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Tuesday Tidings

An Election Primer

- Equities

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- **History argues that investors should root for the challenger, irrespective of party.** The debate over who is better for the stock market, a Democrat or a Republican, can be somewhat distracting even as the data shows better returns under Democrat Presidents over the course of their terms. However, challenger wins provide more insight as they typically generate a much stronger S&P 500 gain, on average, in the subsequent year and over the full term, regardless of party affiliation.
- **Close polling data currently suggest that the 2012 election outcome may come down to the wire.** Many political pundits see a close race with both campaigns' strategy teams highlighting voter turnout as the critical factor in many swing states that will decide the electoral college results. In this context, the investment community may spend much of the next couple of months poring over polls more so than business trends though there will still be a focus on consumer spending, jobs, central bank policies, the ISM and even German court decisions. Most experts anticipate that the Republicans will hold the House of Representatives and there will be a very close contest over Senate control.
- **Fiscal policy and its debt impact may be a crucial dynamic for equity risk premiums and valuation.** Uncertainty over the fiscal cliff and how it is addressed potentially in the so-called lame duck session is a substantive issue when considering 2013 EPS. But, the bigger issue of how America deals with its sluggish economy and growing debt burden given trillion dollar deficits seems to be the overwhelming question for P/E ratios which have become somewhat disconnected from interest rate levels. Risk premiums are near 30-year highs, holding down valuation, though arguably lower than they were soon after World War II when government debt as a percent of GDP was quite elevated as well. In this context, the market's price/book ratio likely would benefit from smaller government.
- **A Romney victory may benefit several industries such as Energy, Health Care, Defense, Utilities and Financials.** Given campaign promises to repeal the Dodd-Frank financial bill's restrictions, replace the Affordable Care Act and restrain allegedly excessive regulatory requirements, several industries stand to gain from a possible Romney win. In addition, the defense establishment, currently facing major spending cuts, traditionally has been backed more aggressively by Republicans, while coal miners and electric power companies most likely would enjoy some environmental related relief.
- **Obama's re-election would be more supportive of alternative energy, generic pharmaceuticals, technology and entertainment.** Many of the beneficiaries of a potential Republican White House would likely be underperformers should Barrack Obama hold on to the presidency in November and several other industries should get a boost. To some degree, a showdown over tax increases might negatively impact higher end consumption, though stock market levels are probably more crucial. Any tax treatment that shows a preference for capital gains over dividend income might also help tech startups and stock buyback activity incrementally.

See Appendix A-1 for Analyst Certification, Important Disclosures and non-US research analyst disclosures.

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Political Silly Season Is in Full Swing

With the Republican National Convention over and the Democratic one taking place right after Labor Day, it can be suggested that the election season is now on the front burner as Americans begin to get inundated with political rhetoric and advertising for the next couple of months leading to November 6. For a good number of undecided voters, the election campaign has just started in earnest even as many engaged investors seem to think that it has been going on for months already. Intriguingly, it does appear that the outcome is far from certain, with polls suggesting that, while President Obama has the edge currently his lead has dwindled into the margin of error, with critical swing states such as Ohio, Virginia and Florida still very much in play. Indeed, most political pundits see the election's final result as coming down to roughly 10 highly contested states. Citi's political analyst Tina Fordham recently posited that a review of various metrics ultimately still argues for an Obama victory (see August 2nd Global Political Insights - Mid-year Outlook: Rising Geopolitical Risks and the New UltraVox Populi Will Carry On Into 2013), and this is supported by Figure 1. Some independent pollsters such as Charlie Cook still see it as a tossup given the electoral college count for the swing states (see Figure 2) and the President's inability thus far to achieve a consistent 50% approval rating which has been the baseline for incumbents winning second terms since World War II. Nevertheless, the implications of who wins are fairly meaningful.

Figure 1. General Election: Romney vs Obama National Polls

Poll	Date	Sample	MoE	Obama (D)	Romney (R)	Spread
RCP Average	**8/13 - 8/28**	**--**	**--**	**46.8**	**45.7**	**Obama +1.1**
Democracy Corps (D)	8/23 - 8/27	1000 LV	3.1	49	47	Obama +2
CBS News	8/22 - 8/26	1051 RV	3	46	45	Obama +1
ABC News/Wash Post	8/22 - 8/25	857 RV	4	46	47	Romney +1
CNN/Opinion Research	8/22 - 8/23	719 LV	3.5	49	47	Obama +2
FOX News	8/19 - 8/21	1007 LV	3	44	45	Romney +1
Gallup (Wednesday)	7-Day Tracking	3050 RV	2	47	46	Obama +1
Rasmussen (Wednesday)	3-Day Tracking	1500 LV	3	46	45	Obama +1
Resurgent Republic (R)	8/16 - 8/22	1000 LV	3.1	46	45	Obama +1
Associated Press/GfK	8/16 - 8/20	885 RV	4.1	47	46	Obama +1
NBC News/Wall St. Jrnl	8/16 - 8/20	1000 RV	3.1	48	44	Obama +4
Monmouth/SurveyUSA/Braun	8/15 - 8/19	1149 LV	2.9	46	45	Obama +1
LA Times/USC	8/13 - 8/19	954 LV	3.2	48	46	Obama +2

Source: Real Clear Politics

Figure 2. Cook Political Report Electoral College Voting Ratings

Solid D	Likely D	Lean D	Toss Up	Lean R	Likely R	Solid R
15 STATES	**2 STATES**	**2 STATES**	**8 STATES**	**1 STATES**	**4 STATES**	**19 STATES**
California (55)	Maine-02 (1)	Michigan (16)	Colorado (9)	North Carolina (15)	Arizona (11)	Alabama (9)
Connecticut (7)	Minnesota (10)	Pennsylvania (20)	Florida (29)		Georgia (16)	Alaska (3)
Delaware (3)	New Mexico (5)		Iowa (6)		Indiana (11)	Arkansas (6)
District of Columbia (3)			Nevada (6)		Missouri (10)	Idaho (4)
Hawaii (4)			New Hampshire (4)		Nebraska-02 (1)	Kansas (6)
Illinois (20)			Ohio (18)			Kentucky (8)
Maine-AL (2)			Virginia (13)			Louisiana (8)
Maine-01 (1)			Wisconsin (10)			Mississippi (6)
Maryland (10)						Montana (3)
Massachusetts (11)						Nebraska-AL (2)
New Jersey (14)						Nebraska-01 (1)
New York (29)						Nebraska-03 (1)
Oregon (7)						North Dakota (3)
Rhode Island (4)						Oklahoma (7)
Vermont (3)						South Carolina (9)
Washington (12)						South Dakota (3)
						Tennessee (11)
						Texas (38)
						Utah (6)
						West Virginia (5)
						Wyoming (3)
185 votes	16 votes	36 votes	95 votes	15 votes	49 votes	142 votes
Maine and Nebraska can split their electoral votes						
201 Electoral Votes						191 Electoral Votes
	237 Electoral Votes				206 Electoral Votes	

Source: Cook Political Report

Figure 3 highlights that a challenger win over an incumbent is usually best for the stock market in the year following the election as well as over the course of the term, irrespective of party affiliation, thereby underscoring a possible favoring for Romney from the investment community. Yet, Figure 4 shows that equities generally have done better under Democrat presidents, but some dissection of the data could render this data unreliable since it can be affected by who was in control of Congress at the time (and not just the White House), economic factors and/or the impact of stock market price trends prior to any particular administration – for example, President Reagan's first term's stock market strength benefited from back-to-back recessions ending as he entered office and a lowering of interest rates; President George W. Bush's first term was hurt by the collapse of the tech bubble; and, the recovery off of the Great Recession helped boost President Obama's stock market numbers. Hence, Figure 3 was constructed to protect against inherent political biases while capturing change as a possible catalyst for equities.

Figure 3.

S&P 500 Performance During Presidential Cycles, By Year

President (*denotes incumbent when elected)	Election Year	Party	1st Year of Pres. Cycle Year	1st Year Full Year Perf.	2nd Year of Pres. Cycle Year	2nd Year Full Year Perf.	3rd Year of Pres. Cycle Year	3rd Year Full Year Perf.	4th Year of Pres. Cycle Year	4th Year Full Year Perf.	Four-Year Cycle Return
*William McKinley (T. Roosevelt as of 9/14/01)	1900	Rep	1901	15.7%	1902	1.3%	1903	-18.4%	1904	25.6%	20.1%
*Theodore Roosevelt	1904	Rep	1905	15.6%	1906	3.1%	1907	-33.2%	1908	37.4%	9.5%
William H. Taft	1908	Rep	1909	14.1%	1910	-12.1%	1911	0.7%	1912	3.0%	3.9%
Woodrow Wilson	1912	Dem	1913	-14.3%	1914	-8.6%	1915	29.0%	1916	3.4%	4.5%
*Woodrow Wilson	1916	Dem	1917	-30.6%	1918	16.4%	1919	14.0%	1920	-24.5%	-30.5%
Warren G. Harding (C. Coolidge as of 8/2/23)	1920	Rep	1921	7.4%	1922	20.9%	1923	-1.5%	1924	18.8%	52.0%
*Calvin Coolidge	1924	Rep	1925	23.3%	1926	5.7%	1927	30.9%	1928	37.9%	135.2%
Herbert Hoover	1928	Rep	1929	-11.9%	1930	-28.5%	1931	-47.0%	1932	-15.2%	-71.7%
Franklin D. Roosevelt	1932	Dem	1933	46.6%	1934	-6.0%	1935	41.5%	1936	27.8%	149.4%
*Franklin D. Roosevelt	1936	Dem	1937	-38.6%	1938	25.3%	1939	-5.4%	1940	-15.3%	-38.4%
*Franklin D. Roosevelt	1940	Dem	1941	-17.9%	1942	12.4%	1943	19.4%	1944	13.8%	25.5%
Franklin D. Roosevelt (Truman as of 4/12/45)	1944	Dem	1945	30.7%	1946	-11.9%	1947	0.0%	1948	-0.7%	14.5%
*Harry S. Truman	1948	Dem	1949	10.3%	1950	21.8%	1951	16.5%	1952	11.8%	74.8%
Dwight D. Eisenhower	1952	Rep	1953	-6.6%	1954	45.0%	1955	26.4%	1956	2.6%	75.6%
*Dwight D. Eisenhower	1956	Rep	1957	-14.3%	1958	38.1%	1959	8.5%	1960	-3.0%	24.5%
John F. Kennedy (Johnson as of 11/23/63)	1960	Dem	1961	23.1%	1962	-11.8%	1963	18.9%	1964	13.0%	45.8%
*Lyndon B. Johnson	1964	Dem	1965	9.1%	1966	-13.1%	1967	20.1%	1968	7.7%	22.5%
Richard M. Nixon	1968	Rep	1969	-11.4%	1970	0.1%	1971	10.8%	1972	15.6%	13.7%
*Richard M. Nixon (Ford as of 8/9/74)	1972	Rep	1973	-17.4%	1974	-29.7%	1975	31.5%	1976	19.1%	-9.0%
Jimmy Carter	1976	Dem	1977	-11.5%	1978	1.1%	1979	12.3%	1980	25.8%	26.3%
Ronald Reagan	1980	Rep	1981	-9.7%	1982	14.8%	1983	17.3%	1984	1.4%	23.2%
*Ronald Reagan	1984	Rep	1985	26.3%	1986	14.6%	1987	2.0%	1988	12.4%	66.1%
George H.W. Bush	1988	Rep	1989	27.3%	1990	-6.6%	1991	26.3%	1992	4.5%	56.9%
William J. Clinton	1992	Dem	1993	7.1%	1994	-1.5%	1995	34.1%	1996	20.3%	70.0%
*William J. Clinton	1996	Dem	1997	31.0%	1998	26.7%	1999	19.5%	2000	-10.1%	78.2%
George W. Bush	2000	Rep	2001	-13.0%	2002	-23.4%	2003	26.4%	2004	9.0%	-8.2%
*George W. Bush	2004	Rep	2005	3.0%	2006	13.6%	2007	3.5%	2008	-38.5%	-25.5%
Barack H. Obama	2008	Dem	2009	23.5%	2010	12.8%	2011	0.0%	2012		
Overall Average				4.2%		4.3%		10.9%		7.5%	30.0%
Median				7.2%		2.2%		15.2%		9.0%	23.2%
Average after incumbent wins re-election				1.2%		11.2%		8.7%		2.7%	31.1%
Average following an incumbent loss[1]				7.4%		-0.3%		30.5%		13.2%	61.8%
Average following an incumbent loss[2]				3.6%		-0.1%		26.8%		15.7%	54.7%

Notes:
FDR's last term is counted as Truman's first term and is not included in any incumbent averages.
Years in Nixon's and McKinley's 2nd terms are not included in the incumbent averages if they did not serve for more than half of the year in question. The time served by their successor was counted as the successor's first term.
[1] Incumbents who lost re-election bid: William Howard Taft (1912), Herbert Hoover (1932), Jimmy Carter (1980), George H.W. Bush (1992)
[2] Average following an incumbent loss (if include Gerald Ford)

Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 4.

S&P 500 Annual Performance: During Presidential Years

	Average	Median
Democratic	11.20%	12.78%
Republican	6.29%	6.47%

Note: Annual returns 1943-2011

Source: Haver Analytics and Citi Research – US Equity Strategy

We would add that the so-called election cycle supports better returns in the latter two years of any four-year term but one can easily recall that 2008 did not fit that bill. On the other hand, 2012 thus far is doing fairly well, exceeding the annual median gain of nearly 9% experienced during the typical fourth year (looking back at past returns over more than 100 years). However, it is notable that the median gain for the third year is 15% and the S&P 500 hardly budged in 2011.

Importantly, The Cook Political Report suggests that the House of Representative will stay Republican with the maximum potential loss of eight seats versus the 25 that would be needed for the Speaker's gavel to change hands. The Senate races are far closer with either party potentially winning slight control even as Missouri just shifted to leaning Democrat according to some pollsters due to the Todd Akin controversy. Intriguingly, the senatorial contest in Ohio also may come down to turnout as most observers do not forecast a so-called "wave" election this year. A quick look at the Intrade website, also shows a current 90% chance of the GOP holding the House and a near 50% shot at taking the Senate.

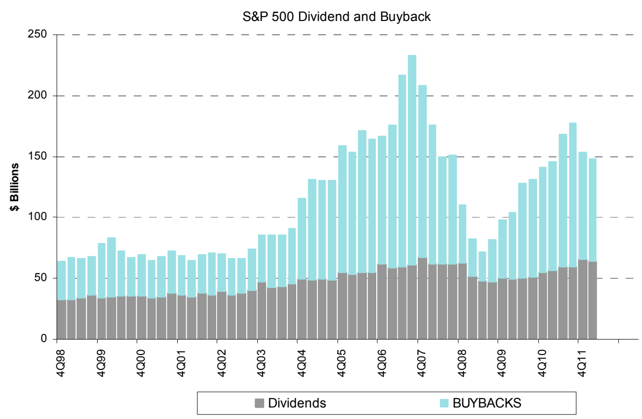
Generally, Republicans have been associated with several industries that would benefit from a GOP victory. Candidate Romney has proposed repealing Dodd-Frank, replacing "Obamacare" and doing away with alleged heavy handed regulations that supposedly has impeded the business sector. He has also reiterated comments from Defense Secretary Panetta about the dangers of severe defense industry spending cuts coming under the sequestration programs on top of current budget proposals to trim back military appropriations. In this context, theoretical Romney stock winners would include health care, defense, financial as well as energy and mining entities, not to mention utilities. With respect to managed care stocks, we suspect that multiple expansion would ensue if Romney were to prevail.

In contrast, a President Obama reelection would more likely be supportive of areas such as alternative energy, generic pharmaceuticals (as a result of their lower cost relative to more expensive branded drugs), the technology industry and the entertainment or media complex. In addition, one could argue that lower end income consumer stocks (such as dollar stores) might also gain since the threat to cut backs of entitlement support payments would be removed. A tax system favoring capital gains over dividends also might encourage more stock buyback activity as well as provide a greater incentive for funding new business startups. From an almost binary perspective, beneficiaries of a Republican win would most probably become underperformers under an Obama victory.

Figure 5 highlights that corporations already have been using their cash for buybacks and dividend increases, with capital investment also rebounding as highlighted in our August 10, 2012 Monday Morning Musings (The Capex Constant) despite a misperception that management teams have been hoarding cash –

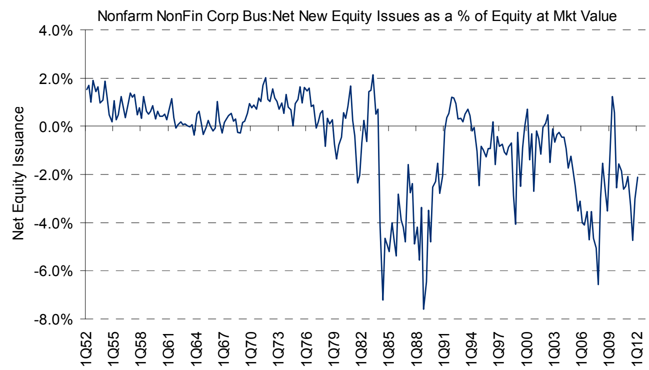
though one suspects that more cash could be used for the aforementioned three purposes if greater confidence was in place. Interestingly, buyback activity (or "de-equitization", a term coined by Citi's global equity strategist Robert Buckland) can be a meaningful contributor to equity market upside opportunity (see Figure 6) with the S&P 500 being likely to shrink by as much as 3% due to stock buybacks this year. Companies could choose to reallocate more money towards buy-ins versus dividends if the Bush tax cuts expire and the treatment of dividend income rebounds to ordinary income tax rates (39.6% for upper income Americans) as compared with the higher (pre-Bush tax cuts) 20.0% for capital gains, without incorporating the unearned income taxes from the new health care law.

Figure 5.



Source: Haver Analytics and Citi Research – US Equity Strategy

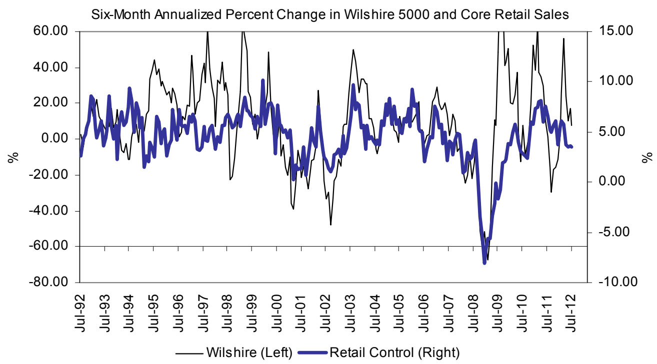
Figure 6.



Source: Haver Analytics and Citi Research – US Equity Strategy

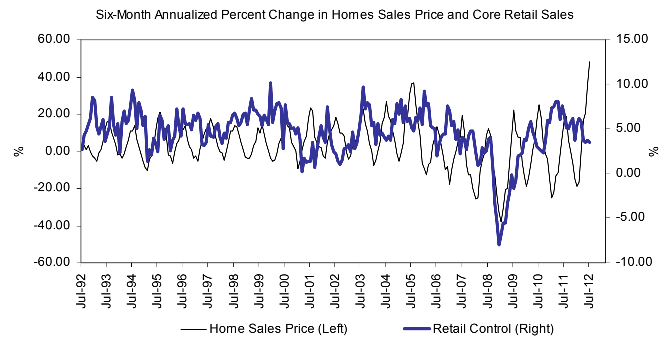
A large amount of debate has taken place in what has been deemed "fairness" by one side and "class warfare" by the other with respect to raising taxes on higher income Americans. Lifting taxes on job creators has been demonized as has the alleged selfish greed arguments, but probably the most essential aspect is its impact on economic growth. Over the last several years, we have cited that since the top 20% of American income earners account for almost 50% of discretionary spending in the country, their financial well being is quite important to non-health care consumer spending (which comprises roughly 56% of GDP). Since this same cohort of Americans own about 90% of all equities, the stock market direction appears to have far more impact on core retail sales than do home prices (see Figures 7 and 8) and the same may be true for tax rates. As a result, gains in the S&P 500 thus far in 2012 do not intimate a major consumption slowdown, but share prices can be volatile, thereby influencing these key consumers' confidence levels.

Figure 7.



Source: Haver Analytics and Citi Research – US Equity Strategy

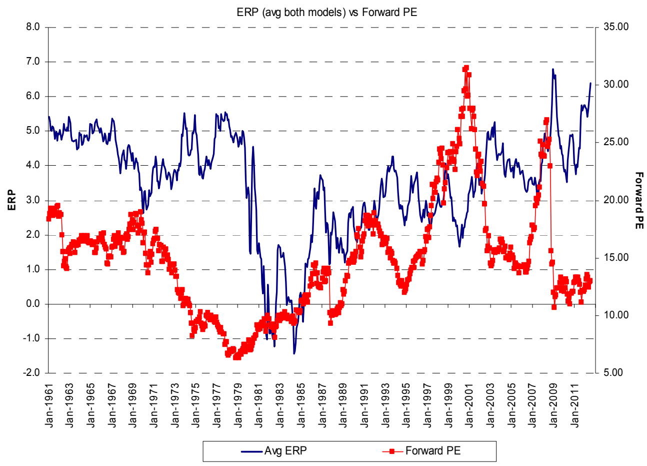
Figure 8.



Source: Haver Analytics and Citi Research – US Equity Strategy

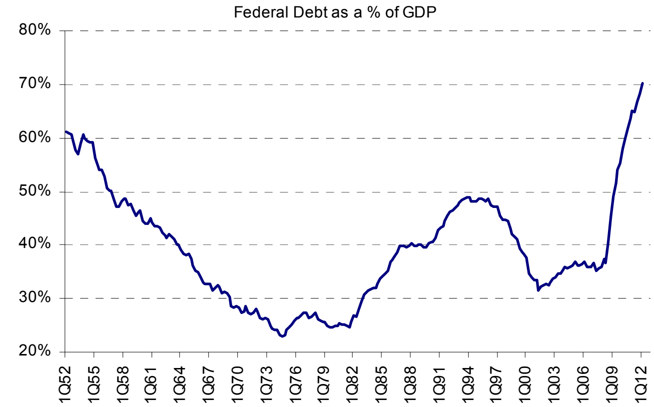
The country's fiscal policy direction could be very much decided in the upcoming election and in many respects this is the biggest long-term issue facing the country even as persistent unemployment may be the most problematic short-term one. Fiscal direction is vital, in our opinion, but jobs are urgent. In this regard, there is a tendency to emphasize the urgent over the vital in the near term since it is the one directly in front of the individual at a specific point in time. Yet, given the problems across the pond, investors are deeply worried about large deficits, rising debt and sclerotic GDP trends in the US ultimately leading to either higher tax rates (as seen in France), austerity (such as Greece and Ireland) or higher interest rates (think Spain and Italy), or even some combination of all three. In our opinion, the high debt levels and fears over how to address them in a polarized political environment facing an imminent fiscal cliff and required debt ceiling lift in 1Q13 has acted as a depressant on investor risk tolerance. Hence, equity risk premiums have risen to near 30-year highs and P/E valuations consequently have suffered (see Figure 9). We believe this must be reversed for equities to perform well over time and supports our view that fiscal reform will be necessary as part of our Raging Bull thesis outlined last December (Equity Strategy - The Raging Bull Thesis) which highlighted the probability of a secular bull market beginning in 2013. In addition, debt as a proportion of GDP has climbed to levels last seen immediately after World War II (see Figure 10) and also a period in which dividend yields exceeded Treasury bond yields (as is true today). Accordingly, the manner in which America addresses its fiscal challenges seems very much tied to P/E multiple expansion or contraction potential.

Figure 9.



Source: Haver Analytics and Citi Research – US Equity Strategy

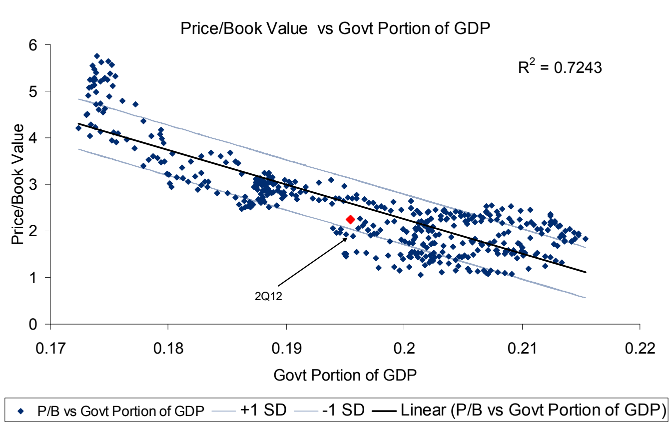
Figure 10.



Source: Haver Analytics and Citi Research – US Equity Strategy

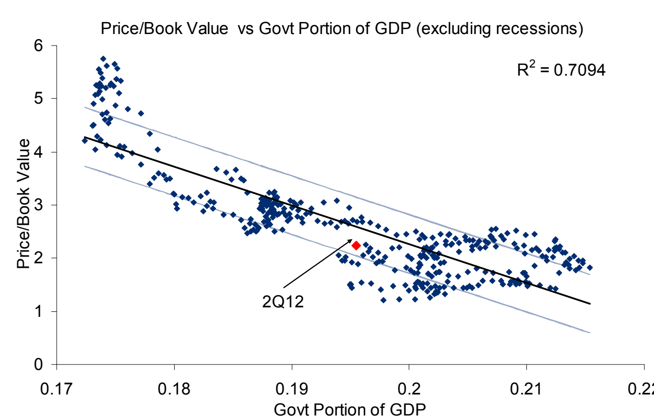
In the past, we have shown that the market's price/book has an intriguing relationship with government size as a percent of GDP, with lower multiples when it is climbing (see Figure 11). However, some have criticized the approach and disagreed with the premise since the percent of GDP climbs when the economy is in recession as the private sector backs away while, at the same time, fiscal stimulus steps up. Hence, it is assumed that the correlation is being affected mainly by cyclical considerations. Accordingly, we ran the same analysis removing the data during recession periods and still found a fairly significant R^2 correlation (see Figure 12), implying that market participants seem to value stocks less when the government's proportion of the economy get larger and accords higher valuation when it shrinks, reflecting its seeming preference for corporate and consumer spending. Note that the correlation is much lower when looking at other regional markets and economies.

Figure 11.



Source: Haver Analytics and Citi Research – US Equity Strategy

Figure 12.



Source: Haver Analytics and Citi Research – US Equity Strategy

In our May 10, 2012 Washington Watch report (Confronting Congressional Confusion), we contended that no apparent resolution to the fiscal cliff was plausible before the elections since both sides had ideological considerations that prevented any compromises which would potentially dishearten their core voter bases. There

is little reason to change that perspective now and especially in light of a tight race where voter turnout is being cited as the possible difference maker. Data on voter enthusiasm currently favors the Republicans but such emotional states tend to be very fluid and also might be subject to sample errors.

Going over the fiscal cliff cannot be viewed as a positive development for investors, as noted in our August 14, 2012 Equity Strategy report, A Random "Cliff" Walk Down Wall Street, given the risk of a 15%-20% market correction should a recession ensue. The election outcome may force compromises that would have been deemed almost unthinkable in the past few months as the losing side tends to wipe away its tears and eventually gets down to the business of governing. The debt ceiling fight last year left many bruises (amidst voter disgust) but an agreement got done ultimately even if things weren't fully resolved until essentially the stroke of midnight and one might see a similar drawn out compromise heading towards the eve of 2013.

Our sense is that equity investors would prefer a Romney victory overall even in the face of the data presented in Figure 4, since it might be seen as a more pro-business development but fiscal reform most likely will be necessary in the next administration regardless of who takes the oath of office next January. As mentioned earlier, dividend tax treatment may shift next year depending on who wins and there could be some willingness to generate special one-time dividends late this year to lock in returns at the current 15% tax rate. As a result, Figure 13 lists a number of companies with large inside ownership which might be compelled to declare and pay out a large sum before December 31. Outside shareholders thus would be able to participate equally with the insiders looking for an efficient way to distribute earnings.

Figure 13. Insider Dividend Screen

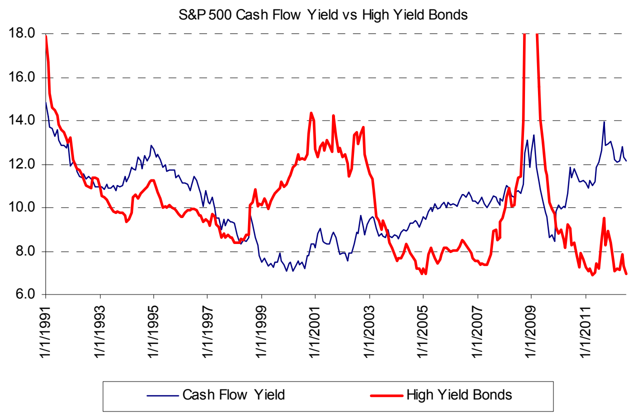
Company Symbol	Company Name	GICS Sector Name	% of Closely Held Shares	FCF as % Market Value	LT Debt % Total Capital	ST Debt % Total Debt
ADVS	Advent Software Inc.	Information Technology	68.59	5.84%	12.72%	10.53%
BIO	Bio-Rad Laboratories Inc. Cl A	Health Care	43.93	5.46%	28.32%	0.11%
CCMP	Cabot Microelectronics Corp.	Information Technology	37.29	8.52%	36.90%	6.25%
CASC	Cascade Corp.	Industrials	41.81	5.52%	1.50%	16.79%
CCRN	Cross Country Healthcare Inc.	Health Care	34.16	11.45%	11.92%	10.93%
CUB	Cubic Corp.	Industrials	40.49	8.72%	1.17%	38.78%
DISCA	Discovery Communications Inc. Serie	Consumer Discretionary	75.34	5.16%	44.51%	0.38%
EHTH	eHealth Inc.	Financials	41.95	6.08%	0.00%	N/A
NPO	EnPro Industries Inc.	Industrials	39.78	6.06%	47.36%	4.25%
ESE	ESCO Technologies Inc.	Industrials	40.26	5.67%	9.42%	41.67%
EXPE	Expedia Inc.	Consumer Discretionary	65.17	9.36%	35.86%	0.00%
BEN	Franklin Resources Inc.	Financials	35.09	5.07%	15.20%	16.48%
GME	GameStop Corp. Cl A	Consumer Discretionary	34.74	19.84%	0.00%	N/A
LM	Legg Mason Inc.	Financials	32.72	12.47%	19.98%	3.58%
LOGM	LogMeIn Inc.	Information Technology	34.30	5.59%	0.00%	N/A
MANT	ManTech International Corp. Cl A	Information Technology	53.73	16.50%	15.04%	0.00%
MCS	Marcus Corp.	Consumer Discretionary	49.37	5.65%	23.60%	42.57%
MDCO	Medicines Co.	Health Care	70.14	7.39%	29.36%	0.00%
MCRL	Micrel Inc.	Information Technology	52.80	5.62%	0.00%	N/A
MOH	Molina Healthcare Inc.	Health Care	65.46	14.39%	26.50%	0.42%
NDAQ	NASDAQ OMX Group Inc.	Financials	31.21	15.11%	28.04%	2.25%
NCIT	NCI Inc.	Information Technology	78.25	33.73%	13.87%	0.00%
PZZA	Papa John's International Inc.	Consumer Discretionary	34.96	5.82%	18.77%	0.00%
PDCO	Patterson Cos. Inc.	Health Care	37.31	6.27%	32.72%	14.71%
SNI	Scripps Networks Interactive Inc. Cl A	Consumer Discretionary	42.13	6.95%	48.44%	0.00%
SYNA	Synaptics Inc.	Information Technology	31.38	7.77%	0.58%	0.00%
TTEC	Teletech Holdings Inc.	Information Technology	57.59	8.20%	14.90%	0.55%
TG	Tredegar Corp.	Materials	45.44	9.77%	19.79%	0.00%
WTS	Watts Water Technologies Inc. Cl A	Industrials	62.84	6.77%	24.57%	19.99%
ZEP	Zep Inc.	Materials	45.78	7.43%	42.04%	10.64%

Parameters for screen: Universe: S&P 1500, Percentage of closely held shares > 30 %, LTM FCF > 5% of market value, ST debt < 50% of total debt, LT debt < 50% total capitalization

Source: FactSet and Citi Research – US Equity Strategy

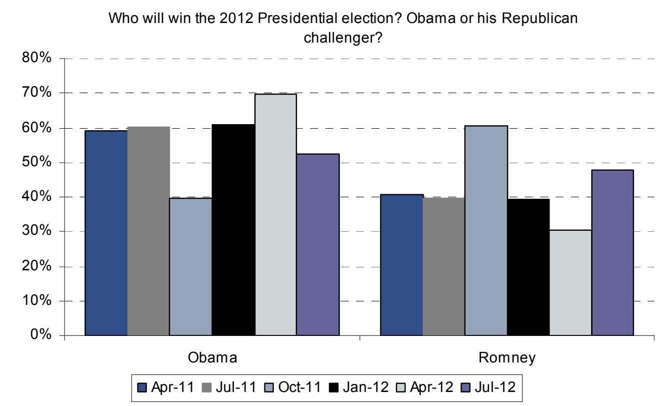
There is still much to be decided upon between now and year-end with a great deal of it being dependent on the outcome of the Presidential elections. Will mergers & acquisitions step up after the elections especially given large corporate cash holdings and cheap financing costs relative to cash flow (see Figure 14)? Will tax policy uncertainty be resolved once the results are known? Can the lame duck Congress defer the cliff until the next Congress is sworn in to address broader fiscal reform? Most investors expect some extension of tax cuts and no recession such that the cluster of top down 2013 sell-side EPS estimates remain in the $105-$110 range, but at the same token, the majority of institutional clients we surveyed in early July also expect President Obama to win reelection though by a tighter margin than perceived earlier on in 2012 (see Figure 15). In this sense, an Obama win should not derail equities while a Romney victory might push them higher given a seeming preference from Wall Streeters based on client discussions and reported campaign contributions. Almost any way you cut it, the next two months should prove interesting.

Figure 14.



Source: FactSet and Citi Research – US Equity Strategy

Figure 15.



Source: Citi Research – US Equity Strategy

Appendix A-1

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