

MV Capital Management Thought Leadership

Election's Over: What Happens Next?

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On September 14 of this year the S&P 500 ended the day at 1465, representing its 52-week high closing point. This turned out to be peak – at least so far – of a synthetic rally that had begun earlier in the summer. We call it “synthetic” because the rally was driven by a sequence of statements and policy moves by central bankers to try and stimulate the economy – or at least keep it from going into reverse. It could perhaps less charitably be called a sugar high – as in a burst of energy that is bound to wear off and require a general sobering up. From where we stand today the broad-based index is about 5% off that September high point.

Mid-September was also about the time that a large part of the country started to tune into the US election. Campaign season was in full swing, with a non-stop barrage of polls and opinions arguing about who was up, who was down, what issues the race was turning on. Debates and other campaign events diverted attention from the things that have been weighing on the economy for most of the year: Europe, the approaching fiscal cliff, unemployment, household budgets under strain. Then, last night it was all over. The election landscape became clearer in the wake of President Obama's re-election, the retention of the Senate by the Democrats and the keeping of the House of Representatives by the Republicans.

Clearer in terms of the political composition, yes. But not clearer in terms of what happens now at a practical level. There are some major challenges in the immediate future, and some real cause for hope in the months beyond. Let's look at the present realities.

The Cliff Looms

The just-concluded election removes one major uncertainty from the equation. At least we now know who the players are going to be. The worst-case scenario that was entirely plausible in the days leading up to the election was that of a hung jury. A split vote in the Electoral College, or too-close-to-call races in the major swing states of Ohio or Florida – the kind of thing that would keep partisan warfare on center stage with nothing of economic consequence getting resolved. Thankfully we didn't get that outcome. The presidential race was called before midnight and the Senate and House majorities are clear, even if there are still a few seats where votes continue to be counted. Better the devil you know than the devil you don't know.

But that's not going to be of much comfort to anyone familiar with the ways of Washington over the last two years. In effect we have the same principals sitting at the table now that we did in 2011, when intransigence and political posturing brought us to the very edge of defaulting on our debt. Is there any reason to believe that this time is going to be different? And let's be clear, this fiscal cliff is not an illusion. The fiscal cliff will happen if our politicians do what they do best – nothing. If no action is taken between now and January 1, 2013, \$600 billion of tax increases and spending cuts come into immediate effect. That's a \$600 billion gut punch that would very likely send a tender economic recovery back into negative growth. The effects of this on everything from jobs to consumer spending to business investment – not to mention the likely ripple effect on other troubled world economies from Brussels to Beijing – would be devastating. Not to put too fine a line on it, but we cannot afford to fall off this cliff.

Learning to Get Along

We won't know for at least a few days whether we're going to see a depressing – and dangerous – return to business as usual or if there will be some kind of a new spirit in the air. For the next couple days – probably for the rest of this week – the bruised and bloody politicians will be nursing their sores and

tending to their most immediate concerns – whether they still have jobs, who their allies are, how to spin their victories or defeats. Some of the initial grunts making the rounds of the news shows are not particularly inspiring. But we believe there is at least a reasonable case to make that we are not headed for a carbon-copy repeat of August 2011 – that it's not just déjà vu all over again as Yogi Berra would have said. This case for some positive change is not based in wishful “wouldn't it be nice” dreaming, but in cold hard reality. Whether they like it or not, the White House and the divided Red/Blue Congress are stuck with each other for at least the next two and very likely the next four years. There are political realities for both parties that may place a higher priority on cooperation than was the case a couple summers ago.

As the campaign unfolded over the last couple months one thing we saw trend upwards was general voter sentiment about the economy. It was subtle at times, but you saw it in the polls. More Americans have been paying attention to the numbers during these past weeks, and more of them see at least some signs that things are turning around. The last Consumer Confidence Index reading before the election was the highest it had been since before Obama was elected back in 2008.

And therein the pressure on the political players. Nobody is going to want to be the one voters hold responsible for driving a potentially growing economic recovery off the cliff. And after this election there aren't too many people who will cut the politicians a lot of slack. Not many people – conservative, liberal or in between – thought this was a particularly uplifting election season. Approval ratings are unimpressive across the board. There will likely be a price to pay for reckless gamesmanship.

The process is not likely to be pretty or fun to watch. There's a reason they call the actions of forming and implementing policy “sausage making”. And they may not resolve for once and for all each of the issues that have to be decided on in the next six short weeks. But from a standpoint that we believe is both rational and hopeful, we think there is reason to believe that things will get done and the worst case outcome will be avoided. And rest assured we will take no chances as we carefully and objectively watch what unfolds over the coming days and weeks.

With warm regards,

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