MACROCOSM

# Two Faddish Indicators and Their Fatal Flaws
Monday, September 9, 2024
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**The Sahm Rule and Lichtman's Keys to the White House aren't all they're cracked up to be.**

Clients are asking us about two predictive indicators wielded by charismatic spokespeople – the Sahm Rule of economist Claudia Sahm, which is predicting a recession, and the "Keys to the White House" presidential election model of Alan Lichtman, which is predicting that Kamala Harris will be elected in November. Both indicators are thought to have perfect track records. But, of course, it's trickier than that.

**FIRST, LICHTMAN'S "KEYS"**    *Lichtman's method is based on 13 "keys"* – elements describing the political, economic and social environment, *many of which are highly subjective*. The incumbent party's candidate is predicted to win unless the non-incumbent party's candidate captures at least six of the keys. *Lichtman says Trump is capturing only three keys, with a chance for two more at most by election day.*

Lichtman's model has been running out-of-sample since 1984, and claims a perfect track record. Trump's win in 2016 is problematic however, because while Lichtman indeed predicted he would win, that prediction was explicitly with respect to the popular vote, which Trump lost decisively.

- *Lichtman's prediction contradicts our election model based exclusively on objective economic inputs, which is predicting that Donald Trump will be elected*, though narrowly (see "Weekly Investment Strategy Summary" September 9, 2024). Out-of-sample, the model correctly predicted Obama in 2012 (our forecast was within one Electoral College vote!) and Trump in 2016; it was wrong in predicting Trump in 2020.
- *Lichtman also contradicts the closely watched model of Nate Silver, which is calling for Trump to win*, but even more narrowly than our model expects. Out-of-sample, he correctly predicted Obama in 2008 and 2012, and Biden in 2020. But he incorrectly predicted Clinton in 2016. Silver's model has been based exclusively on polling data – but very cleverly applied. This cycle his model has begun to incorporate six economic variables which strongly overlap those of our model.

The table on the following page lists the 13 keys and Lichtman's judgement about them and, as necessary, his rationale. We offer our

## Update to strategic view

**US POLITICS, US MACRO:** Lichtman's "Keys to the White House" presidential election model is predicting Harris, while our model and Nate Silver's are predicting Trump. The "Keys" do not have the perfect track record that is claimed, and the model is in fact only a subjective analytical framework. The "Sahm Rule" triggered its recession call with July jobs on a rounded basis, and with August jobs with full decimal precision. The rule is always late, by an average of 3.7 months. We erred Friday in saying the rule was not triggered with August jobs, but our erroneous calculation produces a better track record. Either way, a July or August trigger would mean the business cycle peaked something like four to five months ago, and that's not supported by other data.

[Strategy dashboard]

comments, not so much to agree or disagree, but to show how very subjective many of these keys really are.

- *As you look down the list, put out of your mind the claim – or even the reality – that Lichtman has a great track record*. We all know that while a track record is an indispensable qualifier, it is no guarantee of future success. Indeed, in competitive markets – whether financial or political – strategies with good track records become uniquely poised for future failure.
- *As you look down the list, ask yourself whether you would agree with the way Lichtman has awarded the keys*. There's a lot of subjectivity here. And who's to say how to weight the keys? Lichtman apparently treats them all equally.
- *And as you look down the list, be sensitive to your prejudices and your wishes. They will influence your judgment. And they influence Lichtman's, which is all this so-called model comes down to.*

| Key | Definition | Lichtman's call | Our comment |
| --- | --- | --- | --- |
| Party mandate | Incumbent gained House seats in the midterms | Trump | Objective. The GOP flipped the House in 2022. |
| No primary contest | There is no serious contest for the incumbent party nomination | Harris "The Democrats… united overwhelmingly behind Harris." | It is objectively true there was no significant opposition to Biden in the primaries. But Harris's nomination is not the result of primaries at all, so it is inherently subjective to call this one way or the other. |
| Incumbent seeking re-election | Incumbent party candidate is the sitting president. | Trump | Objective. Harris is not the president, so this goes to Trump. |
| No third party | There is no significant third party or independent campaign. | Harris | In the modern era in which the election is determined by narrow margins in battleground states, fringe candidates are more significant – how significant is subjective. Furthermore, this election, it is not known yet in which states Kennedy's name will be on the ballot, nor the extent to which his endorsement of Trump will influence the vote whether or not his name is on the ballot. |
| Strong short-term economy | The economy is not in recession during the election campaign. | Harris "The economy is clearly not in recession." | This seems more objective than it is. First, polls show voters |

| | | | exhausted by the cumulative inflation of the last three years, despite the economy not being officially in recession. Second, recessions are officially called well after-the-fact – so who's to say we aren't in one now? We don't think we are. The Sahm Rule and other indicators disagree. |
|---|---|---|---|
| Strong long-term economy | Real per capita economic growth during the term equals or exceeds mean growth during the previous two terms. | Harris | Objective. It does. As we predicted, by the way. |
| Major policy change | The incumbent administration effects major changes in national policy. | Harris "Rejoining the Paris Accords…the CHPS bill, the infrastructure bill, the inflation reduction and climate change bill [sic]." | It is subjective what is, and what is perceived as, "major." |
| No social unrest | There is no sustained social unrest during the term. | Harris "There have been sporadic protests… there are lot of protestors upset with Biden's policies in the Middle East. But with Harris, not Biden, front-and-center that has dampened social unrest." | Subjective. The present protests against Israel are particularly difficult to grasp because they represent a schism within the incumbent party itself. |
| No scandal | The incumbent administration is untainted by major scandal. | Harris "Republicans for years have been trying to pin a scandal on Biden and come up empty… there has to be some bi-partisan recognition of actual corruption." | Subjective. Depends what you mean by "major." |
| No foreign or military failure | The incumbent administration suffers no major failure in foreign or military affairs. | OPEN "The Biden administration is deeply invested in the war in Gaza which is a humanitarian disaster with no end is sight." | Lichtman's failure to even mention the failed withdrawal from Afghanistan or the failure to deter Russian aggression in Ukraine shows how subjective this is. |
| Major foreign or military success | The incumbent administration achieves a major success in foreign or military affairs. | OPEN No comments. | Lichtman is silent, perhaps because there have been no successes. But that would mean he should award the key to Trump. He does not explain why he has not |

| | | | done so; he only notes that even awarding the key to Trump would not put him over the top. |
|---|---|---|---|
| Charismatic incumbent | The incumbent party candidate is charismatic or a national hero. | Trump "You have to be a once in a generation broadly inspirational candidate. Harris has not met that standard." | Subjective. Ronald Reagan in 1984 is the only incumbent to whom Lichtman awarded this key. |
| Uncharismatic challenger | The challenging party candidate is not charismatic or a national hero. | Harris "Some people think Donald Trump is a god, but he only appeals to a narrow base." | Subjective. Lichtman judged Trump "uncharismatic" in 2016 and 2020, too. Hard to square with the reality that he has made himself into far-and-away the world's most famous and fascinating person, in or out of office. |

**SECOND, SAHM'S "RULE"** The [Sahm Rule](#) uses a simple transformation of the unemployment rate to determine the onset of recession earlier than the National Bureau of Economic Analysis would typically [make it official](#). The rule is triggered if the three-month average of the unemployment rate exceeds its minimum of the previous twelve months by 50 bp. *Using the rounded unemployment rate data* provided by the Bureau of Labor Statistics, *the rule was triggered with the July jobs report released in August* (see ["On the July Jobs Report"](#) August 2, 2024).The rule appears superficially to have an excellent track record, with just one false positive (please see the chart below).
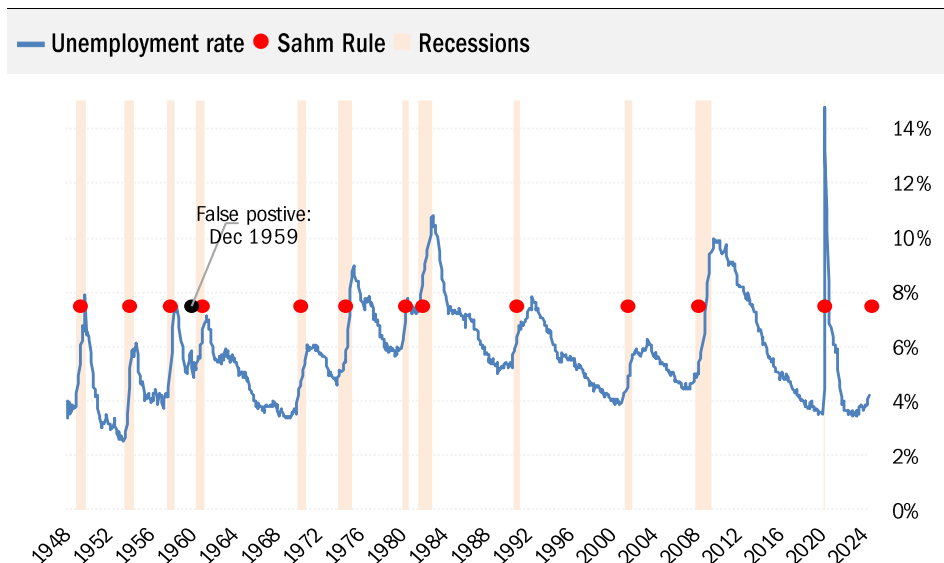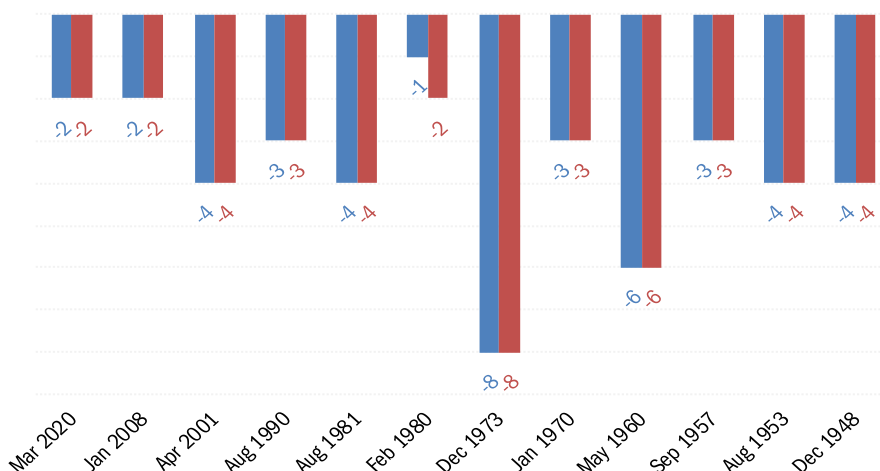


Source: BLS, NBER, TrendMacro calculations

*Without rounding,* using full decimal precision, *the rule was not in fact triggered in July, but in August* with the jobs data released last week (see ["On the August Jobs Report"](#) September 6, 2024).

We mistakenly reported that the rule had not been triggered in August at full decimal precision, and we thank an alert client for catching our error and telling us about it (we have posted a correction). We had been calculating the rule assuming the "previous twelve months" of the average unemployment rate included the current month – it, in fact, does not.

- But our error is actually quite revealing. It turns out that *the rule's track record is actually slightly improved doing it our way, the wrong way*.
- *The Sahm Rule is always late.* Rounded, it has never predicted a recession less than one month after the last month of the business cycle expansion – in one case as late as six months, and in another case eight months (please see the chart below). Using full decimal precision made no difference except in one case.

Sahm Rule triggers, by recession: number of months following last month of expansion
■ Rounded ■ Full decimal precision



Source: BLS, NBER, TrendMacro calculations

- *On average, the Sahm Rule is late by 3.7 months*. Doing it our way, the wrong way, we can reduce that error to 3.6 months. Obviously, that's not a big deal – but it shows you how precarious it is to potentially make consequential strategic decisions based on the exact triggering of a so-called "rule" when it's always late to begin with, and then doing it wrong can make it slightly better.
- And besides – *reality check!* – *if the rule's average latency holds, that means the economy peaked something like four to five months ago*. That just doesn't match very much other data – and continued payrolls growth and soaring S&P 500 forward earnings estimates would seem to flatly contradict it.

*Oh. But we have learned one important thing from all this. In the future we're going to start calling our indicators – like, say, our monetarist inflation model – "rules" or "keys." We'll get a lot more respect.*

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[About us]

**Bottom line**

Lichtman's "Keys to the White House" presidential election model is predicting Harris, while our model and Nate Silver's are predicting Trump. The "Keys" do not have the perfect track record that is claimed, and the model is in fact only a subjective analytical framework. The "Sahm Rule" triggered its recession call with July jobs on a rounded basis, and with August jobs with full decimal precision. The rule is always late, by an average of 3.7 months. We erred Friday in saying the rule was not triggered with August jobs, but our erroneous calculation produces a better track record. Either way, a July or August trigger would mean the business cycle peaked something like four to five months ago, and that's not supported by other data.