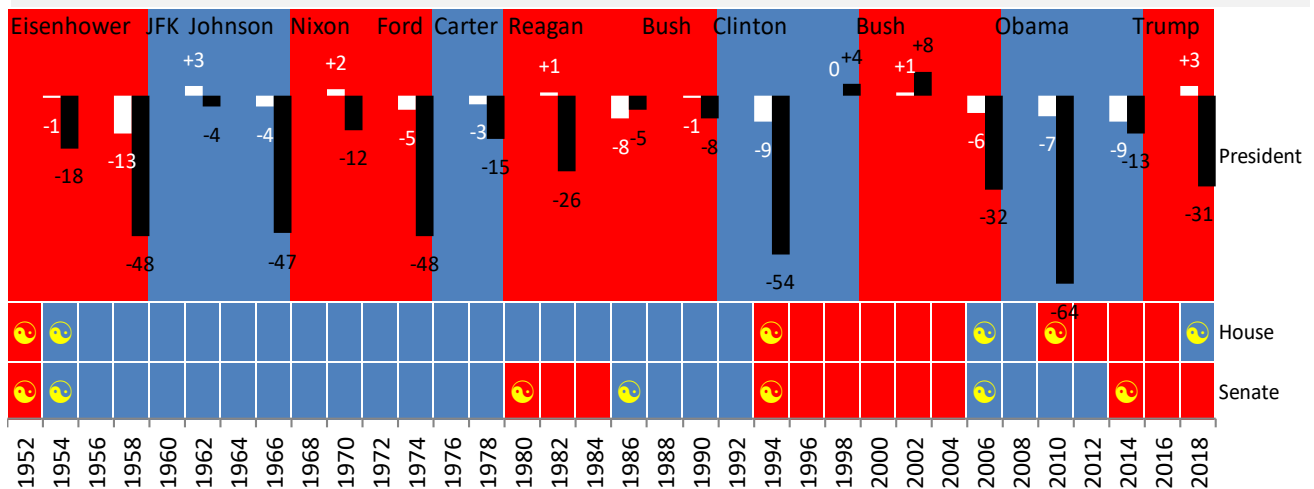
Update to strategic view

US MACRO, US STOCKS: The uncertainty is over, with no “blue wave” or “wipe-out,” and no repudiation of Trump, his pro-growth agenda, or the animal spirits he represents. After intensive campaigning, Trump is taking the outcome as a success. This may lead to a more cooperative negotiating posture with China, but it remains to be seen how Xi will react. Pro-growth policy can move forward without the House, with the Senate’s advice and consent...

How does this election reflect on President Donald J. Trump, and the powerful [animal spirits](#) that he represents? We think it can only be seen as

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Mid-year election gains/losses in □Senate ■House for president’s party ■ GOP ■ Dem ☯ Flip



Source: Senate and House Clerks, TrendMacro calculations

reflecting favorably. Trump campaigned heavily and visibly for generally successful senatorial and gubernatorial candidates – if he were being repudiated, they would not have been so successful overall.

Update to strategic view

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And by historical norms, this was a solid outcome for Trump (please see the chart on the previous page). In the average mid-term, a president's party loses 24 seats in the House (the GOP lost 31, about 1/3 standard deviation from the mean). But in the average mid-term, a president's party loses 4 seats in the Senate (the GOP *gained* 3, matching the largest prior gain ever, in 1962). This was not even remotely the much-vaunted "[blue wave](#)" in the Congress or "[wipe-out](#)" in governors.

...power more secure, and with show-boating obstructionists in the GOP gone. Talk about "infrastructure spending" is pointless. Tax cuts are secure; none expire in 2019-20. House Democrats have no leverage to force repeal. Disruptive displays will likely backfire for 2020. If they realize that, there could be a constructive policy relationship as there was between Clinton and Gingrich.

- Any immediate impact on markets will come first from the alleviation of uncertainty. At last year-end, looking ahead to 2018 (see "[2018 Outlook: From Denial to Acceptance](#)" December 29, 2017), we identified this as a key risk-event – and now we're through it successfully. That sense of relief likely why, over about the last 90 years, US stocks have risen on the day after midterms by an average of 0.3%, ten times the gain of a typical day.

House of Representatives: 23 GOP to flip to Dems

- 🔄 Flip ★ Open seat
- 12 Dems in Trump districts
- 23 GOP in Clinton districts

Senate: 2 GOP to flip to Dems

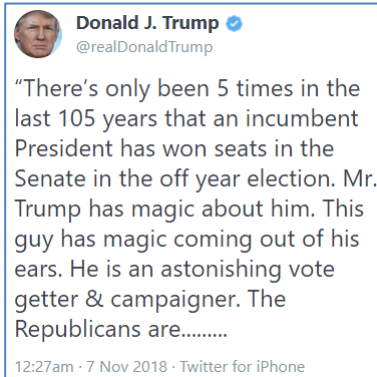
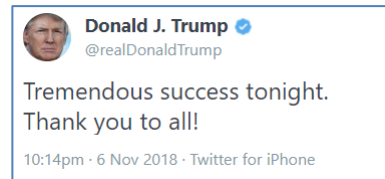
- 🔄 Flip ★ Open seat
- 10 Dems in Trump states
- 1 GOP in Clinton states

Democratic representatives	2016 votes	Republican representatives	2016 votes
Tom O'Halleran AZ-01	50.7%	Martha McSally AZ-02 🔄	57.0% ★
Cheri Bustos IL-17	60.3%	Jeff Denham CA-10	51.7%
Dave Loebsack IA-02	53.7%	David Valadao CA-21	56.7%
Tim Walz MN-01 🔄	50.3% ★	Steve Knight CA-25 🔄	53.1%
Collin Peterson MN-07	52.5%	Ed Royce CA-39	57.2% ★
Rick Nolan MN-08 🔄	50.2% ★	Mimi Walters CA-45	58.6%
Jacky Rosen NV-03	47.2% ★	Dana Rohrabacher CA-48 🔄	58.3%
Carol Shea-Porter NH-01	45.8% ★	Darrell Issa CA-49 🔄	50.3% ★
Josh Gottheimer NJ-05	51.1%	Mike Coffman CO-06 🔄	50.9%
Sean Patrick Maloney NY-18	55.6%	Carlos Curbelo FL-26 🔄	53.0%
Conor Lamb PA-17	53.8%	Ileana Ros-Lehtinen FL-27 🔄	54.9% ★
Ron Kind WI-03	98.9%	Peter Roskam IL-06 🔄	59.2%
Average	59.6%	Kevin Yoder KS-03 🔄	51.3%
		Erik Paulsen MN-03 🔄	56.7%
		Leonard Lance NJ-07 🔄	54.1%
		John Katko NY-24	60.5%
		Ryan Costello PA-06 🔄	57.3%
		Patrick Meenan PA-07 🔄	59.5% ★
		John Culberson TX-07 🔄	56.2%
		Will Hurd TX-23	48.3%
		Pete Sessions TX-32 🔄	71.1%
		Barbara Comstock VA-10 🔄	52.7%
		Dave Reichert WA-08 🔄	60.2% ★
		Average	55.9%

Democratic senators	Republican senators
Baldwin (WI)	Barrasso (WY)
Brown (OH)	Cochran (MS) ★
Cantwell (WA)	Corker (TN) ★
Cardin (MD)	Cruz (TX)
Carper (DE)	Fischer (NE)
Casey (PA)	Flake (AZ) ★
Donnelly (IN) 🔄	Hatch (UT) ★
Feinstein (CA)	Heller (NV) 🔄
Gillibrand (NY)	Wicker (MS)
Heinrich (NM)	
Heitkamp (ND) 🔄	
Hirono (HI)	
Kaine (VA)	
King (ME)(I)	
Klobuchar (MN)	
Manchin (WV)	
McCaskill (MO) 🔄	
Menendez (NJ)	
Murphy (CT)	
Nelson (FL) 🔄	
Sanders (VT)(I)	
Smith (MN)	
Stabenow (MI)	
Tester (MT)	
Warren (MA)	
Whitehouse (RI)	

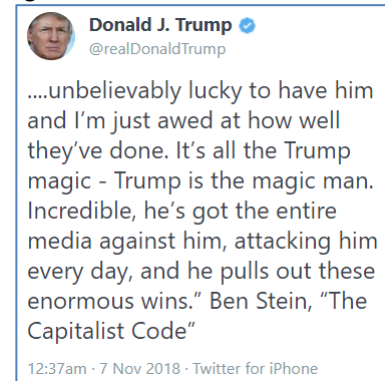
Source: Various. TrendMoose calculations

- Further immediate impact will come from how Trump signals he intends to regard this outcome. So far we have [a tweet early last night](#), characterizing it as a “tremendous success.” Hours later, before bed, other tweets followed, in which he [took credit](#) for the success in the Senate – quoting one description of him as “an astonishing vote getter &



campaigner” and [another claiming](#) that Republicans “realize how important he is because of what he did in campaigning for them.” Unseemly perhaps, but he’s not wrong.

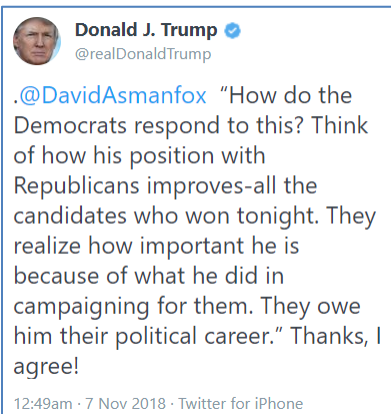
- This is important because he tends to be magnanimous in victory, and aggressive when attacked, which is actually not unusual for a president (recall Obama’s aggressive reaction to his 2014 mid-term defeat). So if this attitude continues,



markets could leap to conclusions about a softening negotiating posture in the high-stakes trade negotiation with China. But it’s hardly that simple, because the mid-term may

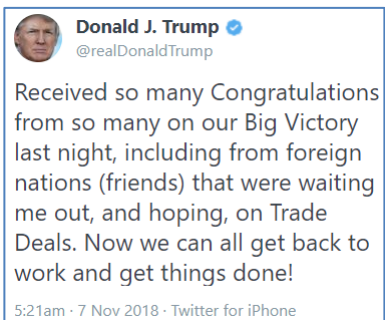
also change the negotiating posture of Chinese president Xi Jinping, and it is far from clear what result will arise from any particular combination of counterparty postures anyway.

- As of this writing he’s out of bed, [and tweeting](#), as though reading our minds on this, “Received so many Congratulations from so many on our Big Victory last night, including from foreign nations (friends) that were waiting me out, and hoping, on Trade Deals.” Sounds to us like he’s reminding Xi that there’s still a lot to talk about at

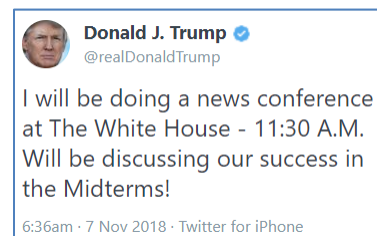


month-end in Buenos Aires.

- Let’s not read too much into mere noise – from Trump’s tweets or from markets – but it may be worth noting that Chinese stocks were down a bit overnight, while as of this writing futures markets indicate US stocks will have a strong open. Directionally at least, that’s a favorable reaction to the election in



terms of Trump’s relative negotiating position (see [“Did China Just Run Up the White Flag in the Trade War?”](#) July 10, 2018). We’ll see if the rally lasts – Trump has tweeted [he will be giving a news conference](#) at 11:30 am.



- After that, market impact will come from whatever policy results, if any, can

emanate from the likely gridlock of a split Congress. There have been only been six years in the post-war period with the partisan configuration of GOP president and Senate, and Democratic

House – 1981 to 1987 – during which the average annual return to the S&P 500 was 19.2%. Not a lot of data, but for whatever it's worth, not a bad result either.

- *We think that retaining – indeed, enhancing – GOP control of the Senate is a necessary and sufficient condition for keeping pro-growth policy moving forward.* The Senate's "advice and consent" power – over not just Supreme Court justices and federal judges, but Federal Reserve governors, cabinet officials and agency heads – makes it the gatekeeper for Trump's deregulatory and pro-property rights agenda. That's a powerful impetus for growth.
- The retirement of aggressive anti-Trump show-boater obstructionist Republicans Robert Corker (TN) and Jeffrey Flake (AZ) – along with the death of John McCain (AZ) – and their replacement by three staunch conservatives, strengthen the reliability of the Senate as a conduit for Trump's agenda. Newly elected Senator Mitt Romney (UT) may play the obstructionist role now, but he'll be one out of 54, not three out of 51.
- No one should worry about the tax cuts – none of them are expiring in 2019 or 2020. We've heard [some scare stories](#) about the Democratic House using the leverage of a debt ceiling negotiation to force Trump to agree to roll back the corporate tax cuts. We think that risk is so remote as to be ridiculous.
- And no one ought to get excited about the elusive gold ring of "infrastructure spending," which arguably becomes easier with Democratic control of the House. We think neither Trump nor the GOP Senate has any serious interest in it.

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What are the implications for the 2020 election?

- Wins by the GOP in the governors races in massive swing states Ohio and Florida will be both a bulwark against House redistricting after the census of 2020, and generally useful for Trump in the presidential election – but it's only the preservation of the *status quo*. At the margin, smaller swing states Michigan and Wisconsin – both of which were essential to Trump's 2016 win – fell to Democratic gubernatorial candidates. It's a net loss to the GOP for 2020, no question about it.
- *In the coming weeks we'll recalibrate and unveil to clients our presidential election prediction model for 2020.* Our model correctly predicts every election from 1952 in back-testing, and it correctly predicted in real-time Obama's re-election in 2012 and Trump's election in 2016. It is heavily influenced by the very reliable pattern that incumbents running for re-election always win unless (a) their party has held the White House for two or more terms already or (b) the economy is especially weak. In 2020 Trump will be running as an incumbent, with the GOP only having held the White House for a single term. *We're pretty sure that the model will predict that Trump will win, assuming that he runs, and assuming that the economy is not in recession at election time.*
- Democrats may use control of the House to harass Trump with various investigative initiatives, or with impeachment bills against Trump or Justice Brett Kavanaugh. These will go nowhere. But will

- they be effective as political theater?
- We will make a subjective observation here, and we ask our Democratic clients to bear with us, and trust that we are just trying to honestly call ‘em as we see ‘em.
 - We think the Democrats did as *well* as they did in the *House* yesterday because there was fairly widespread discipline and restraint in not talking about impeachment during the campaign. And we think the Democrats did as *poorly* as they did in the *Senate* because of their over-the-top theatrics in the Kavanaugh hearings, which doomed the incumbent red state Democrats who voted against him, just as we predicted (see [“Chinese Tariff Torture”](#) October 29, 2018). *So to the extent that the Democrats use control of the House to be more obnoxious than Trump, they are unlikely to help defeat him in 2020.*
 - If Democrats in the House realize this, they may find it in their advantage to strategically cooperate with Trump in various initiatives – say, confirming the US Canada Mexico Agreement that replaces NAFTA – to show that they can govern. *Who knows. Bill Clinton found a way to work with Newt Gingrich. Maybe Donald Trump can find a way to work with Nancy Pelosi, or whomever is the next speaker.*

Bottom line

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