

America's High-Stake Midterm Elections

The stakes in the upcoming congressional midterm elections (November 6) are particularly high. The Republicans currently control both the House and the Senate. Not only would the loss of one or both chambers of Congress bring Trump's agenda to a skidding halt, it could even signal the beginning of impeachment proceedings against him.

The 2018 midterms can also be divided into two separate elections. The Democrats are favoured to regain control of the House on account of Republican vulnerability in numerous suburban areas, whereas the Republicans look set to retain control of the Senate as the outcome there hinges more on rural states where Trump still has strong support. In all, 435 seats in the House of Representatives and 35 of the 100 seats in the Senate will be up for grabs in November 2018.

Historically, the incumbent president's party has not fared well in midterm elections. It has lost seats in the House in 9 of the last 10 elections held halfway through the president's first term. In the Senate, it has managed somewhat better. The sitting president's party has given up seats in only 6 of those 10 elections. Historically, supporters of the party not in power have tended to be more motivated to show up at the polls.

House of Representatives

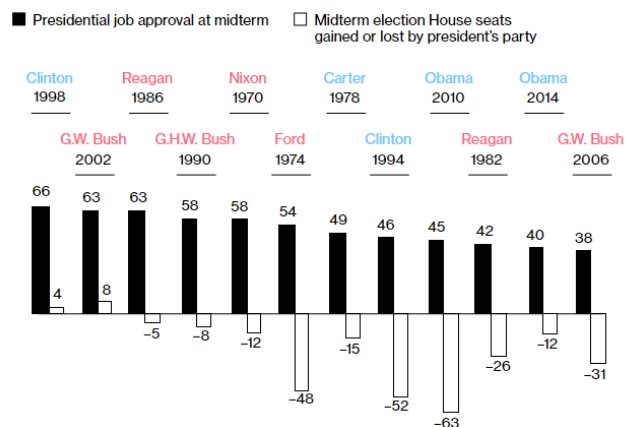
Republicans currently hold a 237-to-193 seat majority (with 5 vacancies) in the House of Representatives. For the Democrats to seize control of the House, they would have to gain 24 seats. Their greatest hope for gains lies in the 23 Republican-controlled districts won by Hillary Clinton in the last presidential election.

In the midterm elections from 1934 to 2014, the president's party lost an average 27 House seats, and 25 in the first term.¹ In the post-war era, the president's party has gained midterm seats only twice: in 1998 under Bill Clinton (5 seats) and in 2002 under George W. Bush (2 seats). It is generally believed Clinton got a bump in the polls because of public disapproval of him being targeted for impeachment, while Bush benefited from a rally-around-the-flag moment following 9/11.

Historically, the president's approval rating has been a more reliable indicator of the outcome of the midterm elections than has been the state of the economy. President Trump's average approval rating is currently hovering in the 41% range. (Some argue this figure does not take into account people who refuse to admit they are Trump supporters.)

President's Midterm Party Losses

According to Gallup, President Trump's job approval stood at 41% on Sept. 2



Sources: Gallup, American Presidency Project, Bloomberg research

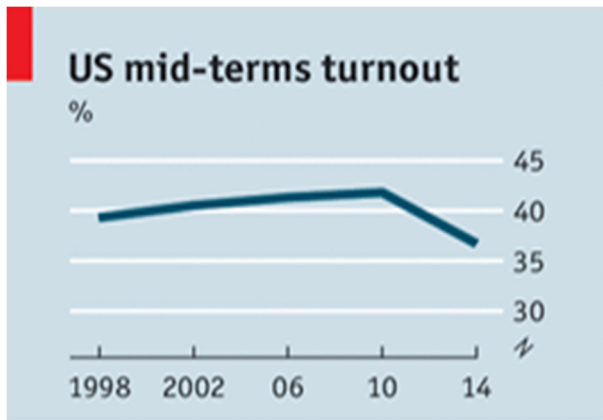
Source: "GOP Braces for Democratic Surge in November," Bloomberg, September 6, 2018

¹ "Republicans will need more than the economy to hold the House," The Hill, September 1, 2018

But Republicans have important structural advantages

Voter turnout

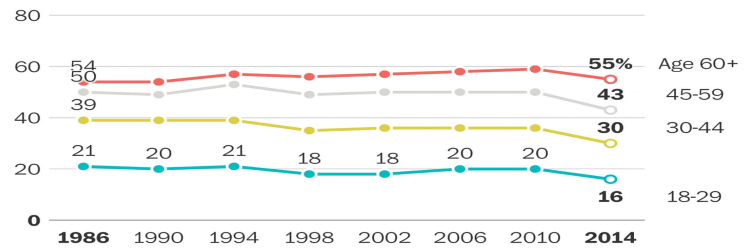
Historically, the relatively low voter turnout in the midterms has favoured the Republicans. This is because younger people, who make up a large part of the Democratic base, tend to vote at lower levels than do older white voters, who tend to favour the Republicans. In 2014, voter participation in the midterms was 37% compared with 55% in the last presidential election.



The Economist

Under 1 out of 6 Americans under age 30 voted in 2014, will 2018 be different?

Percent turnout among eligible voters in midterm congressional (non-presidential year) elections



Source: United States Elections Project analysis of U.S. Census Bureau data

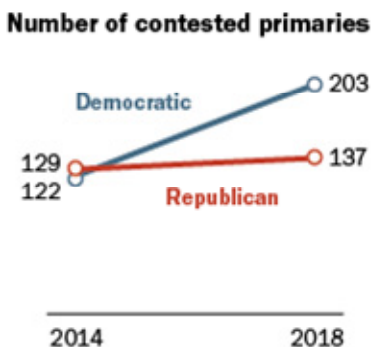
EMILY GUSKIN/THE WASHINGTON POST

Sources: “Many American states are making voting harder,” The Economist, August 11, 2018, and “Are young voters going to sway the midterms?” Washington Post, August 1, 2018

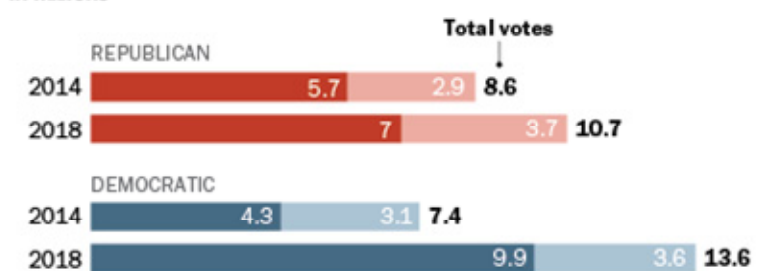
The Democrats are hoping that disapproval of President Trump will motivate millennial voters and other Democratic supporters to show up at the polls in greater numbers. So far, based on the total number of votes cast in the primaries (where candidates are selected for the general election), the Democratic base appears far more enthusiastic about voting than their Republican counterparts do.

More contested House races are driving higher turnout, particularly among Democrats

Among the 31 states that held their primaries by June 30 of each year



Number of votes in contested and uncontested primaries



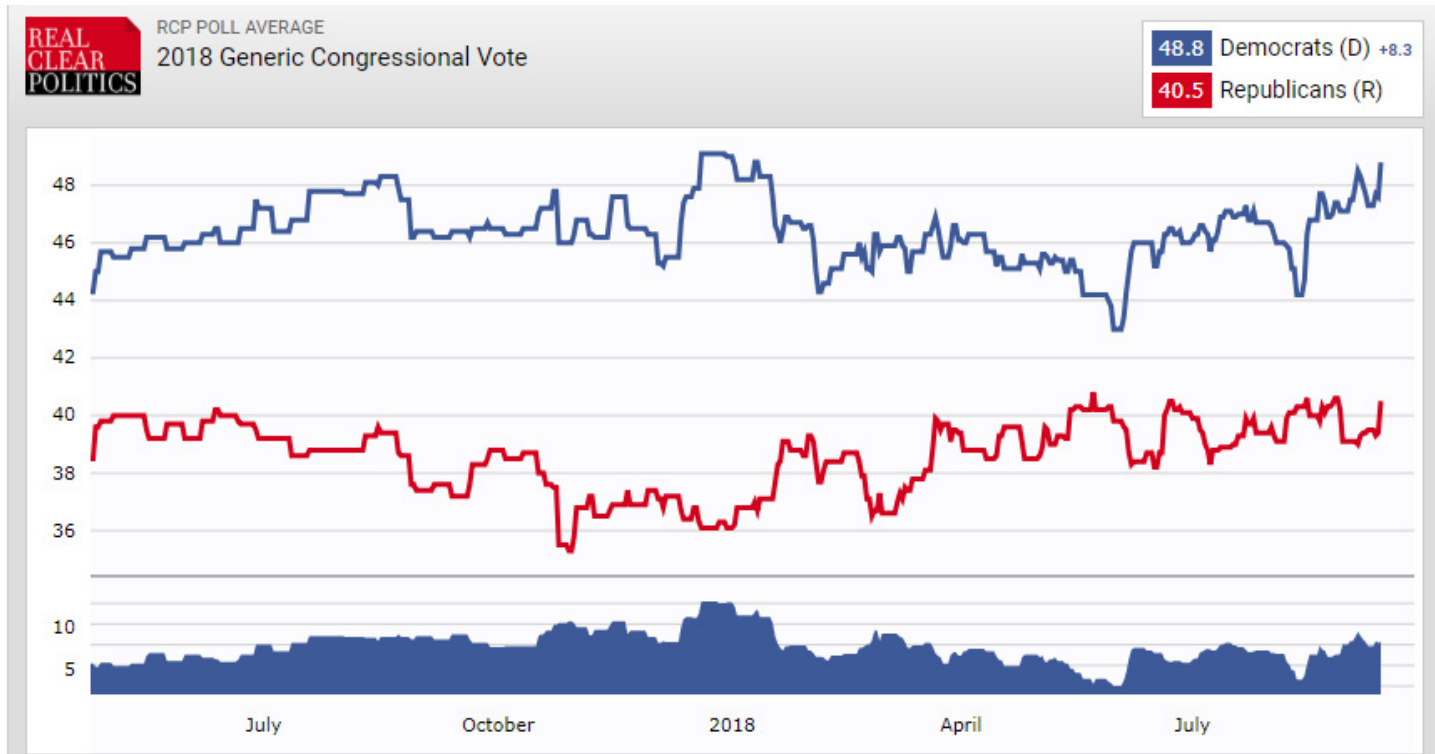
Note: Contested races defined as those with at least two candidates' names on the primary election ballot.
Source: Pew Research Center analysis of state election data.

PEW RESEARCH CENTER

Source: “Turnout in this year’s U.S. House primaries is up,” Pew Research, July 27, 2018

Geographic location of most voters

However, the apparent greater voter enthusiasm of the Democratic base is at least partially counteracted by two factors working in the Republicans' favour. 1) The tendency for Democrats to win with overwhelming margins in heavily Democratic urban areas, thus wasting votes; and 2) gerrymandering, which is the process whereby state governors redraw the boundaries of legislative districts to favour their party, essentially by moving likely non-supporters to districts lost in advance. **In order to overcome these barriers and have a chance of regaining control of the House of Representatives, Democrats would have to win the congressional popular vote by at least 7 percentage points.** As the following chart illustrates, they are currently just above this threshold in the polls.

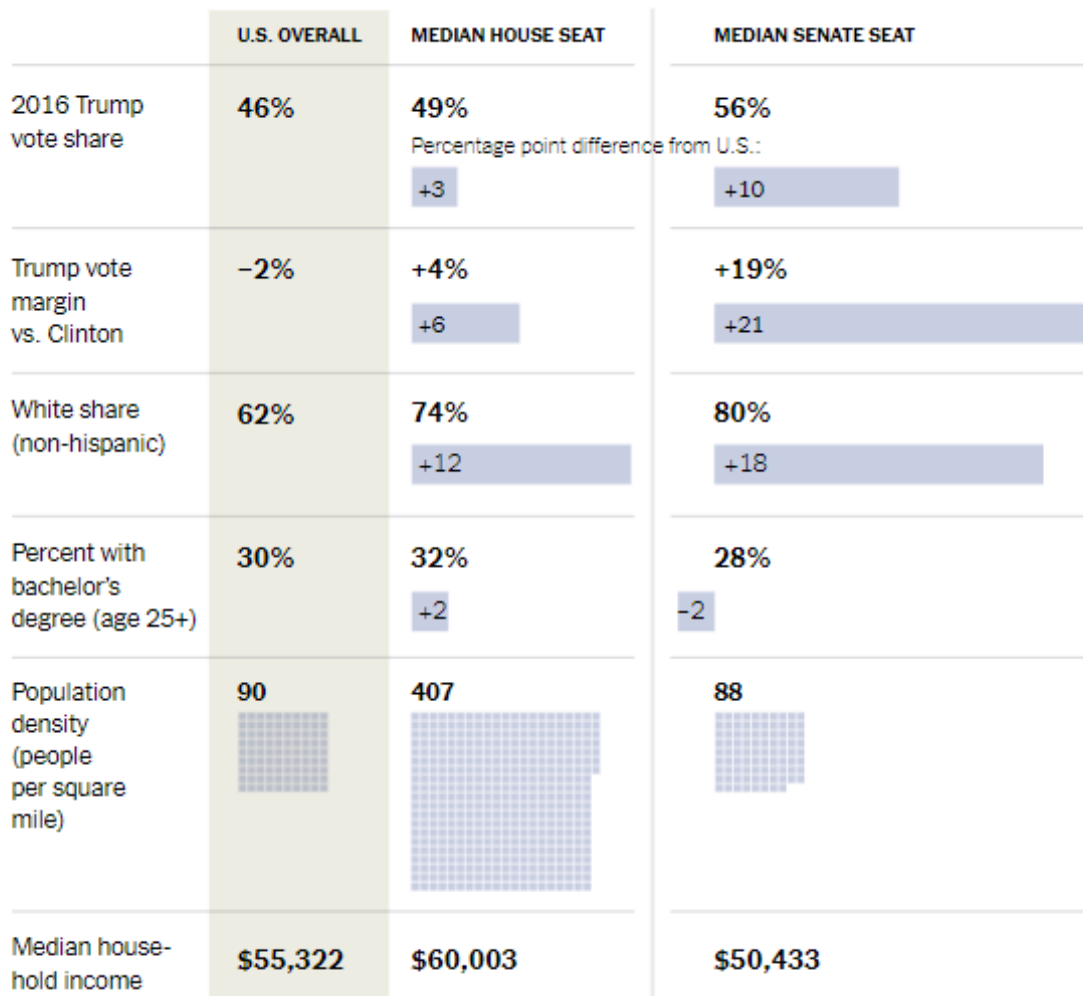


The midterms also hugely important for gerrymandering

Most state governors, also, are up for re-election in November 2018. The winners will be in a position to reshape the house electoral districts of their state during the 2020 national census, an exercise conducted every ten years. During the last census, Republican governors were able to shape federal districts in a way that greatly benefitted the Republicans in the 2010 midterm congressional elections.

Senate map favours Republicans

Though their majority hangs by only a two-vote margin (51 to 49), Republicans are relatively well-positioned to retain control of the Senate. Democrats will be defending 26 seats, compared with just 9 for Republicans. This includes ten Democratic seats in regions that Trump won in the last presidential election. In contrast, only one Republican seat is at stake in a state that Clinton won (Nevada). As illustrated in the following chart, the median Senate seat is more rural and pro-Trump than is the median House seat. Regardless of population, each state has two senators.



Source: "Why Even a Blue Wave Could Have Limited Gains," New York Times. August 20, 2018

What if Democrats win the House of Representatives?

- The GOP would not be able to pass any more major bills with just Republican support.
- A Democratic House Majority would gain control of all of the investigative committees and launch several new investigations into the Trump administration.
- Regardless of whether Muller has completed his investigation, it would increase the risk of Democrats beginning impeachment proceedings against Trump (more on this later).

What if Democrats take the Senate as well?

Democrats gaining control of the Senate would be an even greater blow to the Trump administration. First, it would give Democrats veto power over Trump's nomination of judges and heads of regulatory agencies. Second, Democrats would be able to launch investigations against Trump from the Senate.

How difficult is it to impeach a president?

The process of removing a president from office for an alleged criminal offence begins in the House of Representatives. If a simple majority (50+1) votes to begin impeachment proceedings, the matter proceeds to the Senate, where a two-third majority (67 votes) is then required to actually remove a president from office. Impeachment has been attempted only three times in the history of the United States:

- In 1868, the House voted to impeach Andrew Johnson for firing the Secretary of War. The Senate fell just one vote short of the two-third majority needed for the motion to pass.
- In 1974, Richard Nixon resigned from the presidency when it became clear he would be impeached by the House and convicted by the Senate for crimes related to the Watergate scandal.
- In 1998, the House voted to impeach Bill Clinton for lying under oath about having an affair with intern Monica Lewinsky, but the motion failed to muster sufficient votes in the Senate.

There is a risk, also, of the impeachment inquiry drifting towards unrelated matters. In the 1990s, Kenneth Starr was appointed Independent Counsel to investigate then President Bill Clinton's involvement in a failed real estate investment deal. The probe ultimately led to impeachment proceedings against Clinton for lying under oath about his affair with an intern. **In our opinion, the biggest risk that President Trump faces is not being found guilty of collusion with Russia but being charged or targeted for impeachment for something unrelated, such as lying under oath about his business dealings or taxes.**

What stands in the way of Trump's impeachment?

While many congressional Republicans do not like Trump, they are kept in line by the fact that the vast majority of Republican voters still support him. Attacking the President would be electoral suicide for them. **However, this reluctance to turn against President Trump could begin to crumble if investigations reveal that Trump committed a major crime and/or if his popularity among the Republican base collapses (see chart below).** If his approval rating among the Republican rank and file were to drop below 70% for a prolonged period Trump would have reason to worry.

Donald Trump Job Approval by Party Identification

Weekly averages from Gallup Daily tracking

	Republicans	Independents	Democrats
	%	%	%
2018			
2018 Sep 3-9	85	36	8
2018 Aug 27-Sep 2	85	36	9
2018 Aug 20-26	85	35	10
2018 Aug 13-19	87	39	7
2018 Aug 6-12	82	34	7
2018 Jul 30-Aug 5	89	33	7
2018 Jul 23-29	87	34	8
2018 Jul 16-22	85	37	11
2018 Jul 9-15	90	38	8
2018 Jul 2-8	87	36	9
2018 Jun 25-Jul 1	87	36	10
2018 Jun 18-24	87	38	5
2018 Jun 11-17	90	42	10
2018 Jun 4-10	90	35	8
2018 May 28-Jun 3	87	34	11
2018 May 21-27	85	35	8
2018 May 14-20	89	38	9
2018 May 7-13	84	35	12

Partisan divide over Mueller investigation

The recent convictions of President Trump’s former campaign chairman Paul Manafort and his long-time lawyer Michael Cohen are cases in point. To Trump’s detractors, they can provide valuable information on Trump’s alleged Russian dealings in exchange for a lenient plea deal. To Trump’s supporters, however, the fact they have both been charged for matters unrelated to the Russian investigation is proof Mueller is nowhere near to proving that Trump colluded with the Russians.

Harvard Law Professor Alan M. Dershowitz has labelled this bitter divide “the criminalization of political differences” where only errors made by members of one’s own political tribe are forgiven.

Conclusion

The most likely outcome of the midterms is a split decision between the House and the Senate. This would mean a Democratic House majority launching more investigations against Trump and perhaps even beginning impeachment proceedings. While impeachment proceedings would most likely be unsuccessful, they would create a major distraction. At the same time, a Republican Senate majority would continue confirming the President’s judicial and government appointees.

Whether Republicans manage to cling to a majority in the House and/or the Senate or whether Democrats take control, power struggles and divisions within both parties mean there will be more gridlock. Indeed, the members of both parties most likely to lose their seats in 2018 are moderates who in the past have worked across the aisle.

Similar to Obama after losing control of the Congress in 2010, President Trump will likely have to rely on executive orders and regulatory agencies to advance his agenda. (Heads of regulatory agencies can often implement changes without congressional approval.)

Finally, losing seats in the midterms is not necessarily a career ender. Presidents Reagan in 1982, Clinton in 1994 and Obama in 2010 suffered major losses in their first midterm elections and still managed to get re-elected.

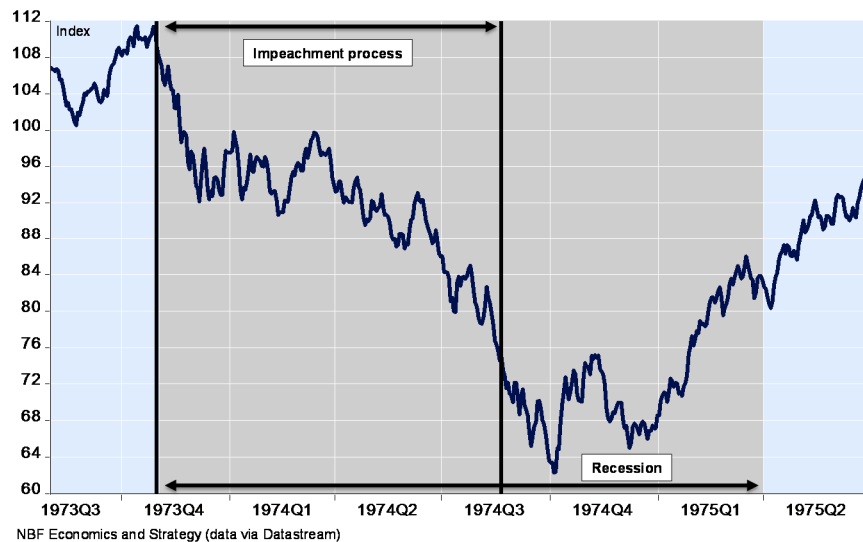
Where Trump's favourability is concerned, investors are advised to monitor Trump's support among the Republican rank and file and the right-leaning media very closely. Were Trump to lose this support, he would be in serious political trouble and much more vulnerable to impeachment.

Past impeachment episodes have had limited impact on financial markets

In February 1974, when Congress initiated impeachment proceedings against Nixon (resigned in August), the S&P 500 was already trending downward. While his impeachment no doubt added to the gloom, the main driver behind this bear market was the oil crisis and the collapse of the dollar-gold peg.

S&P 500: Perspective on Nixon's impeachment process

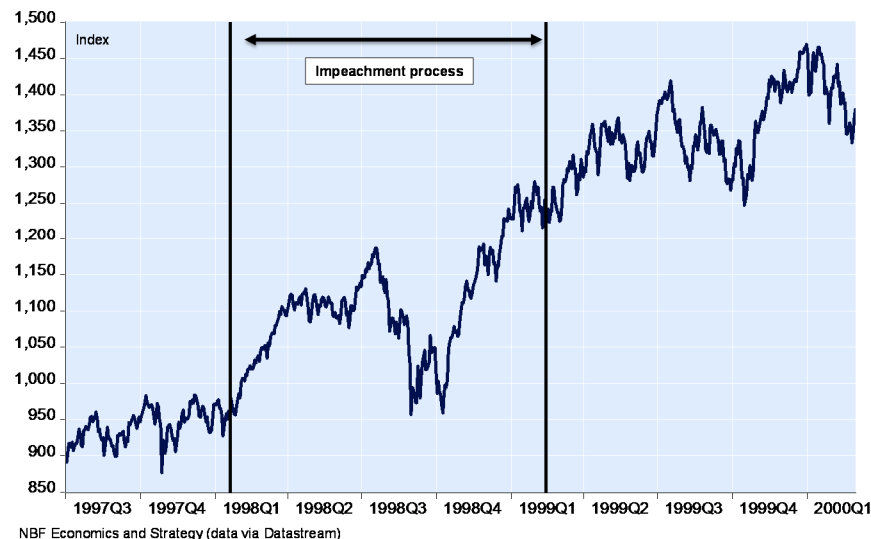
S&P 500 Composite Index



In contrast, Clinton's impeachment episode (December 1998 to February 1999) was marked only by a brief market correction caused by the Asian crisis. Quick actions by the Federal Reserve and the IMF quickly put markets back on the uptrend.

S&P 500: Perspective on Clinton's impeachment process

S&P 500 Composite Index



Why protectionism will outlast Trump

Regardless of who wins the midterms and the next presidential election in 2020, protectionism will remain part of the American political landscape for the foreseeable future. A quote from a letter sent last April by Democratic Senate leader Chuck Schumer regarding NAFTA negotiations to the Trump administration is a case in point: “I strongly believe that we should not miss this opportunity to protect our dairy producers from Canada’s recent predatory trade practices.”²

Further proof can be found in a bill recently passed with strong bipartisan support called the Foreign Investment Risk Review Modernization Act. This legislation not only strengthens the ability of the Department of Defense to decide who should be allowed to invest in the United States, it also makes it a lot harder for American companies to form joint ventures in countries like China, the main target of this legislation. One of the very few things Democrats and Republicans agree on is that a tougher line should be taken against China’s trade policies.

Democrats have veered left on many issues

While much has been said about the Republican Party’s ideological shift under Trump, it is important to note that the Democrats, too, are undergoing a major realignment of their own. This can be seen from their growing support for government-provided health insurance, guaranteed income schemes and tuition-free education. A recent Gallup poll found that a higher percentage of Democrats had a more positive view of socialism than of capitalism.

Views About Capitalism and Socialism: by Party

	Positive view of capitalism	Positive view of socialism
	%	%
Democrats/Leaners		
2018	47	57
2016	56	58
2012	55	53
2010	53	53
Republicans/Leaners		
2018	71	16
2016	68	13
2012	72	23
2010	72	17

GALLUP

Source: “Democrats More Positive About Socialism Than Capitalism,” Gallup, August 13, 2018

Angelo Katsoras

² “Senior U.S. legislator: new NAFTA must lower Canada’s ‘dairy wall,’” Canadian Press, April 16, 2018

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