

Investment Insight

Reflections on the US Elections: Renewing the American Experiment of Self-Government

This, then, is a story of Lincoln's political genius revealed through his extraordinary array of personal qualities that enabled him to form friendships with men who had previously opposed him; to repair injured feelings that, left untended, might have escalated into permanent hostility; to assume responsibility for the failures of subordinates; to share credit with ease; and to learn from mistakes. He possessed an acute understanding of the sources of power inherent in the presidency, an unparalleled ability to keep his governing coalition intact, a tough-minded appreciation of the need to protect his presidential prerogatives, and a masterful sense of timing.

Doris Kearns Goodwin, *Team of Rivals: The Political Genius of Abraham Lincoln*

As we sat down for a quiet coffee this Sunday morning, we caught a glimpse of our copy of American historian Doris Kearns Goodwin's *Team of Rivals*, her seminal biographical portrait of Abraham Lincoln and his cabinet, resting on the bookcase. It seemed timely to revisit it.

Leafing through the pages we were reminded of the qualities that have shone through some of the more visionary US presidencies and how so often in the past, at times when the nation stood at crossroads, moral and visionary leadership provided the path forward. And yet as we head into the November elections this year, it has become increasingly obvious that such leadership is sorely lacking with a rhetoric that is not just hyperbolic and demagogic at its core but also reckless and dangerous.

How should we think about the US elections from an investment perspective? At the core of our investment approach is the principle that the companies we choose are largely masters of their own destiny. They have strong entrenched competitive advantages that enable them to prevail through the macroeconomic and political environment over the long term. And in many respects the nature of the US political system means that despite the rhetoric, actual policy implementation by either candidate will be tempered by Congress and the courts as counterbalancing powers. Yet one cannot help but acknowledge that what we have been witnessing over the last year is a progressive shift in the post-crisis geopolitical and economic balance of the world. The US elections represent a crossroads whose outcome will have long term implications for the structures of the economies that our investments operate in.

Fukuyama does it again

Francis Fukuyama, author of the 1990s infamous *End of History*, has published another polemic seeking to explain our times. As reductive as his previous work, his *Political Order and Political Decay* (published in 2014) is just as perceptive in its argument: The US and indeed other developed democracies have entered into a process of decay, in many respects because the global economic, social and environmental circumstances which their institutions were set up to address have fundamentally changed over the years. Partisan polarisation, the rise of well financed interest groups and a sclerotic federal bureaucracy

have all further contributed to the progressive degeneration of the political system, with recurrent budgetary crises and a lack of policy innovation as manifestations of the resulting dysfunctionality. This disarray according to Fukuyama is of course not unique to the US political system and, if it can act as trigger for political renewal, it can be a force for the better. With dark echoes of a previous era's disastrous approach to the Great Depression, he writes that "political decay is in many ways a condition of political development: the old has to break down to make way for the new. But the transitions can be extremely chaotic and violent."

Are we in such a transition? It is clear that the presidential campaign has provided a platform for a large section of the US population who feel they have been left behind to vent their frustration. The issues being raised are wide ranging, from immigration and trade to stagnating incomes and calls for more aggressive regulation of the financial sector, as large swathes of voters have turned to radical outsiders in protest of what they see as a corrupt Establishment.

Globalization: Not everyone is able to adapt

In many respects, these are common themes emerging across the political spectrum in developed economies. The vote for Brexit in the UK, the rise of the Front National in France and of the AfD in Germany are all different notes off the same sheet. That is why it is not wholly without cause that these voices for radical change are becoming increasingly loud. The liberalization of global trade and large scale deregulation that we have seen over the last decades has of course translated into increased prosperity for the global population at large. But at the same time it has exposed the traditional manufacturing bases, whether in the American Rustbelt or the English Northeast, to a perfect storm of unfettered global competition and technological advances in automation. At the same time, with government budgets digesting the effects of the Great Recession brought on by the global financial crisis, a substantial portion of the social benefits that would have shielded them from these effects have been paired back.

It is therefore hardly a surprise that Donald Trump's populist agenda has gained such momentum with his promise to "Make America Great Again" by restoring manufacturing jobs to American workers. It is the connecting fibre in the pledge to tear up trade agreements, oppose immigration or "build the wall" amidst protestations that China, Mexico and other trading partners are "killing" US jobs because of bad deals struck by "stupid" trade negotiators.

At the heart of the trade and immigration debate is the unequal distribution of both the benefits and detriments of trade. According to the Department of Commerce, from 1993 to 2008 the growth in export-supported jobs accounted for 40% of total jobs growth in the US, underlying the aggregate benefits to the economy. But at the same time between 1.0 and 2.4 million jobs have been lost from 1999 to 2011 due to import competition from China, and 800,000 from such competition from Mexico. Tellingly the unemployment rate for workers with a college degree is 2.4% but more than 7.4% for those without a high school diploma. With automation rapidly increasing productivity at the same time, a wide swathe of blue collar jobs have become obsolete. In many ways the failure of the political establishment has been to sufficiently cushion such losses and retrain the labour force. Perhaps Germany with its ferocious pursuit of apprentices and

other active labour force interventions has offered a better economic model to adapt to this change.

Lessons from history

The current political dilemmas carry poignant echoes of the past. In the post-World War One period, a similarly disenfranchised US populace faced the vote between candidates James Cox and Warren Harding. The issues on which that election was fought were in many respects similar. It was an election dominated by the social and economic aftermath of the Great War. Weary of international engagement, with the economy struggling to absorb the excess capacity built during the wartime era and rife unemployment amidst returning servicemen, the election result gave a 26% victory margin to Harding. This was a loud rejection of the Progressive Era championed by the Presidencies of Theodore Roosevelt and Woodrow Wilson and a call for a “return to normalcy”. In fact the policies that followed including the 1922 Fordney-McCumber and 1930 Smoot Hawley Tariff Acts were forerunners to the Great Depression and the political ripples that in turn it triggered.

Therefore the answer cannot be retreating to national protectionism, dismantling 50 years of trade liberalisation, and deporting 11 million immigrants from the country. Free trade agreements induce participating trade partners to buy roughly 13 times more manufactured goods from the US compared with other countries. Asian countries not included in free trade agreements place tariffs on US manufacturing as high as 80% for auto products and 70% on capital equipment. The economic effects of dismantling current trade agreements would be profound.

Our answer to what should follow the present decay, if that is what it is, is a renewal of hope and a forceful role of government similar to what the US experienced under Franklin D. Roosevelt after the Great Depression, and Ronald Reagan after the profound recession of the 1970s. From our position today, these two presidents have more qualities in common than divide them. They had clear views about what ailed the country, deeply held convictions about how to right the ills, and a belief in the positive power of the presidency to achieve the change they sought - in Roosevelt’s case by harnessing the power of government and in Reagan’s by constraining its excesses. They each were able to swing the pendulum back from the extremes to which it had been pulled. Nothing is more important than that today.

Renewal and rebuilding

That is why we think there is a need today for a renewal in that belief. Government has a critical role to play in establishing balanced policies centred firmly in the middle ground. Reagan today might provide US companies with tax incentives as he did throughout his presidency, to repatriate part of their foreign earnings estimated at between \$2.0-2.5 trillion which could provide the firepower to instigate a far reaching upgrade in the country’s ageing infrastructure and stimulate job creation. Roosevelt on the other hand would recognize as he did that government has an opportunity to do what markets will not, and that with an average age of 24 years in 2015, US government fixed assets are the oldest since records began in 1925.

Renewing public infrastructure would be a policy that could find acceptance on both sides of Congress. The Clinton platform has proposed a \$275 billion infrastructure spending program on housing, highways, broadband access and rail, sea and air transportation,

which would be supplemented by the creation of a \$25 billion investment bank that would provide government sponsored loans. These sums in fact would only scratch the surface. The American Society of Civil Engineers estimates that it would take \$3.6 trillion to adequately upgrade the country's infrastructure, an investment that would not provide a quick fix given the time frames required for its implementation, but that in the long-term would generate significant benefits to productivity and GDP.

But what if?

How much damage could a Trump presidency actually cause? The president of course does have power to direct domestic policy, especially through the use of executive orders, a power which could be used to withdraw from existing trade treaties and impose tariffs. The very disfunctionality of Congress has caused Barack Obama to make use of this power, notably to reform immigration law and to tighten gun controls. Ultimately though the winner's ability to implement and execute policy will be constrained by the outcome of the congressional elections. At its heart, the US Constitution incorporates the principle of the 'separation of powers', the checks and balances with which each branch of power tempers and regulates the others.

Although the presidential contest has gathered the majority of the attention, the control of both houses of Congress is also at stake. Up for election are 34 seats in the Senate as well as all 435 House positions. Republicans currently hold a 54-46 majority in the Senate and a 246-188 majority in Congress. The most likely current outcome is Senate control passing to the Democrats and the House remaining firmly in Republican hands, which would lead to the kind of split government that Fukuyama might decry, but which has been a feature of American political life and whose inability to agree on legislation is a result of the overall polarisation of politics, not of the split itself.

And even if Trump were to prevail against all odds and carry the Republicans along, or if Hillary Clinton were to sweep the Democrats into control, not just of the Senate but the House, the parties are hardly cohesive political units. Deep fault lines in both parties emerged during the primaries, and although the Democrats have since managed to pull together, it has become increasingly obvious that the Republican Party is deeply divided and at odds with its presidential candidate. Republican control of the executive and legislative branches would be troubling but the most likely outcome still is a divided government, which would be challenged to deliver policies that address the issues that have defined this election.

The path of progress and renewal

The most crucial crossroads of all of course is the third branch of government, the Judicial headed by the Supreme Court. The upcoming president's likely opportunity to appoint three or more justices will have a profound effect on the future direction of the US. Given the US Supreme Court's key role in interpreting the Constitution its composition will have lasting effects on both social and economic policy. With US demographics becoming ever more diverse and millennials surpassing baby boomers as the largest population, public opinion solidly supports the progressive achievements of equality, opportunity and moderation won over the past decades and protected so far by the longevity of the Supreme Court, which has constituted the last bastion of moderation amidst the disfunctionality of the political system.

We can only hope that the outcome on November 8th takes us down the path of progress and renewal. The next president will define the direction of the country for a period that far exceeds his or her tenure. And a Supreme Court that reflects the opinions and demographics of the nation would be a beacon from which to begin the work of building bridges, physically and between people, to renew faith in the resilience of the United States and its promise of life, liberty and the pursuit of happiness.

From my perspective here in London, I can only agree with the observation Lincoln himself made about what is at stake more than 150 years ago, as quoted by Goodwin:

It is not until one visits old, oppressed, suffering Europe, that he can appreciate his own government (...) (and) that he realizes the fearful responsibility of the American people to the nations of the whole earth, to carry successfully through the experiment (...) (t)hat men are capable of self-government.

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