2018 Holiday Eye on the Market: a note to my spouse on the 2020 US Presidential election

There were positive gains in US growth stocks this year while almost everything else was flat/down; the chart below tells the story. While we expect US GDP and profits to continue to rise in 2019, in most business cycles, asset prices peak a year or so *before* corporate profits and the economy do. In other words, a rising economy and rising profits often don't translate into rising asset prices this late in the cycle, particularly with the US President channeling Andrew Jackson and Hoover instead of Reagan (see links below). We will review all of this in our 2019 Outlook, released as usual on January 1st. The biggest binary issue for investors: the long-term US trade and political conflict with China, since I can imagine a substantial market recovery or decline based on how it plays out. Looks like a low single-digit return year in 2019 at best, after -3% to 1% returns on diversified stock-bond mixes in 2018.

At this time each year, I depart from standard investment commentary to write something different. This year, the Holiday *Eye on the Market* is a note to my spouse on the 2020 US Presidential election. Please skip this note and read one of the pieces below if politics raises your blood pressure to unacceptable levels. Happy New Year.

Michael Cembalest
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Select Eye on the Market topics, 2018

How business cycles end, and the twilight of the largest monetary intervention in history

2018 *Eye on the Market* energy paper: fact and fantasy along the road to de-carbonization

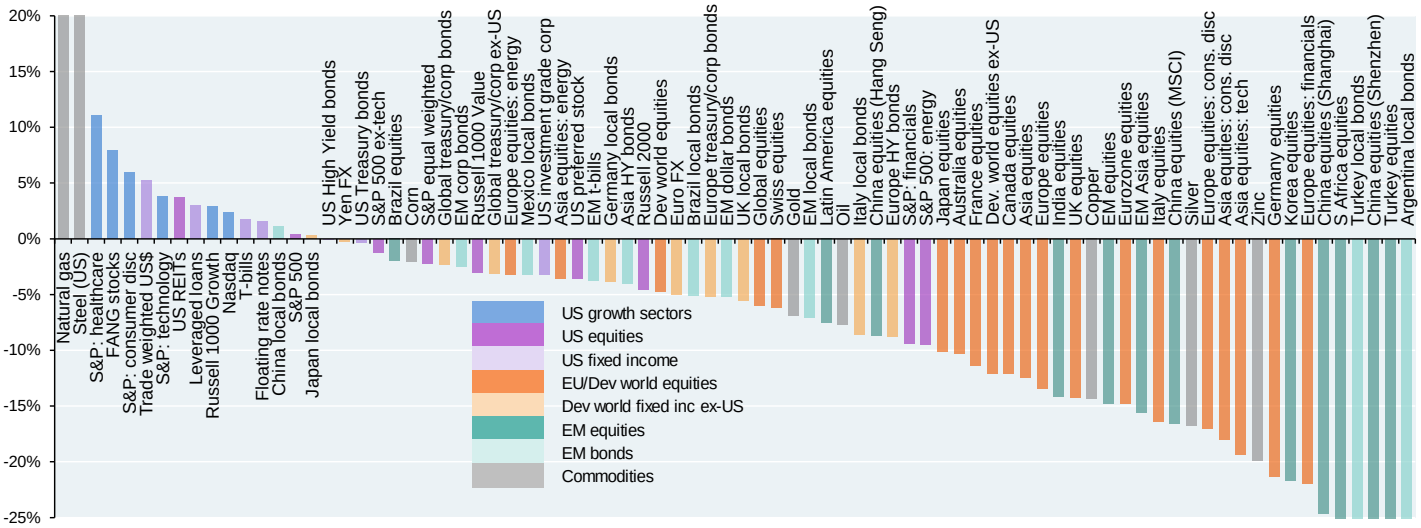
On private equity dry powder: implications for investors of growing committed and unspent capital

The State of the States: the full cost of unfunded pension and retiree healthcare obligations

Midterms: adjusted for economic and market conditions, the worst incumbent House loss in 100 years

Trumpism for Investors: Themes and parallels to prior US Presidents, from Jackson to Bush

2018: US growth stocks up, almost everything else flat/down as the global stimulus cycle comes to an end
Year to date returns in US$



Source: Bloomberg, J.P. Morgan Asset Management. December 10, 2018. Returns beyond chart axes: Natural gas +55%, Steel (US) +33%, S Africa equities -27%, Turkey local bonds -31%, China equities (Shenzhen) -33%, Turkey equities -41%, Argentina local bonds -53%.

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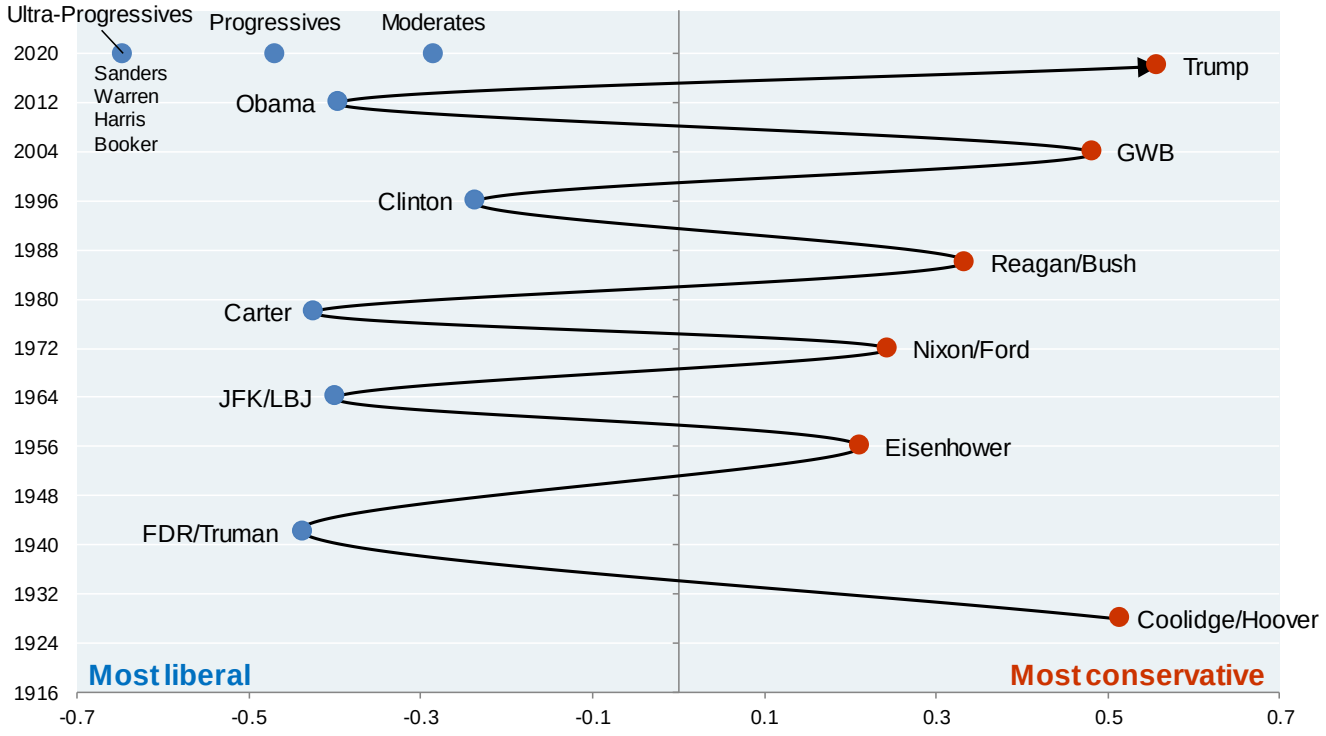
"Good luck with that"

I know you have a vision, a hope, I'm not sure what to call it, that goes something like this: in 2020, a moderate defeats the President in the GOP primary and a moderate wins the Democratic primary, with both candidates reflecting the homespun values of your father, raised in rural Indiana (Kewanna, pop. 600) in the 1930's before serving as head of surgery for the 121st medevac hospital in Korea, the Chief of Surgery at Northwestern Hospital and as one of the team doctors for the Chicago Cubs. My response? As you say to me in moments of my own delusions: "**good luck with that**". If the political pendulum swings, it may swing pretty far. The chart shows the degree of liberalism/conservatism by administration since 1924. Given the ideological intensity of the Trump administration and of progressives in the Democratic Party, you may face a choice in 2020 that reflects the extremes of the last 100 years rather than the middle[1], at least as it relates to the liberalism/conservatism measure shown below.

The political ideology of Presidential administrations, and a look at 2020



Who's included in each administration's score

2020 Ultra-progressives: Warren, Sanders, Harris, Booker
2020 Progressives: S. Brown, Giilibrand, Merkley
2020 Moderates: Bennet, Biden, Casey, Klobuchar, O'Rourke
Trump admin: Cotton, Graham, Hatch, McCarthy, Meadows, Paul, Perdue, Ryan, Scalise, Sessions
Obama admin: Biden, Durbin, H. Clinton, Kennedy, Kerry, Obama, Pelosi, Reid, Waxman
GWB admin: Ashcroft, Blunt, Cheney, DeLay, Kyl, McConnell, Santorum
Clinton admin: Bentsen, Carper, Chiles, Gephardt, H. Ford, Nunn, Robb
Reagan/Bush admin: Baker, Bush, Dole, Kemp, Latta, Laxalt, Lugar, Michel
Carter admin: Bayh, Byrd, Hawkins, Mondale, O'Neill, Wright
Nixon/Ford admin: Ford, Lott, Percy, Rhodes, Sandman, Scott, Wiggins
JFK/LBJ admin: Bolling, Humphrey, JFK, Johnson, Mansfield, McCarthy, McCormack
Eisenhower admin: Dirksen, Dulles, Flanders, Nixon, Saltonsall, Smith, Taft
FDR/Truman admin: Barkley, Black, Byrns, Garner, Guffey, McCormack, Robinson, Sabath, Truman
Coolidge/Hoover admin: Curtis, Hawley, Longworth, Moses, Tilson, Watson

Methodology: Each administration's ideology is based on politicians we selected (left), which include members of its Executive Branch with Congressional voting histories, and prominent members of Congress that supported major legislative initiatives of that administration, and/or defended its political and governing principles. The dots show the average for the group, and were computed using Nokken-Poole first dimension Voteview data, sourced below. In general terms, Voteview scores reflect the ideological intensity of politicians by looking at how frequently they voted with their bloc. Please see appendix for details.

Data: Jeffrey Lewis, Keith Poole, Howard Rosenthal, Adam Boche, Aaron Rudkin and Luke Sonnet (2018). Voteview: Congressional Roll-Call Votes Database.

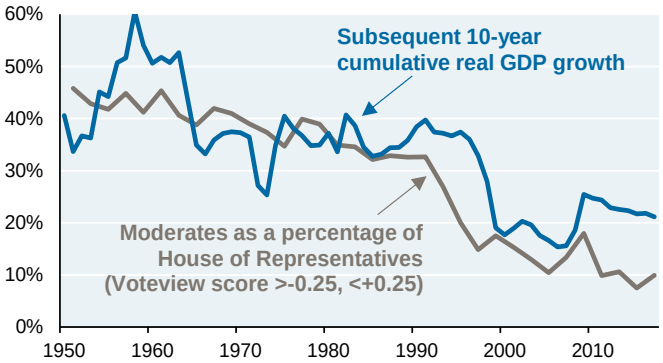
Michael Cembalest, J.P. Morgan Asset Management, 2018.

[1] According to Brookings, 44% of House primary candidates identified as Progressive this year (up from 29% in 2016), and the Congressional Progressive Caucus is now the largest Democratic caucus with close to 100 members. In 2018, for the first time in the history of the Gallup poll, **more Democrats aged 18-29 had a positive view of socialism than of capitalism**.

What the chart measures. The underlying data measure the liberalism or conservatism of politicians based on their voting patterns in Congress, and have been used since the 1980's in peer-reviewed studies on public policy, the legislative process and polarization (see p4). The chart conveys the intensity with which each Administration and its prominent supporters in Congress adhere to a liberal or conservative ideology, and the frequency with which they break from the party line. The chart is ***not*** meant to establish a moral, social or ethical equivalence between observations at equal distances from zero. That's not something that can be captured in a chart, and is a judgment made in the hearts and minds of voters.

Why the gap matters. Look at the next two charts. The US was more prosperous when there were more moderate politicians around. Yes, post-war growth declined mostly due to falling birthrates and rising longevity[2]. But I'm convinced that the collapse in the political center played a role as well, leading to one-sided policymaking that gets implemented and repealed as the pendulum swings, and issues left unaddressed since the divisions are too wide. I'd like to see a return of the moderates like your father[3], but I don't think it will happen anytime soon now that the furies have been unleashed. The erosion of political norms and constitutional conventions now taking place[4], and some of the reaction to it, makes life more difficult for moderates in both parties. Hence this note about 2020 and the choice you may face compared to your preferred scenario[5].

Moderates in Congress and GDP growth that followed



Source: Conference Board; Congressional Budget Office (GDP projections to 2028); Voteview database (Lewis et al, UCLA); JPMAM calculations. 2018.

The Decline in Congressional problem-solving

Congress	Year	Avg # of witnesses testifying at hearings	Percentage of hearings devoted to proposed solutions
92nd	1971-73	15	65%
100th	1987-89	11	48%
111th	2009-11	6	20%

More one-sided hearings devoting less time to problem-solving. The capacity of government to assess problems has declined due to a "self-conscious attempt to limit serious discussions of aspects of complex problems" through formal and informal restrictions.

"*Congressional Dysfunction and the Decline of Problem Solving*", Lewallen, Jones and Theriault, Univ of Tampa/UT Austin.

Whichever party wins in 2020, legislators will eventually have to grapple with issues constraining US growth. Our chairman (Jamie) asked me to work on a project assessing "**negative productivity agents**": crumbling transportation and electricity infrastructure, the lack of high speed rail, coastal exposure to storm surges, healthcare costs, sub-par reading and math scores, the world's highest litigation costs, the economic cost of racial inequality, land use regulation and its adverse impact on labor mobility and housing, the negative impact of arbitrary state licensing, the need for immigration reform, the sad fact that the US leads the developed world in obesity, gun violence, incarceration and opioid use, and the projection from the CBO that by 2030, 100% of Federal tax revenues will be needed to pay entitlements and interest, with nothing left for discretionary spending. **You can read the presentation here**. The challenges are complex; the chart above suggests that in the past, moderates did a better job of solving them.

Michael

[2] See "*Why Does Economic Growth Keep Slowing Down?*", Federal Reserve Bank of St. Louis, February 9, 2017.

[3] **I miss your father**. He liked fishing, pie and diners, and disliked parties, small talk and fine restaurants. When your mother threw out his old tweed caps and bought him a new one for Christmas, he told your brother John to throw out the new cap and retrieve the old ones from the trash. He bought a new (brown) car in less than five minutes since he hated shopping. He got sick on vacation but never at work. I apologize in advance but I am gradually becoming him.

[4] See "*Political Norms, Constitutional Conventions, and President Donald Trump*", Indiana Law Journal, 2017, Siegel (Duke); and "*The Trump Presidency and American Democracy: A Historical and Comparative Analysis*", Perspectives on Politics, Oct 2018, Lieberman, Mettler, Pepinsky, Roberts, and Valelly (Johns Hopkins/Cornell/Swarthmore)

[5] Even so, I doubt you will spend much time deciding whom you will vote for.

Appendix: the Political Pendulum chart

Voteview methodology, our chart and further reading on polarization

- "Voteview" data is derived from a spatial model of parliamentary voting, and assigns liberal/conservative scores to every politician since the 1st Congress in 1789 based on their voting records. It has been used in peer-reviewed studies of polarization and Congressional history since the 1980's. The project began with pioneering work done by Keith Poole at the University of Georgia and Howard Rosenthal at NYU/Carnegie Mellon ("*The Polarization of American Politics*", 1984), and is now maintained by UCLA's Department of Political Science.
- Using Voteview data, I computed a liberal/conservative score for each administration based on the average score of politicians most closely aligned with it: (a) members of its Executive Branch with their own voting histories, and (b) prominent supporters in Congress that helped pass that administration's major legislation, and/or that defended its political and governing principles. The judgments on which politicians to include are my own (the names I selected appear below the chart), and any historian's lists could differ; I think they represent each administration's political orientation reasonably well.
- There are good resources to read on the issue of polarization and its impact on American society, and on the ability of American democracy to withstand the current unorthodoxy. Some recommendations: Nolan McCarty at Princeton, Jack Balkin at Yale, Neil Siegel at Duke, David Spence at the University of Texas and Norm Ornstein at the American Enterprise Institute.

On the selection of prominent members and supporters for each administration

- The rightward migration of the **red** dots in the chart since the 1950's is notable. So is the outlying moderation of the Clinton administration, which sprung from the now-defunct Democratic Leadership Council's desire to reverse the poor performance of progressive Democratic Presidential candidates in 1972, 1980, 1984 and 1988.
- The decision to define someone as a Congressional supporter is **subjective**. Eugene McCarthy, for example, was an opponent of the Vietnam War whose political movement was reportedly a key factor driving LBJ not to run for a second term. However, McCarthy was also a key ally to JFK and LBJ in passing the landmark Great Society legislation of the 1960's, and has therefore been included as one of their prominent ideological supporters in Congress.
- Congressional supporters were hardest to develop for **Jimmy Carter**, given his Administration's well-publicized battles with his own party, including House Speaker Tip O'Neill. These conflicts culminated in a decision by Senator Ted Kennedy to run against President Carter during the 1980 Democratic primary. Carter's battles with Democrats in Congress are described by historians as contributing to the poor ranking of his presidency.
- If the **Nixon** administration's less extreme ideological position surprises you, there are plenty of Nixon quotes illustrating how he felt about the Goldwater wing of the Party: "*A Republican can't stray too far from the right wingers because they can dominate a primary and are even more important in a close general election. The far right kooks are just like the nuts on the left…There's only one thing as bad as a far left liberal and that's a damn right wing conservative*." [Presidential Studies Quarterly, former Nixon aide John Whitaker, Winter 1996]. Ironically, **Goldwater** was the one who delivered the news to Nixon in 1974 that the majority of Republicans would not stop his impeachment and conviction if he remained in office.

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