TrendMacrolytics

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POLITICAL PULSE

# The Bush Breakout

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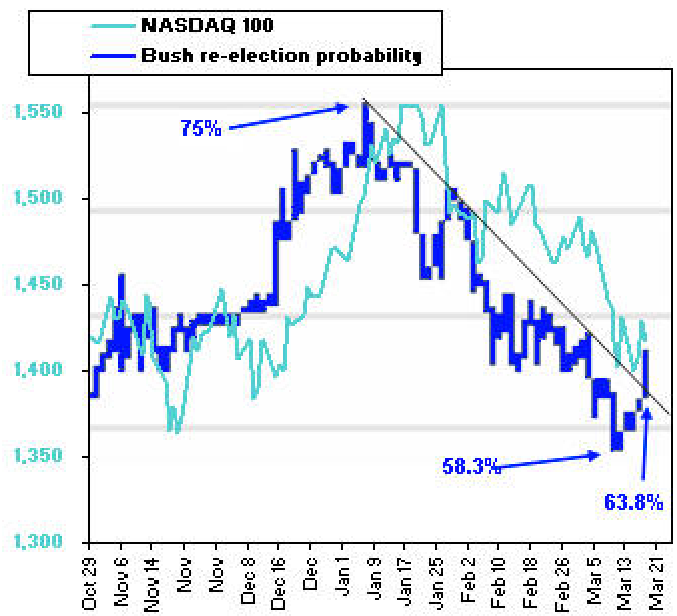
**After two months of silence, Bush is back. It's time to unwind the Kerry trade.**

It appears that **George W. Bush** has broken out. The futures contract on the President's re-election probability traded on **Tradesports.com** pulled out of its strong year-to-date downtrend yesterday**.** In a week it has risen from a near life-of-contract low of a 58.3% probability of re-election -- when we suggested that we may be at Bush's low water mark -- to 63.8% yesterday (see "The Kerry Trade" March 12, 2004).




The breakdown in the Bush contract in mid-January prefigured the breakdown in the NASDAQ by one week. If the current Bush breakout can be sustained and extended, the NASDAQ will soon break out, too, and no doubt the rest of the market will follow.

The tech sector is most sensitive to the chances of Bush's re-election because it is most sensitive to the risk of the repeal or non-extension of the tax cuts enacted last year, which reduced the top rates on dividend income and capital gains. These reductions in the penalties to investment and risk-taking have been powerful pro-growth stimulants to the economy overall, and to the capital-sensitive tech sector most of all. As President, **John Kerry** would work to repeal those tax cuts, and veto attempts by a **Republican congress** to extend them (see "Tough Times for Tech" March 8, 2004).

Valuations now are such that investors are being well paid to take risk on the expectation that Bush's fortunes are indeed turning around here. According to our "Yield Gap" valuation model, the risk premium in the Technology Sector is wider now than at any time since October 2002, the bottom of the bear market in tech stocks. The *relative* risk premium of the tech sector -- comparing it to the rest of the S&P 500 -- is wider now than at any time since March 2001, which was a significant intermediate-term bottom for tech.

How confident should we be that the Bush breakout will last? As a short-term proposition at least, it is surely the case that the winding down of the **Democratic** primary season marks the end of a period of intense free publicity for Kerry in which he has been able to position himself as a man of destiny, coming from behind to clinch his party's nomination. It's been a time -- to use the language of securities analysis -- of easy comparables. Now the comparables are getting harder. George W. Bush is not **Howard Dean**. Already a new ***New York Times*/CBS**

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poll shows John Kerry's approval rating falling from 37% to 28% over the last two weeks, while Bush's has risen from 41% to 43%.

Kerry's momentum against Bush in the primary season has been based on his ability to sow fears about what is, in reality, a strongly improving economic outlook. Supposedly slow employment growth has been cleverly linked to deep-seated post-9/11 national security concerns, by exaggerating the scope and impact of the loss of American jobs to Third World countries. The *NYT*/CBS poll shows that the economy and jobs are now cited as America's top two most important issues by 31% of voters, up from 22% at mid-December.

After two months of virtual silence, Bush has begun to fight back on this front. The mere fact that he is finally speaking at all is a good thing -- his silence allowed doubts to fester. Better yet, he's saying the right things.

Based on our conversations with **White House** insiders and recent public statements of administration officials, we are convinced that Bush grasps the importance of both reframing the public's perception of the economic recovery of the last year, and linking his economic policies to his natural brand-strength in national security. In a major speech last week he introduced the expression "economic isolationism" as a way of rebuking anti-globalization protectionists, and drawing the analogy between the projection of American economic strength to the projection of American military strength.

We also note that **Secretary of State Colin Powell** has made it clear during his visit to **India** this week -- clear in his characteristically understated way -- that the **United States** expects reciprocity in the elimination of trade barriers. A "get tough" position with the nations that are linked in the public's mind with the supposed exporting of American jobs is a way to be seen both as "doing something" and addressing implicit national security concerns. And in the dubious realm of "doing something," Powell's admonitions about the virtues of trade reciprocity are a major uptick from **Treasury Secretary John Snow's** reckless gambit to coerce a revaluation of the **Chinese** yuan for trade "competitiveness" purposes. Ironically, the Chinese may soon be forced to take that step -- not to appease **US** protectionists, but to guard against the inflationary consequences of being linked to a devalued dollar.

And we cannot overlook the importance of last week's terrorist attacks in **Spain**, and their potential for re-igniting public interest in issues on which Bush has real brand strength. In the *NYT*/CBS poll, the number of voters who believe Bush did the right thing by attacking **Iraq** grew from 54% to 58% over the last two weeks. And Bush is perceived as far stronger than Kerry in terms of expected protection against terrorist attack: 78% favorable, compared to 61%. Terrorism and threats of terrorism in Europe -- and the perceived appeasement of terrorists by European leaders -- can only help Bush.

Today we are establishing a new **Model Position long the NASDAQ 100**. We will use this morning's weak opening to set an initial 50% allocation, a partial position reflecting the partial information we have at this time. As we continue to see the Bush campaign develop winning messages and opportunities, and it becomes clearer that this is a significant inflection point, we would expect to increase the position to full allocation. TM