



Praying for Time

Our September 8th piece reviewed many of the market and economic issues at stake in the election. With one month to go¹, two last topics: the election as referendum on America, and the rising possibility of a contested process that may not resemble the last 225 years of orderly transfer of power.

Part I: How well does the “system” work, and for whom?

In an August research report, JP Morgan’s Investment Bank recommended that investors position for rising odds of a Trump re-election. The reasons cited: if protests are seen as violent, that could materially affect voting patterns; and the tendency for Trump voters to mislead pollsters. On the former, the authors wrote that perception of violent demonstrations could boost Republicans vote outcomes by 2%-8% this year, a range they based on demonstrations and county-level US election results from 1960 to 1972. Sounds very empirical, right?

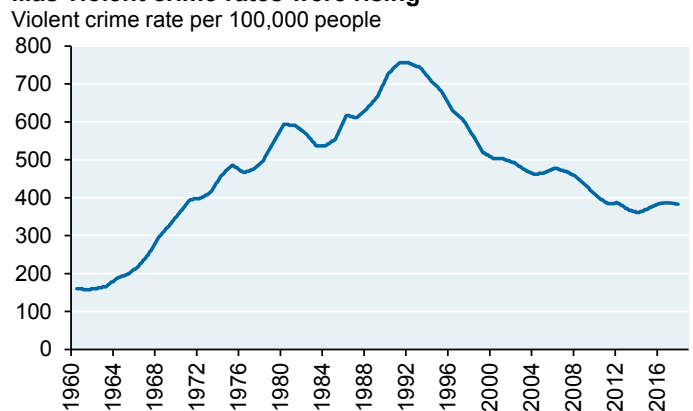
But this is not 1960 or 1972, when most Americans still trusted the Federal government as an antidote to chaos, and when violent crime rates were steadily rising. In fact, a September 2020 CNN/SSRS poll found that 58% of Americans consider the Trump administration’s response to the protests “more harmful”, compared to 33% that consider it “more helpful”. Given the broad range of administration policies, strategies and statements, **while some voters may see the administration as guardians against lawlessness, there may be just as many voters who see the current administration as purveyors of it.**

In the 1960s, trust in the Federal Government was high...



Source: Pew Research. 2019.

...as violent crime rates were rising



Source: Congressional Research Service, FBI. 2017.

Rather than focusing on protests in isolation, I think the election may instead be a referendum on how well the “system” works in America, and for whom. If social media has the power to transform how voters interpret protests, it also has the power to convey how the rest of the developed world lives, and how the US stacks up against it. The chart on the next page compares the US to the World Bank’s high income country universe:

- The US ranks at the very top for **equity investors² and entrepreneurs**, given lower regulatory burdens, lower tax burdens, greater ease of hiring/firing, ease of doing business and a legal system which quickly resolves commercial disputes; all of which contribute to top decile profits growth and equity returns
- For **workers**, the US ranks above average on median income, housing costs (renting or owning) and the OECD’s measure of a “Better Life” (jobs, housing, earnings, work-life balance, environment and safety)

¹ The underperformance this year of stocks with higher tax burdens (i.e., more at risk from higher corporate tax rates), and the record 25% valuation discount of healthcare stocks vs the S&P 500, suggest that **markets are pricing in substantial chances of a Democratic sweep** (see page 4 for charts).

² 56% of private sector and state/local workers participate in Defined Benefit or Defined Contribution plans, most of which have substantial allocations to US equities. Similarly, 55%-60% of US households own equities as part of their household wealth, either in investment accounts and/or in retirement plans.



- There are cracks in the **US judicial and legal system**: the US ranks median or below on judicial independence and corruption. On corruption, the US score has worsened by 6 points since 2017. In the history of the Transparency International index, this large a decline in 2 years is very rare in developed countries, and is the same as the decline in Hungary’s corruption score during the autocratic administration of Viktor Orban³
- The US ranks below median on **homelessness, basic education and healthcare (including COVID mortality)**
- The US ranks poorly on **income distribution, generational mobility and poverty**
- The US ranks at the very bottom on **civil/criminal justice and discrimination**, in contrast to the ideals and principles laid out in its founding documents

Some of these problems have existed for decades. But in 2020, voters may be more inclined than ever to judge an incumbent President on whether his administration made these problems better on the margin, or made them worse.

How well does the US "system" work, and for whom?

US rank within the World Bank's 34 High Income countries, 100 = best rank, 0 = worst rank



Sources: World Economic Forum, Fraser Institute, Heritage Foundation/WSJ, World Bank, OECD, International Labor Organization, Institute for Health Metrics and Evaluation, World Justice Project, Johns Hopkins, MSCI, JP Morgan Asset Management. 2020.

World Bank High Income countries: Aus, Aut, Bel, Can, Chl, Cze, Dnk, Est, Fin, Fra, Deu, Grc, Hun, Ice, Irl, Isr, Ita, Jpn, Kor, Lva, Ltu, Lux, Nld, Nzl, Nor, Pol, Prt, Svk, Svn, Esp, Swe, Swi, UK, Usa

³ See “The EU Watches as Hungary Kills Democracy”, Atlantic Monthly, April 2, 2020



Part II: Praying for time after November 3rd

Given the expected surge in mail-in voting and relentless (and reportedly unfounded⁴) criticism of the process by Trump and his Attorney General⁵, I included a primer on election procedures in our Labor Day *Eye on the Market*. As we described previously, Congress will almost certainly do one the following on Jan 6th:

- Announce a President based on Electoral College results
- Or, announce a Contingent Election in the House to choose a new President if the Electoral College fails to produce a candidate with a simple majority of accepted electoral votes
- Or, if the Contingent Election fails to produce a winning candidate, designate the Speaker of the House as Acting President starting Jan 20th and until sufficient rounds of House voting have determined a winner

However, this primer didn't sufficiently cover all the steps that are fraught with potential for legal uncertainty, judicial interpretation and political gamesmanship⁶. There have already been 300 lawsuits filed regarding the 2020 election, and the election is still more than a month away. Furthermore, the President of the United States was cited by multiple news outlets as having declined to commit to a peaceful transfer of power after the election (this is one of those sentences that you live your entire life not expecting to ever write).

Here are some of the most important uncertainties to keep in mind that did not appear in our September piece:

- **Six weeks may not be long enough.** While 6 weeks (Nov 3rd to Dec 14th when the Electoral College meets) sounds like a long time for states to count absentee ballots and resolve provisional ballots, it may not be; New York didn't certify primary results from its June elections until August. Absentee ballots may exceed 30%-40% in some states, and in the case of a requested or automatic recount, they may end up having to be counted twice. The Supreme Court did not overturn a lower Federal Court decision ordering a state to extend absentee ballot vote deadlines from "received on election day to "postmarked on election day", which extends the vote counting process. Finally, there are countless opportunities for election lawyers to file court challenges, alleging fraud, legal violations, biases in voting locations relative to population density or other irregularities, with forum-shopping to increase chances of finding a sympathetic judge
- **More than one set of electoral results from a given state.** Secretaries of State generally oversee and certify election results (in some states, they only pass along results to the Governor). But...there's also the possibility that other entities submit their *own* results to the Electoral College as well (the Governor and/or the State Legislature), a morass which would fall to the Congress to sort out in early January (and here, special powers are vested in the incumbent Vice President, who is technically the President of the Senate)
- **A candidate could win with less than 270 votes.** If some electoral votes are not reported by December 14, or if some electoral votes are rejected by Congress for procedural reasons, there's a chance that instead of resorting to a Contingent Election⁷, Congress would select a President as long as one candidate obtained a majority of *accepted* electoral votes received by the Dec 14th deadline. In that case, the electoral threshold required would decline from 270 to a lower number equal to half the accepted electors plus one.
- **What if the composition of the new Congress isn't known yet?** Parts of the process require oversight, approval and intervention by the *new* 117th Congress in early January, but control of the Senate might not be known by then if there are close unresolved races which affect the partisan balance in that chamber

⁴ See multiple stories in CNN, Washington Post, AP News, NYT and NPR that debunk Trump assertions on mail-in voting.

⁵ Read any article by Donald Ayer (former US Deputy Attorney General) or Randall Eliason (George Washington Law School, former Assistant US Attorney) on Bill Barr to get a sense for the role the current Attorney General might play in the election.

⁶ Many thanks to Michael Morley, Assistant Professor of Law at Florida State University and a specialist on election law, constitutional law and the federal courts, for assistance on this section.

⁷ **Contingent Elections** are more likely in a three candidate race in which no one candidate receives a majority. In typical years with only two candidates, this is less likely, particularly since as stated above, Congress may declare a winner from the Electoral College even if one candidate has less than 270 electors, as long as they have a majority of **accepted** electors. A faithless elector scenario could still require a Contingent Election even with two candidates, as described on page 4.



And then there are the “unknown” unknowns:

- **Late reporting.** If a state doesn’t complete its vote until count after Dec 14th, or if the state completes the vote count before Dec 14th and submits afterwards once judicial challenges are resolved, will Congress still accept the results? Technically, it could be both unconstitutional and against federal law to count electoral votes submitted after Dec 14th since the process would not have been “uniform” across all states
- **Incomplete reporting.** What if a state submits results on Dec 14th based on voting information that is 97% counted, but with the knowledge that a small number of absentee ballots remain uncounted?
- **What happens if faithless electors change the outcome?** What would Congress do if the Electoral College vote were very close with Candidate A ahead in early December, but on Dec 14th, a few electors decide to throw the election to Candidate B, or to abstain or vote for some other candidate to prevent Candidate A from obtaining an electoral majority? In some states, there are no explicit rules against “faithless” electors, while in others, they are technically not allowed but there is little to no enforcement to stop them in time. Only in specific states are faithless electors expressly disallowed and replaced immediately. If faithless electors were allowed to stand and no candidate received a majority, there’s a scenario in which the election of the President would then revert to the House as per Contingent Election rules
- **What if Congress violates its own rules?** Most political analysts assume that Congress will follow the Electoral Count Act (“ECA”). But if Congress violates the Act, there may be no way for an aggrieved party to go to court to try to enforce it since Congress has sovereign immunity from being sued
- **Congress may overrule the federal courts.** If federal courts issued rulings in election contests or post-election litigation specifying that the Constitution (or federal law) requires certain votes to be counted, or prohibits certain votes from being counted, it’s unclear whether Congress would be bound by them. The Constitution assigns power to count electoral votes exclusively to Congress, so there’s an argument that Congress could essentially ignore them
- **Nightmare scenario: dueling inaugurations.** Assume in the new Congress that Democrats control the House and the GOP controls the Senate. If Democrats believe that VP Pence is attempting to skew the count through his rulings as chair of the joint session on Jan 6th, they could leave to deny a quorum and refuse to recognize his announcement of the winner. It could also lead to a situation where House Democrats insist that a new President has not yet been picked (meaning the Speaker would take over as Acting President on Jan 20th), while the Senate and the GOP insist that Trump has been picked. In the election of 1876, up until the day or two before Election Day, the two major parties were each planning their own inauguration and reaching out to military Generals to see which “new” President they’d be willing to take orders from

Like many Americans, I’m praying for time so that the process can be carried out fairly and accurately, and praying that a winner is clear well before the Electoral College meets in December.

Michael Cembalest, JP Morgan Asset Management

Appendix charts:

Stocks sensitive to higher tax rates underperforming in 2020

Relative return of high tax stocks vs low tax stocks, Jan 2017 = 100



Source: Bloomberg. September 29, 2020.

Healthcare sector valuation premium/(discount) vs S&P 500

Percent



Source: Bloomberg, Datastream. September 29, 2020.



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