

## POLITICAL PULSE

## Trump's To Lose

Friday, August 12, 2016

**Donald Luskin**

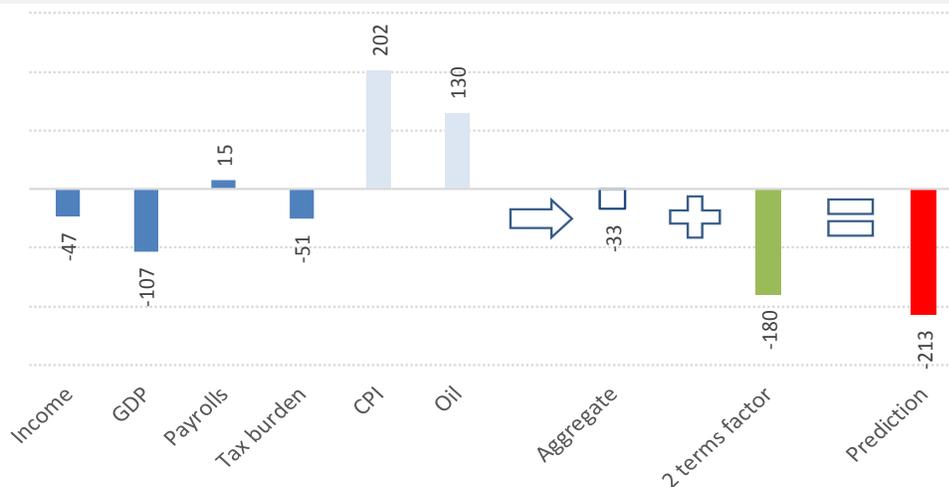
**Like Brexit: "It can't happen! A catastrophe!" Trump can win, and markets are unprepared.**

The seeming [collapse beyond redemption](#) of Donald J. Trump's presidential campaign creates a dangerous situation for markets, very much like the set-up going into the Brexit referendum in June. As with Brexit, Trump is now given little chance of winning. As with Brexit, he is being demonized by the establishment as a catastrophic threat. *But as with Brexit, his populist insurgent campaign actually has a much better-than-expected chance of winning. If Trump wins, just as with Brexit, it will both be a surprise to markets and perceived at first as a catastrophe.* This is exactly what we warned about at year-end as we looked ahead to 2016 (see ["2016: Two Charts, Six Words, One Man"](#) December 31, 2015).

We will offer our subjective analysis of the way the dynamics of the campaign are shaping up, but first we must set the stage by going back to basics.

- Our election model (see ["Modeling the 2016 Presidential Election"](#) November 12, 2014) – which correctly explains every election starting with 1952, and correctly predicted in real-time Barack Obama's win in 2012 within just four Electoral College votes – is now saying that *Trump will win by a comfortable margin of 213* (please see the chart below).

**Our election model** Electoral College votes + For incumbent party – Against



Source: TrendMacro calculations

### Update to strategic view

**US ELECTION MODEL, US STOCKS:** Within days, Trump has gone from a slight lead in the polls to seeming collapse. We think the market never expected him to win, but now it has written him off entirely. It's just like Brexit – an anti-establishment movement given no chance of victory, and warned against by the establishment as a catastrophe. So Brexit happened, markets had to undergo a major correction. Our election model says Trump should win. He has on his side the reliable only-two-terms pattern that can only be overcome by a very strong economy, and yet the economy is weak. This demonization phase was entirely expected. Trump's optimal strategic position is, ironically, just like Obama's, who enjoyed the same advantages: "hope and change." He has made a terrible mistake by emphasizing fear instead. There is still plenty of time for him to come back. If he does, and if he wins, it will shock markets just as Brexit did – and will be a buying opportunity.

[\[Strategy dashboard\]](#)

- A decisive factor in the model is the historical fact that starting with the election of 1952, with only one exception, *neither party has been able to hold the White House for more than two consecutive terms.* In our model, the only-two-terms pattern is worth 180 Electoral College votes for the candidate of the non-incumbent party.
- It is uncomfortable to have a “dummy variable” loom so large in our model. But the historical record clearly shows that the electorate acquires an appetite for change every eight years. And as has been demonstrated by Trump’s nomination, Bernie Sanders’ insurgency, and for that matter anti-establishment movements around the world, including Brexit – that appetite is especially intense right now.
- The one exception to the only-two-terms pattern was the 1988 election, when the economy was strong enough to enable George H. W. Bush to overcome it. *All Bush-41 had to do was promise four more years of the Reagan boom. The Obama economy is definitely not strong enough for Clinton to do likewise.*
- Our model has found that six economic factors matter to elections. Three of the most heavily weighted – GDP, personal income and tax burden – count against Clinton. The other heavily weighted factor, payrolls, is only a slight positive for her, with the last two strong months insufficient to beef up a poor trailing 12 months. Low inflation and oil prices count in Clinton’s favor, but they are not weighted heavily.
- *In aggregate the six economic factors hurt Clinton, adding another 33 Electoral College votes to the 180 hurdle that the only-two-terms pattern already puts in her way* (again, please see the chart on the previous page).
- *So as our going-in proposition here, we have to think that this game isn’t over yet, and it is being played on a field that is tilted for Trump – no matter how bleak it looks for him at this exact moment.*

Our model offers a powerful framework for understanding the optimal strategies available to the candidates. Trump has stumbled badly because he hasn’t been employing his optimal strategy – or at least he hasn’t been employing it well. Clinton on the other hand has been acting optimally.

- *Optimal strategy is driven by dealing with the only-two-terms pattern.* Its heavy weighting in the model reflects its very high explanatory power, which is to say: it is very important that candidates position themselves optimally in light of it.
- For Trump, the optimal positioning strategy is to articulate the need for change, make himself as different as possible from the *status quo*, all while comforting voters that they should dare to embrace the risks of change. It’s standard practice for any candidate running against a two-term incumbent party. Obama did it in 2008 – it was sloganized as “hope and change.” It worked. It almost always does.
- *To be sure, it is strange to liken Trump to Obama in any way. But this they share in common.*
- For Clinton, in the absence of a strong economy, the only available

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## Recommended Reading

### [Doubting a Down-Ballot Wave](#)

Charlie Cook  
**Cook Political Report**  
August 9, 2016

### [The Fed’s shifting perspective on the economy and its implications for monetary policy](#)

Ben Bernanke  
Brookings Institution  
August 8, 2016

### [The Growing Size and Incomes of the Upper Middle Class](#)

Stephen Rose  
Urban Institute  
June 21, 2016

### [How Paul Krugman Made Donald Trump Possible](#)

Karol Marcowicz  
*The Daily Beast*  
August 5, 2016

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positioning strategy is to scare voters into believing that their intense appetite for change isn't sufficient to justify the risk of rolling the dice on an anti-establishment figure like Trump. As the record shows, this strategy normally doesn't work, but it remains the optimal available one.

- Yes, there is certainly the case to be made that this usually unsuccessful strategy *will work this time* against Trump. Clinton is certainly free to be harsh with Trump in ways and to a degree that John McCain could never have done with Barack Obama.
- *To sum up, Trump's optimal branding position is "hope and change," while Clinton's is "change is scary."*

So now we find ourselves at exactly the strategic moment that we predicted months ago, before Trump had clinched the GOP nomination (see "[Trump May Be First Since Reagan To Unleash America's Animal Spirits](#)" March 19, 2016). We wrote:

*If Trump faces Hillary Clinton in the general election, no doubt she'll haul out [the TV commercial](#) that Lyndon Johnson used against Barry Goldwater in 1964, showing a little girl holding a daisy, consumed by a mushroom cloud. Trump is a madman, she will shout...*

**"Daisy" television commercial for Lyndon Johnson** October 1964



Source: YouTube

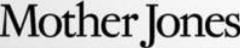
Indeed, in her [acceptance speech at the Democratic convention](#), Hillary Clinton said,

*Imagine, if you dare, imagine, imagine him in the Oval Office facing a real crisis. A man you can bait with a tweet is not a man we can trust with nuclear weapons!*

- It's [not the first time](#) Clinton has used this trope. But with this speech the real campaign began – and as if on cue, as if a memo had gone out, as if a switch had been thrown, the “establishment” of incumbent politicians, media and business, both Left and Right, against which Trump represents an affront and an existential threat, rose up as one to destroy him.
- In the wake of Clinton's nuclear weapons statement, the media chimed in to [praise Obama's "nuclear legacy."](#) to [warn about the excessive unilateral power of presidents](#) over the US nuclear arsenal, and [float unsubstantiated claims that Trump tells advisors he doesn't understand](#) why he shouldn't use nuclear weapons.

- Within days, the consensus has shifted from regarding Trump as eccentric to judging him literally [insane](#).
- Every Trump gag, gaffe, aside, tweet and *ad lib* – the [Muslim "Gold Star family" thing](#), the [Russian hacking thing](#), the [crying baby thing](#), the [get-out-of-the-stock-market thing](#) or the [Second Amendment thing](#) – all of which are taken horribly out of context, and none of which are any different than his well-known pre-convention persona – are endlessly paraded as headline-worthy breaking news. The *New York Times*, that most established of establishment media, legitimized this lynching with [a front-page manifesto](#) justifying the suspension of objectivity in light of the extraordinarily danger that Trump represents.
- Such endless negative publicity creates a poisonous atmosphere for GOP politicians, and hangers-on in the GOP establishment. It is designed to throw them into a [panic](#), a [rush for the exits](#), to get them to [defect to the other side](#). For voters, this is like any other panic. When you see lots of other people panicking, even if you don't know why, it feels like the safest thing to do is to panic right along with them.
- Trump has done this to himself. He is now paying the price for a [terrible strategic mistake](#) at the Republican convention. In his [acceptance speech](#) he focused on voters' *fears* – of terrorism, of foreign competition, and so on. He should have framed the same issues in terms of the need for *change*. His emotional stance was dominated by *anger*. It should have been *hope*.

#### Headlines on Trump's acceptance speech at GOP convention

	"In acceptance speech, Trump's America is a <b>dark</b> and desperate place"
	"Donald Trump offers <b>dark</b> vision of America in GOP convention speech"
	"Donald Trump Takes America on a Journey to the <b>Dark Side</b> "
	"Trump's emotional and <b>dark</b> message: How it will play out"
	"Watch Donald Trump's <b>Dark</b> , Fear-Mongering RNC Speech"
	"Donald Trump's <b>Dark</b> And Scary Night"
	"Donald Trump and the <b>Dark</b> Soul of the GOP"
	"Donald Trump's <b>Dark, Dark</b> Convention Speech"
	"Donald Trump's Angry, <b>Dark</b> Convention Speech Caps Off a Disastrous RNC"
	"The <b>dark</b> , frightening America of Donald Trump"

Source: True News

- Remember, Clinton's only feasible branding position is "change is

scary.” Trump made it easy for her: if the world is really as fearsome a place as Trump says, do you really dare put someone like Trump in charge of it?

- *But Trump does indeed have a message of hope. There truly are attractive aspirational aspects to his persona – his underdog status, his fearlessness, his pride in his business success, and, yes, his wish to make America great again* (see [“Sympathy for the Donald”](#) March 2, 2016).
- *Trump’s better nature was on good display in Monday’s [speech to the Economics Club of Detroit](#) – his growth agenda for a 15% top business tax rate, slashing counter-productive regulations, and encouraging more fracking.*
- But it speaks volumes about Trump’s difficulty in controlling his messaging that [the lead editorial by our friends at the Wall Street Journal](#) the next day acted as though all this were a sudden revelation of entirely new policy initiatives. It was posted on Trump’s campaign website many months ago. In fact we wrote about it ourselves in an op-ed for the *Journal* six weeks ago (see [“Trump’s Pro-Growth Path to Victory”](#) June 21, 2016).
- Perhaps Trump, the Wharton economics major, is relying on [“Prospect Theory”](#) from behavioral economics, which suggests that people are, in fact, willing to take more risks to avoid losses than they are to achieve gains.
- But Clinton is betting the other way, as she must do in her position relative to the only-two-terms pattern – and at the moment, Trump is helping her.
- There’s still almost three months until the election, and Trump was ahead in the polls just three weeks ago. So he has lots of time to re-shape his message toward hope. And remember, Clinton has her own unique vulnerabilities – there is plenty of scope with her for an [“October surprise.”](#) And always in the background remains the fact that the field is truly tilted toward Trump – he has the only-two-terms pattern *and* the economy working in his favor.
- So we repeat that this is exactly like Brexit all over again (see [“On the Brexit Referendum”](#) June 24, 2016). The polls, the pundits, the bookies and the “prediction markets” all wrote it off. The Great and the Good of the global elite all warned it would be a catastrophe. But the electorate’s hunger for change pulled off a stunning upset.
- [It can happen here.](#) And markets are utterly unprepared for it.
- *If Trump is elected, or as the election approaches if the consensus swings toward believing he will be elected, there could be a significant correction as the sheer uncertainty of his effect on the global economy, on top of the endless warnings of catastrophe, come into focus.*
- *Like most candidates, Trump’s policy portfolio is a mixed bag – but that bag contains some superlative pro-growth ideas. We’ll play it as it lays, of course. But for now, we’ll say that if there is a Trump dip, we’ll want to buy it.*

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## Bottom line

Within days, Trump has gone from a slight lead in the polls to seeming collapse. We think the market never expected him to win, but now it has written him off entirely. It's just like Brexit – an anti-establishment movement given no chance of victory, and warned against by the establishment as a catastrophe. When Brexit happened, markets had to undergo a major correction. Our election model says Trump should win. He has on his side the reliable only-two-terms pattern that can only be overcome by a very strong economy, and yet the economy is weak. This demonization phase was entirely expected. Trump's optimal strategic position is, ironically, just like Obama's, who enjoyed the same advantages: "hope and change." He has made a terrible mistake by emphasizing fear instead. There is still plenty of time for him to come back. If he does, and if he wins, it will shock markets just as Brexit did – and will be a buying opportunity. ▶