

POLITICAL PULSE

Coming: The Chaos Election

Tuesday, September 1, 2020
Donald Luskin

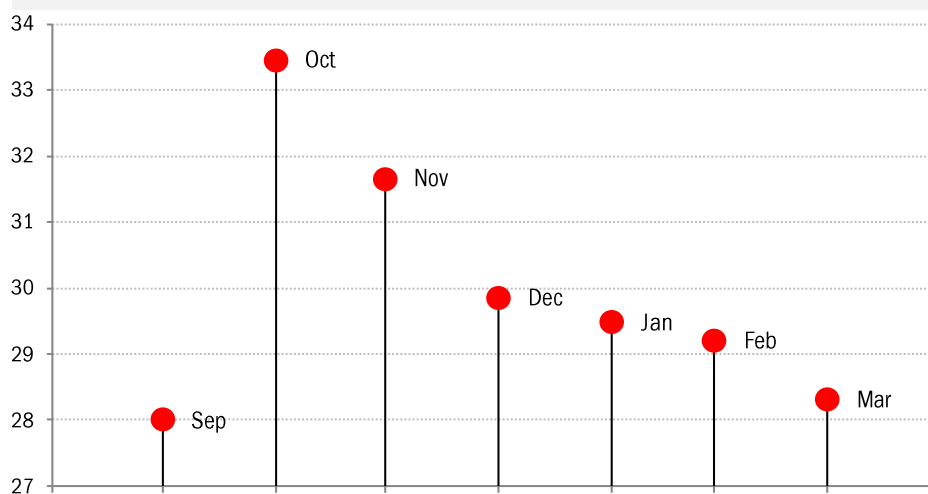
Mr. Market says Trump will win – but there could be weeks of uncertainty after election day.

Trigger warning: sorry, but we are going to have to talk about politics again. Please join us in setting personal preferences aside and using best efforts to objectively assess the outcome of the 2020 elections, and its impact on markets and the economy.

The virtual conventions are over and Labor Day is coming up – the 2020 general election campaign is on for real, and if markets hadn't been focusing on it before, they will have to now (see [“When Is Mr. Market Going to Start Worrying About President Biden?”](#) July 27, 2020). *We think Mr. Market has been focusing on the election already (he is not stupid). We think he expects Donald J. Trump to be re-elected, and he expects the continuation of Trumponomics with its low corporate tax rates and its pro-growth deregulatory agenda* (see, most recently, [“On the Dems’ ‘Virtual Convention’”](#) August 21, 2020).

- *If we are right, then more Mr. Market expects Trump to win, the bigger a drop if Trump loses.*
- The term structure of futures-implied forward S&P 500 volatility jumps around election day. But it doesn't return all the way back to today's level even through Q1-2021 (please see the chart below). *We think this not only reflects hedging against Trump losing, but against ongoing uncertainty, even chaos, even a Constitutional*

Tern structure of futures-implied forward S&P 500 Volatility Index



Source: Bloomberg, TrendMacro calculations

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Update to strategic view

US ELECTION MODEL, US STOCKS, US

MACRO: Equities at new highs mean Mr. Market is expecting Trump to win in November, with four more years of Trumponomics. The term structure of futures-implied forward S&P 500 volatility jumps around election day and doesn't return to today's levels even by March. We think this reflects the fear that widespread balloting by mail will lead to tabulation delays, fraud and possible litigation which, if in a decisive battleground state, could delay the general election result for many weeks. Rhetoric from both parties is conditioning the battlefield to delegitimize the election before it occurs. Meanwhile, post-convention polling and prediction markets show Biden's edge narrowing, and our model has extended its forecast of a Trump win with revisions to Q2-2020 personal income.

[\[Strategy dashboard\]](#)

crisis, if we have a cliff-hanger election in which we don't know the outcome for weeks or months.

- Remember the Florida “hanging chad” election of 2000. It took more than five weeks to determine the outcome, and that only thanks to a controversial Supreme Court ruling. Over that period, the S&P 500 lost as much as 9.6%. With a larger than normal share of absentee ballots from people sheltering from Covid-2019, and all-mail balloting policies in several states, there will be unusual stress on tabulating systems. This will lead to delays which, if they occur in decisive battleground states, will delay the national election result. If the result is close, there will be litigation, and further delays. And yes, this all means [increased potential for fraud](#).
- We hope we won't be misunderstood, because concern about voting-by-mail fraud has been [raised repeatedly by Trump](#) and has become a GOP talking point. But it's a bipartisan matter, and no less worthy a Democrat than [Hillary Clinton recently warned](#) of the very same thing.
- At the same time, Democrats have another related talking point about a potentially chaotic election process – that Trump would refuse to leave the White House if he loses. This, too, has been [said recently by Clinton](#).
- Both parties seem intent on delegitimizing the election before it is even conducted. They are conditioning the battlefield for an election that may not be decided on election night – when at first it may seem that one candidate has one, but then weeks later when mailed ballots are counted the other will have won – and then weeks or even months of litigation in courtrooms around the country. No wonder the forward curve of S&P 500 volatility doesn't calm down for months.
- We'll be writing much more about this. In the meantime, we invite clients to attend our conference call Thursday, September 3, at 1:00 pm ET, with vote fraud expert John Fund (please [email Tom Demas](#) for details).

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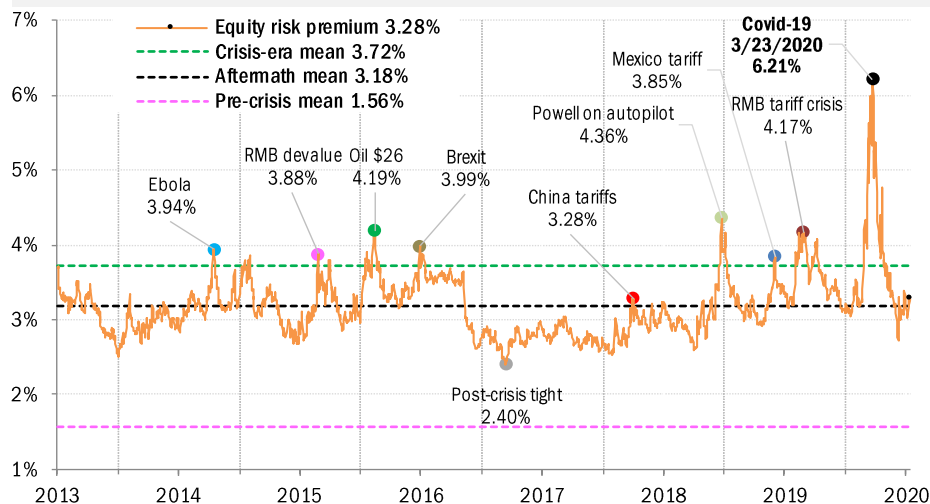
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[\[About us\]](#)

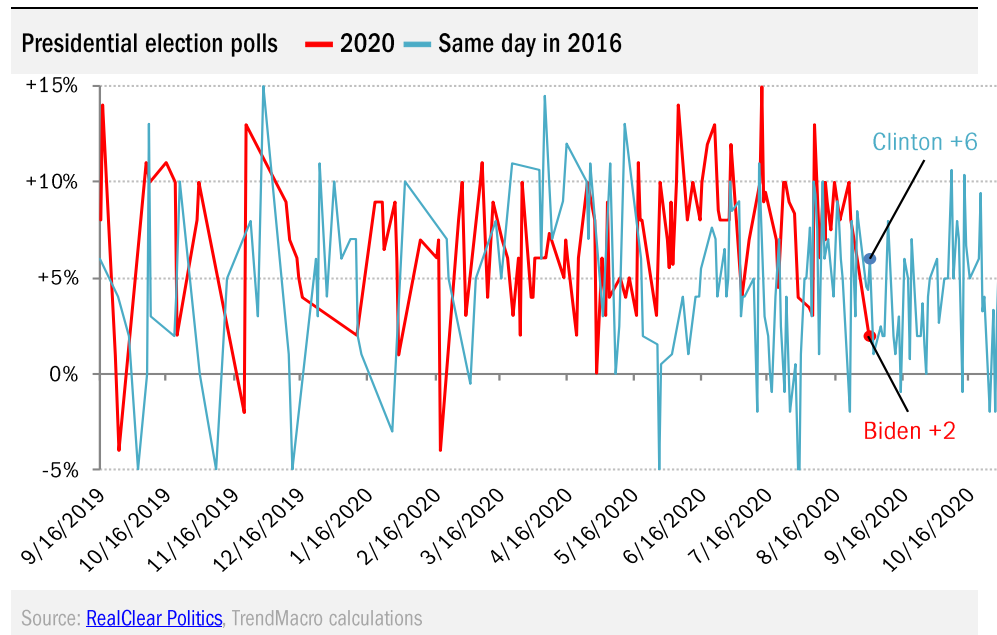
S&P 500 equity risk premium from mid-year 2013



Source: Various, TrendMacro calculations

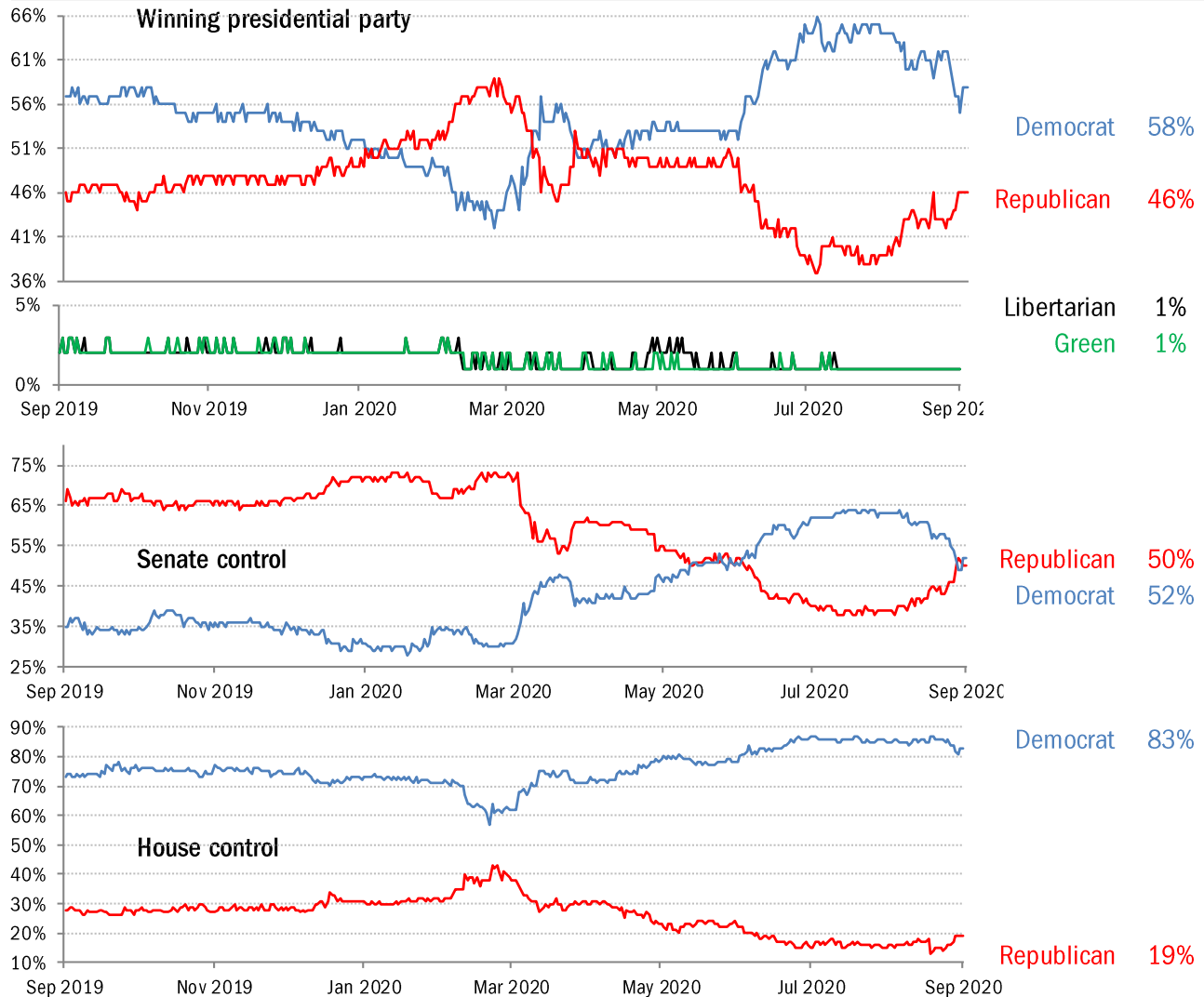
But for the moment all is well, with US equities at new recovery highs and the S&P 500 equity risk premium relative to the 30-yr Treasury yield well below the post-crisis mean (please see the chart on the previous page). It's not quite as narrow as it was at the interim market top in early June, but it's getting to the point where we have to start thinking there isn't much room for error in Mr. Market's expectation that Trump will win.

- Polls may now be beginning to move in the direction of seeing it Mr. Market's way. Now we have the first national poll taken after the Republican convention, and Trump might just be getting the post-convention bounce that Joseph R. Biden didn't get. It shows Biden ahead by 2%, his worst showing since April – and below where Hillary Clinton was polling on the same day in 2016 (please see the chart below).



- At the same time, Trump's chances for the presidency, and the GOP's chances for holding Senate control, are being upgraded in the prediction markets such as the [Predict-It online political futures exchange](#) (please see the charts on the following page).
- Why the turnaround for Trump?
- Much is being written now, [including by some brave Wall Street firms](#), about how ongoing urban violence is playing to Trump's favor. We don't disagree – we've said so before (again, see "[On the Dems' 'Virtual Convention'](#)").
- But we think too little credit is being giving to the GOP for staging a "virtual convention" with both vastly superior production and entertainment values. Its dynamism compared well to the dull and static Democratic convention (again, see "[On the Dems' 'Virtual Convention'](#)"). Let's be frank: it's a show, and the idea is to put on the best one.
- We think it was well-modulated, too. [Trump's acceptance speech](#) on the final evening, at 70 minutes, [was said](#) to be too long and delivered with too little energy. We disagree – after four years in

Futures market-implied probability of 2020 election outcome



Source: [Predict-It](#), TrendMacro calculations

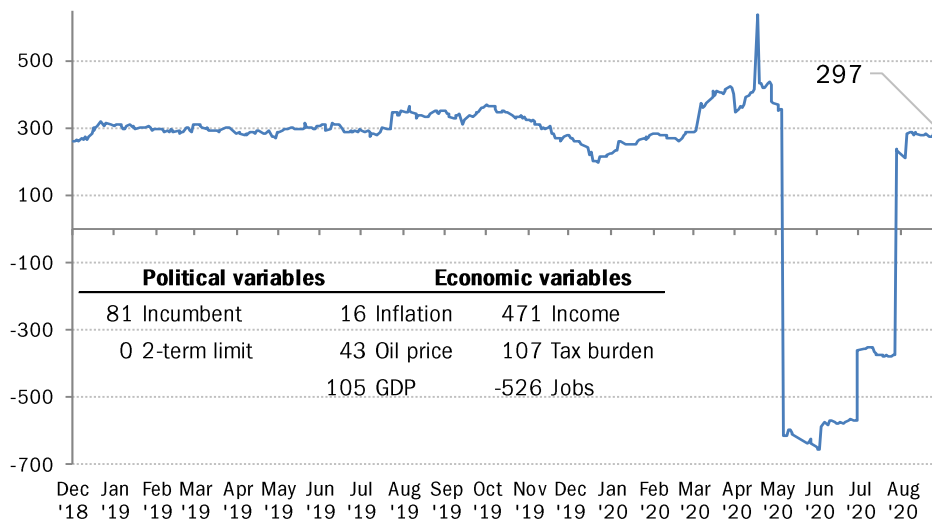
which the critics have begged him to act more presidential, he finally did. Maybe it turns out we like a little Trumpian excitement in our presidents after all, but be that as it may, he left that kind of thing to Kimberly Guilfoyle on Tuesday night.

- And the GOP convention featured a surprisingly diverse cast with a surprisingly inclusive attitude, portraying the GOP as a “big tent” in which minorities and women can thrive. By contrast, the Democratic convention, we believe, made the fatal mistake of portraying the party as an exclusive club in which only minorities and women can thrive. It’s not inclusive if you exclude white males – which, by doing so, implicitly signals that they are “[deplorables](#)”, a branding strategy that likely cost Clinton the election in 2016.
- Now, with new violence having erupted in Kenosha, this posture leaves the Democrats struggling to explain to white suburban families why they are so tolerant of it so long as it is carried out in the name of preferred constituencies. It doesn’t help Biden’s cause – it deeply hurts – for him to belatedly speak out, as he did

Monday, against violence on the one hand, but on the other hand disingenuously blame it on armed white supremacists egged on by Trump.

- The problem for Biden is that there was nothing he could have said that wouldn't have hurt. If he robustly condemns the violence, he risks a schism with the far Left of his own party. If he doesn't, he drives white suburban voters to Trump. We think his entire campaign will be a series of forced errors like this, in which he will at each decision-point have to take the least-bad choice. If he does it perfectly, he will get to election day having taken a series of bad choices – not the worst, but still bad.
- Another such error was his choice of Kamala D. Harris as his running mate (see [“On Harris for Veep”](#) August 11, 2020). He was forced, with Amy Klobuchar having been taken off the field because of her remote culpability in the death of George Floyd, to pick an African American woman (see [“On the June Jobs Report, and Our 2020 Election Model”](#) July 2, 2020). Given his age and the focus on his Veep choice, such a choice has inevitably drawn him from the political center toward his party's social justice wing, and Harris has done nothing to mitigate the damage (again, see [“On the Dems’ ‘Virtual Convention’”](#)).
- The next forced error will be Biden's decision of whether or not to debate Trump. Biden has said repeatedly that [he is eager to do so](#). His pride may demand it, but his self-evident cognitive deficit makes it a highly risky undertaking. Now House Speaker Nancy Pelosi has run interference for him, [floating a trial balloon](#) that Biden should not debate Trump, because “I wouldn't legitimize a conversation [sic] with him.” There's no good choice for Biden here – if he debates he will likely stumble, and if he doesn't, he'll be branded a coward.
- Meanwhile, Trump has good choices every day, because he's the

TrendMacro 2020 presidential election prediction model:
margin in electoral college votes for incumbent party



Source: BLS, BEA, Bloomberg, TrendMacro calculations

president of the United States. He can announce peace deals in the middle east. He can sign executive orders that put billions of dollars in people's pockets (see ["On Trump's Executive Action Stimulus"](#) August 9, 2020). This is why incumbent first-term presidents running for re-election almost always win.

- Finally, our quantitative prediction model agrees with Mr. Market that Trump will win. It is predicting a winning margin of 297 electoral college votes (please see the chart on the previous page). This is driven by a sequence of strong jobs reports and the stimulus-driven record Q2-2020 growth of personal income (see ["Video: What you're not hearing about the economy and the 2020 presidential election"](#) August 3, 2020).
- Last week's "second estimate" from the Bureau of Economic Analysis showed even higher personal income growth than July's "advance estimate." giving Trump 17 additional electoral college votes.
- Looking forward, we expect more payroll growth, and a "fiscal ramp" rather than a "fiscal cliff" for personal income in Q3-2020 (see ["On Trump's Executive Action Stimulus"](#) August 9, 2020). We expect the model's forecasted margin will narrow but stay positive.

Bottom line

Equities at new highs mean Mr. Market is expecting Trump to win in November, with four more years of Trumponomics. The term structure of futures-implied forward S&P 500 volatility jumps around election day and doesn't return to today's levels even by March. We think this reflects the fear that widespread balloting by mail will lead to tabulation delays, fraud and possible litigation which, if in a decisive battleground state, could delay the general election result for many weeks. Rhetoric from both parties is conditioning the battlefield to delegitimize the election before it occurs. Meanwhile, post-convention polling and prediction markets show Biden's edge narrowing, and our model has extended its forecast of a Trump win with revisions to Q2-2020 personal income. ▶