

Global Political Insights

US Elections: Obama Victory Still Likely Despite Romney Boost

- **20 Days to Go and the Race Has Tightened:** Following his successful performance in the first presidential debate, Republican challenger Mitt Romney has seen a boost in his poll ratings, overtaking the president in the national averages for the first time this year. Yet President Barack Obama's advantages remain substantial, as an incumbent president in an improving economic environment. Hence we reiterate our three-month-call for an Obama victory as our base case scenario, but underscore the closeness of the race. Markets are also pricing in this outcome, with Intrade giving a 61.5% probability of an Obama victory. But the pressure is on the president to perform in debates, in part to galvanize his base. Obama's improved performance in the second debate was in line with expectations, and observers will look for movement in the polls, if any, over the next few days.
- **Follow the Data, and Ignore the Partisans & Pundits:** Romney's gains on the national ballot have not translated into leads in the swing states that will decide the election outcome. Indeed, Obama currently leads in 7 of the 10 swing states. This suggests – but doesn't guarantee – that reversion to the mean is forthcoming. Some forecasters already suggest that the 'Romney bounce' may be receding: Monday's Real Clear Politics average showed a drop in Romney's lead from 1.5% to 0.1% (zero-point-one percent).
- **What Would Have to Happen for a Romney Victory:** First, Romney needs a significant shift in the Electoral College, where Obama leads Romney, 217 votes to 191. Ten swing states have 130 votes between them, with 270 votes needed to win. Ohio remains key. Second, he would need a come-from-behind victory virtually unprecedented in post-War history. Outlier events do happen, but they are just that—outliers.
- **Democrats On Top in Senate, Republicans in House:** Republicans' chances to regain the US Senate appear much reduced in the post-convention atmosphere. Races in Wisconsin and Missouri appear to have slipped away for the GOP and Massachusetts moves into the toss-up column, while Connecticut remains competitive. Republicans are expected to hold the House.
- **'Bungee Jumping' & Headline Risk from the Fiscal Cliff:** Fixing the fiscal cliff will be a task for a handful of leading political figures, with the process largely hidden from view. The electoral outcome and its resulting narrative will set the stage for negotiations. We re-iterate our base case that a short-term kick-the-can deal is the likely outcome, based on the thesis that the same players in the same situation will produce the same outcomes. A temporary fall over the cliff in favor of allowing a vote on a "clean" bill in January also can't be ruled out, given the deeply-held views dividing the parties on taxation.

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With thanks to

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The Data-Driven Case for an Obama Victory

Since August, we've argued that President Barack Obama is likely to be re-elected to a second term. While the race has tightened over the past two weeks, we nevertheless reiterate our call.

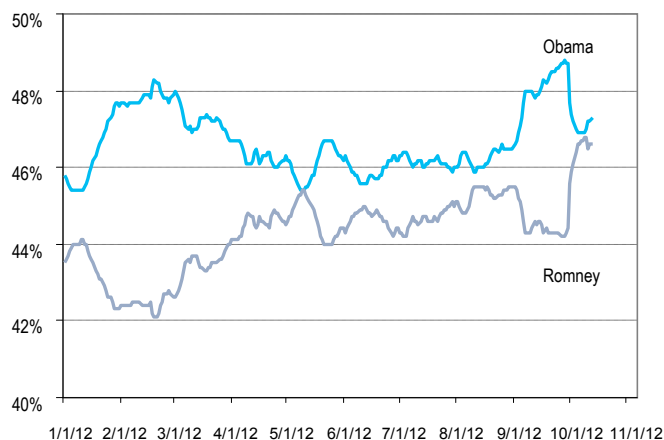
Since August, we've argued that President Barack Obama is likely to be re-elected to a second term. Our view, based on a political science assessment, derives from Obama's year-long lead in the polls and from the marginal improvement in the US economy.¹ While the race has tightened over the past two weeks, we nevertheless reiterate our call, while underscoring that the president's lead has narrowed and the race has returned to the state of play of late summer, prior to the conventions. In our view, investors should focus on the political fundamentals.

With over 500 polls having been conducted in the United States this year, we pay attention to the totality of the data and to the main trends. This focus on rolling averages makes more statistical sense, and it avoids the 'house effects' that come along with a reliance on any individual polling outfit.

Despite Governor Mitt Romney's recent bounce, Obama maintains his lead in the Pollster.com rolling average. The Real Clear Politics average is subject to more volatility, and showed Romney leading between October 9 and October 16.²

Figure 1. Despite Post-Debate Tightening, Obama Still Leads Overall

National Ballot: Obama +1



Latest Polling in the Swing States

Colorado	Obama +2	North Carolina	Romney +3
Florida	Romney +1	Ohio	Obama +3
Iowa	Obama +3	Pennsylvania	Obama +5
Nevada	Obama +2	Virginia	Romney +1/2
New Hampshire	Obama +2	Wisconsin	Obama +4

Latest Intrade Quotes

"Barack Obama to be re-elected president in 2012."

61.5%

YTD High: 78.9% (September 29)

YTD Low: 46.5% (January 8)

Source: Huffington Post/Pollster.com, Intrade. Accessed October 16, 2012.

The conventional wisdom is often flatly incorrect here. As we discuss later, 'come from behind' victories are incredibly rare, if indeed they've ever happened.

This year-long lead is important because, historically, incumbent presidents who have led their challengers all year have gone on to be re-elected, while incumbent presidents who fall behind have been defeated. These incumbents were often behind as early as May (i.e. five months ago). The conventional wisdom is often flatly incorrect here. As we discuss later, 'come from behind' victories are incredibly rare, if indeed they've ever happened.

¹ Tina Fordham. Citi Research note. "[US Elections Outlook: It's Not Just The Economy, Stupid.](#)" September 13, 2012.

Tina Fordham. Citi Research note. "[Mid-year Outlook: Rising Geopolitical Risks and the New UltraVox Populi Will Carry On Into 2013.](#)" August 2, 2012.

² Huffington Post/Pollster.com and Real Clear Politics rolling averages, accessed October 15, 2012. <http://elections.huffingtonpost.com/pollster/>
http://www.realclearpolitics.com/epolls/latest_polls/president/

Looking at other elections in mature industrialized economies in the past year, leaders presiding over countries with positive economic growth, even nominal growth, have tended to be re-elected.

After a week, some commentators suggest that the Romney bump may already be receding, with all eyes on the remaining two debates to see if the momentum can continue.

Romney's favorable ratings, long a persistent liability, have improved six points over the past month and 15 points since the peak of the grueling Republican primaries.

At the same time, as we noted in September, the US economy hit its lows three years ago and is not in recession today, and the swing states have added almost a million jobs. Looking at other elections in mature industrialized economies in the past year, leaders presiding over countries with positive economic growth, even nominal growth, have tended to be re-elected, while those where the economic indicators were going into reverse have been voted out of office.

Why Not Romney (Yet)?

Governor Mitt Romney's poll numbers have surged since his strong performance in the first debate on October 3. Will it be enough to see him to victory? After a week, some commentators suggest that the Romney bump may already be receding, with all eyes focused to see if the momentum can continue.³

Romney's favorable ratings, long a persistent liability, have improved six points over the past month and 15 points since the peak of the grueling Republican primaries. Romney enters the end of October a far more popular candidate, but still one struggling to win over a majority of voters. Favorability ratings are highly correlated with election results, and Romney was hampered by his "upside down" ratings all year.

- **Romney's rise the national polls hasn't been matched by better performances in the states.** Romney's national boost has translated into leads in only two more swing states: Florida and Virginia. Arithmetic says that if Romney makes gains overall, he should also make gains in the swing states. Without these gains, reversion to the mean may be forthcoming.
- **Obama still leads in seven of the ten swing states.** Obama only needs to win 53 electoral votes among the swing states to be re-elected, so even the loss of Florida's 29 votes doesn't substantially endanger his electoral math. Romney needs to make more headway to overtake the president, gaining 79 votes of the 130 at stake.
- **Swing state voters aren't easy to convince.** These states have seen far more campaign activity than the rest of the country, so voters there have been exposed to more information about the candidates and are therefore more likely to have firm opinions. It's also clear that Republicans have been significantly outspent by Democrats up to this point.⁴ These factors make swing state numbers much harder to move than the electorate as a whole, and that's exactly the dynamic we've seen.
- **The momentum in the US economy is still positive, albeit sluggish.** After more than three years, the US employment rate dropped below 8% this month, an economic milestone. Yet Obama saw no discernable boost from the change. In our previous assessment, we cited academic studies highlighting that economic indicators have surprisingly meager effects on election results, especially the unemployment rate with its r^2 of zero.⁵

³ Nate Cohn. "[Is Romney's Bounce Receding?](#)" *Electionate* blog, *The New Republic* online. October 10, 2012.

⁴ Nate Cohn. "[How Romney Is Coping With Obama's Newfound Ad Spending Advantage.](#)" *Electionate* blog, *The New Republic* online. October 5, 2012.

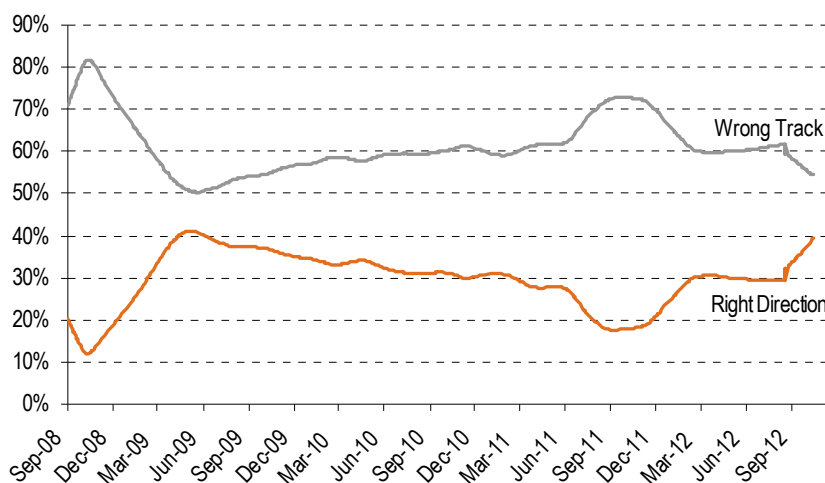
⁵ Tina Fordham. Citi Research note. "[US Elections Outlook: It's Not Just The Economy, Stupid.](#)" September 13, 2012.

- **The premise of the Romney campaign remains problematic.** Romney is ahead of the president in most assessments of his competence on the economy, the overwhelming top priority of voters this year. Romney has argued that Obama should be fired because of the sluggish state of the US economy. But despite slow growth and high unemployment, voters may have lowered their expectations for the recovery, and may not be focusing on these indicators as much as may have been expected.

For those who ask why Romney doesn't lead in an environment of US economic woe and a global anti-incumbent trend, this number may hold the key. A recent Pew poll found that only 36% of Independents, the quintessential swing voters, had heard bad news about the economy recently. The balance heard good or neutral news.⁶ This number is striking because it highlights the struggle that has faced Romney all year.

- **The right direction/wrong track number has improved.** Pollsters have historically asked voters whether they think the country is headed in the right director or off on the wrong track. As we've mentioned in past, this key indicator has been upside-down for as long as a decade and is indicative of a pessimistic 'new normal' in the United States. But the 'right direction' number has approved 10% since July, and this shift is also to Obama's benefit.

Figure 2. The Pessimistic 'New Normal': Off On The Wrong Track Since 2008, Though Some Pollsters Report 2004 or Earlier



Source: Huffington Post/Pollster.com, accessed October 16, 2012.
<http://elections.huffingtonpost.com/pollster/us-right-direction-wrong-track>

- **Political scientists and forecasters say the fundamentals still favor Obama.** Professor James Campbell, the dean of the election watchers in the American political science community, looked at thirteen models published in peer-reviewed journals and found that eight of the thirteen models journals forecast an Obama victory. The combination of all 13 models gives Obama 50.2% of the vote. Other popular models from *The New York Times'* Nate Silver and Emory University professor Drew Linzer also point to an Obama win.⁷

⁶ Pew Research Center. "Record Partisan Gap in Views of Economic News." September 11, 2012.

⁷ Larry Sabato. "Forecasting the Presidential Election: Other Crystal Balls." Sabato's Crystal Ball blog, the University of Virginia Center for Politics. September 13, 2012.

Anything is possible in politics, but we feel comfortable putting a negligible probability on a Bush-Gore scenario.

Bush-Gore Redux? No.

The closeness of the race raises the possibility of a Bush-Gore situation, where the victorious candidate wins the Electoral College but loses the popular vote. This eventuality, which has only happened once in the past 124 years, is highly unlikely.

Obama still leads overall, and in an electorate of 140 million even a 1% victory means a margin of almost 1.5 million votes. Furthermore, arithmetic suggests that Obama's margins of victory in the larger swing states of Ohio and Pennsylvania should more than balance out Romney's margins should the latter win Florida. Anything is possible in politics, but we feel comfortable putting a negligible probability on this scenario.

'Come From Behind' Elections, and the Lack Thereof

A review of past elections shows that the leader in Gallup's October polling has gone on to win in almost every case since 1948. This year, Obama is the October leader.

That Romney has been able to repair his image, damaged by hard-fought Republican primaries and gaffes like his "47%" comment, is significant. This trend is the best single argument to be made for new strength underlying the Romney campaign. Favorability is far better correlated with electoral outcomes than economic indicators which, as we've demonstrated, are not very predictive. So with three weeks left, what are the prospects that Romney can come from behind to win?

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Figure 3. No Challenger in 60 Years Has Overcome an October Deficit. Even the Two Possible Cases Are Questionable.

Year	October Leader (Lead %)	Winner	Year	October Leader (Lead %)	Winner
<u>Year-Long Leads</u>			<u>Lead Changes Earlier in Cycle, Per Gallup</u>		
1964	Johnson +35	Johnson	1968	Nixon +15	Nixon
1972	Nixon +23	Nixon	1988	Bush Sr. +10	Bush Sr.
1984	Reagan +20	Reagan	2004	Bush Jr. +8	Bush Jr.
1996	Clinton +17	Clinton	1960	Kennedy +3	Kennedy
1992	Clinton +13	Clinton	2000	Bush Jr. +3	Bush Jr.
1956	Eisenhower +12	Eisenhower	2008	Obama +2	Obama
1952	Eisenhower +9	Eisenhower	<u>Come From Behind? Not Hardly</u>		
1976	Carter +6	Carter	1948	Dewey +4	Truman*
2012	Obama +2	???	1980	Carter +4	Reagan**

* The weak state of public opinion polling in 1948 raises questions about whether Truman was ever really in danger. ** Modern statistical techniques now show that Reagan led since May, making the conventional wisdom about a late Reagan surge factually incorrect.

Source: Gallup U.S. Presidential Election Center, accessed October 15, 2012.
<http://www.gallup.com/poll/154559/US-Presidential-Election-Center.aspx>

As mentioned, endangered incumbent presidents trail their challengers long before Election Day. Should Romney manage to buck this trend, it would be a first in modern presidential history. To us, the rarity of this event is another argument in favor of our base-case scenario: Obama by a nose in November.

Republican chances to take the Senate have receded since our last update. Republicans need four seats to take control, but a Democratic lead in GOP-held Massachusetts may mean that Republicans could even lose a seat.

And even Gallup's two 'come from behind' cases are problematic. The 1948 campaign is remembered for Truman's relentless whistle-stop tour and that famous "Dewey Defeats Truman" headline. But polling was in such a primitive state at the time, it's difficult to know whether Truman's campaign was truly in jeopardy.

As we have previously noted, the typical narrative of the 1980 campaign, where Reagan swung the election in the final weeks, is flatly wrong. As usual, we look at the totality of the data. Carter – hobbled by vigorous opposition inside the Democratic Party, economic "malaise" and the Iran hostage crisis – trailed Reagan as early as May. This year, a number of commentators have been quick to point this out.⁸

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Democrats on Top in US Senate

We also reiterate our earlier view that the political status quo will continue after the US election: Obama in the White House, Republicans in the US House, and Democrats in the Senate. Republican chances to win the Senate have receded since our last update.

Of the ten Senate races we identified as competitive according to the polling data, Republicans lead today in three (Arizona, Indiana, Nevada), none of which is held by Democrats. Democrats lead in seven (Connecticut, Massachusetts, Missouri, Montana, North Dakota, Virginia and Wisconsin). Retirements will be a wash: Democrats will pick up Maine, while Republicans will pick up Nebraska. Other races, like Florida and Ohio, are not competitive and will be Democratic holds.

Republicans need four seats to take control, but a Democratic lead in GOP-held Massachusetts may mean that Republicans could even lose a seat. Republicans appear to have fallen behind in Montana, North Dakota and Wisconsin, not to mention Missouri, where they led earlier in the cycle. Democrats hold only small leads there, as in Virginia and Connecticut. These states will be the chief battlegrounds over final three weeks.

⁸ John Sides. "[What Really Happened In The 1980 Presidential Campaign](#)." *The Monkey Cage* blog, accessed August 13, 2012.

Fiscal Cliff: 'Bungee Jumping' & Headline Risk

Our basic thesis on the fiscal cliff has been simple: if you have the same players and the same situation, you should expect the same outcomes.

We expect another piecemeal, short-term fiscal deal that temporarily resolves the fiscal cliff problem. The question is the timing: during the lame duck Congress, or in January after tax rates expire and sequestration begins?

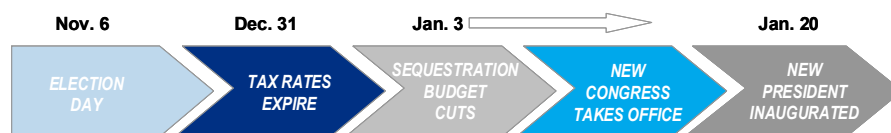
Only a handful of legislative leaders will be key players in fiscal cliff negotiations. This is a positive development for the prognosticator, because it means one can ignore the press statements from the pundits and even from most Members of Congress, because they will not be in the room when a deal is cut.

After the election, Washington's focus will shift to the fiscal cliff. The outgoing 'lame duck' Congress will meet for another two months.

Our basic thesis on the fiscal cliff has been simple: if you have the same players and the same situation, you should expect the same outcomes. Our base-case scenario is that the players remain the same: Obama in the White House and a divided Congress. We expect another piecemeal, short-term fiscal deal that temporarily resolves the fiscal cliff problem. The question is the timing: during the lame duck Congress, or in January after tax rates expire and sequestration begins?

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Figure 4. The Timeline of the Fiscal Cliff



Source: Citi Research

With the resolution of the fiscal cliff buried the minds of only a few, it's impossible to forecast accurately how the sausage will be made. Even so, we highlight these possibilities for investors:

- **The influence of psychology & election results.** Beginning the day after the election, legislative leaders and the President will look to see how their respective parties fared in the election, and how it might affect their leadership standing within their caucuses. From this they can demonstrate how much they can sell to their own Members and how much room for compromise exists. In reality, this means that the roadmap for a fiscal cliff solution is determined by their psychology and their perceptions of the election results. We'll be paying close attention to leaders' statements in reaction to the election.
- **'Bungee jump.'** Policymakers are concerned less about winning than avoiding losing. Going over the cliff for a short period in January may allow both Republicans and Democrats to avoid the toughest of votes, and it's an option that has been discussed widely in the press, both by us and by others. While not necessarily our base-case scenario, we caution investors to be aware.
- **Headline risk.** Regardless of what happens on November 6, we should expect to see a very vocal debate inside both parties about 'who won' and 'who lost.' This debate will be played out loudly in the press in the context of fiscal cliff negotiations. If the news is particularly dire or suggests an impending showdown, there may be market action in response. But investors should remember that very few of these people, even seemingly senior Members of Congress, will have influence over the process.
- **Republican sweep.** A victory for Romney or Senate Republicans may mean that the GOP, fresh from victories at the polls and looking to put their own stamp on a fiscal cliff solution, will hold off until January for its own fix. Timing becomes important, as the new president Romney wouldn't take office until January 20,

twelve market trading days after sequestration begins. (And January 20 is a Sunday, which could push 'day one' activities back another 24 hours.)

- **Blanket extensions.** Though few commentators have discussed it, the possibility of simple blanket extensions to expiring tax cuts and budget cuts is there. Political players tend to downplay this scenario, if only because the simplest solutions have seemed to bedevil Congress over the past few years, but that shouldn't exclude this case as a possibility.
- **A summer tax package?** Obama and Romney have talked about passing comprehensive tax reform in the new Congress, though certainly their packages would look quite different. Both Republicans and Democrats see this commitment as credible, and Hill staffers have been taking meetings and drafting legislation. A new tax code would be about as big a piece of legislation as Congress considers, so the idea that there may be a tax package in the summertime will affect the fiscal cliff negotiations in the winter.

The Unlikely Scenarios

Though multiple outcomes are possible, we feel comfortable putting low to negligible probabilities on these cases:

- **Republican 'capitulation.'** Some have suggested that Republicans will merely defer to a re-elected Obama or, alternatively, a rogue group of Republicans will bolt from their own party to join with the Democratic president. But this isn't a very accurate picture of legislative politics in the United States.

In reality, the one-year fiscal deals of the past few years have been cut between President Obama, House Republican Speaker Boehner and House Democratic leader Pelosi. The majority of both Republicans and Democrats signed off on the packages, leaving ample room for endangered Members on both the left and the right to protect their seats by voting against it. This roadmap is more likely in the American context than the idea that a cadre of renegade Republicans stands ready to throw their lot in with Obama.

- **The 'grand bargain.'** Some commentators have suggested that policymakers can agree on a plan that will provide a definitive resolution to America's deficit problems and reform tax and budget policy. Many of those holding this view are from the business & economics community, where such a 'grand bargain' would certainly be very well-received. But even the historic budget compromises of the 1980's and 1990's weren't so far-reaching, so it stretches the mind to imagine that this option is in the cards for 2012.
- **No action.** Even in this era of polarized politics, no commentator believes that Congress will take zero action and send the US economy back into recession. The question is the timing of a deal, as well as the substance.

**Figure 5. Only A Few Key Figures Will Be
Players in Fiscal Cliff Negotiations**

Democrats

President Barack Obama
Nancy Pelosi, House Democratic leader
Harry Reid, Senate Democratic leader
Sander Levin, House Ways & Means ranking member
Max Baucus, Senate Finance chairman

Republicans

Speaker John Boehner
Mitch McConnell, Senate Republican leader
Dave Camp, House Ways & Means chairman
Orrin Hatch, Senate Finance ranking member

Source: Citi Research

In our view, the numbers don't support the argument by some observers over the past few years that there is undue 'Tea Party influence' over the US budget process.

A Note on the Tea Party

In our view, the numbers don't support the argument by some observers over the past few years that there is undue 'Tea Party influence' over the US budget process. Today the Tea Party Caucus has 60 members, a fraction of the 241 Republicans in the US House.⁹ This proportion is enough neither to block legislation nor to unseat the Republican leadership, should they want to pressure Speaker John Boehner on these issues. (There are four Tea Party members in the US Senate, out of 47 Republicans there.)

It is worth noting that despite Tea Party influence in the 2010 Congressional midterms, Mitt Romney is not a Tea Party member. Rather he was regarded as an establishment candidate in the Republican primaries, not the representative of any ideological or issue-based faction. (Congresswoman Michele Bachmann was the Tea Party candidate.) Congressman Paul Ryan is also not a Tea Party member. He would be considered a budget hawk, although many Tea Party members would certainly support him.

So conservatives and Tea Party members would not see a Romney loss as a rejection of their beliefs. Almost all these members sit in strong Republican districts and will be re-elected this year. To us, this factors into the psychology of Members as they react to the elections and turn their focus to the fiscal cliff as we've described.

What Next?

With January elections in Israel pushing back the imminent threat of an attack on Iran, the civil war in Syria at a stalemate, and the continued dynamics of a post-Arab Spring region, the Middle East will remain in the foreground in 1H 2013. Likewise, US policymakers will deal with the persistent economic crisis in Europe and with new leaders in China.

The next US President will face significant tests at home and abroad. The pressing issues of debt and the deficit will remain prominent, and foreign policy challenges will return to the fore.

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2012 has been a very political year for the United States, but worldwide political risk shows no sign of abating in 2013.

Figure 6. What a Way To Pick the President: Actual Poll Questions from 2012

	Barack Obama	Mitt Romney
Would rather have as the captain of a ship in a storm	48	44
Would rather have babysit your child	49	36
Would win in a fistfight	58	22
More apt to go bungee jumping	60	21
More adept in dealing with an alien invasion	68	?

Source: *Washington Post*/ABC News poll, "[Enthusiasm Rises for Romney: Obama Has a 'Right-Track' Retort](#)," October 15, 2012. Yahoo News/*Esquire* poll, "[Obama up by four points with likely voters](#)," September 13, 2012. National Geographic Channel/Kelton Research poll, "[Obama vs. Romney: Who Would Handle an Alien Invasion Better?](#)" June 28, 2012.

⁹ Office of Congresswoman Michele Bachman. "[Members of the Tea Party Caucus](#)." U.S. House of Representatives, accessed October 15, 2012.

Appendix A-1

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