

# ConnText Podcast

October 2022

TRANSCRIPT

## Mid-Term Elections Outlook with Michael Mix, Managing Director and Portfolio Manager

Conning ConnText is a quarterly podcast that features our firm's view of capital markets, trends and investment strategies for the insurance industry, hosted by Rich Segal, Conning's Global Chief Investment Strategist.

[OPENING MUSIC]

### SEGMENT 1 - OPENING

[Rich Segal (RS)]

Hi and welcome to the fourth Conning ConnText podcast of 2022. This last quarter will close out a very disappointing year for the markets, a year that began with much promise. Instead of making good on that promise, we've seen the worst bond market ever and for equities, while not the worst, it is surely one of the weakest two or three.

Coming to you from our Hartford, Connecticut offices today are Rich Segal (that's me) along with my friend and colleague Michael Mix, Managing Director, Portfolio Management & Trading. We'll take a look at the political environment in the U.S., the upcoming mid-term elections, and the wide-ranging implications that they may hold for markets here and abroad.

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### SEGMENT 2 - ECONOMIC/CAPITAL MARKETS OVERVIEW

[RS]

Odds are increasing for a global recession in the next several quarters, while hopes that it might be short and mild are fading too. In large part this is due to most central banks leaning hard into rising inflation readings, lifting policy rates and paring back balance sheets through QT, quantitative tightening (the People's Bank of China and Bank of Japan are notable exceptions to this). This comes just as the forces creating the rise in consumer prices are set to abate. The upshot is likely recession in the first half of 2023 except in places where it's already started. Recent IMF [International Monetary Fund] projections continue to show a stark weakening trend across all regions. Their call for 2023 global growth is now 2.7%, down more than half from last year's 6%. That comprises barely 5% for Asia, dominated by China, a meager ½ of 1% for Europe and UK, while pegging the U.S. at 1%.

Core inflation readings remain stubbornly high, and that's after adjusting for the volatile and Russia/Ukraine war-damaged food-and-energy components. Chairman Powell will move to tighten monetary policy until it is "sufficiently restrictive" to tame inflation because the central bank's obligation to keep prices stable is, in his view, "unconditional." He has set the goal of positive real rates across the entire yield curve. So we can expect the FOMC, the Open Market Committee of the Federal Reserve System that sets the policy rate, to keep pushing that rate

upward. The all-important terminal rate - the point where tightening stops and recovery can begin - is the level where it exceeds the inflation rate which should be coming down. Where do they cross? And when? Our current best guess is some time in the first half of next year, somewhere above 5%. This puts the electorate in quite a sour mood in the runup to the mid-term elections.

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### SEGMENT 3 – MID-TERM ELECTIONS DISCUSSION WITH MICHAEL MIX

[RS]

Let's draw a picture of where that mood is now. Consumer sentiment is about as weak as any election year in recent memory. The president's approval rating of around 40% is about the worst ever at this stage of an administration. Congressional approval is down to 7% (poison ivy would probably score higher), and about 87% think the country is on the wrong track. In seven of the past eight national elections, the party in power has been replaced.

Now let me get my colleague Michael Mix into the conversation. Mike is a long-time collaborator with me on macro-economics and geopolitics.

Michael, you are in touch with our clients constantly. What are they concerned about regarding the potential election outcomes?

[Michael Mix (MM)]

Yes Rich, we've hearing a lot about this from our clients. They want to know what we think about the likely outcomes, the respective implications for policy of these outcomes, and what it all that might mean for the economy and the capital markets, especially interest rates.

At this point, generic congressional ballot polling is showing that Republicans have a pretty decent chance of taking control of at least one chamber of Congress, most likely the House of Representatives, to the order of 15-20 seats.

So Rich, what are the major implications of a House win by Republicans? Gridlock should be good, right?

[RS]

Well, it should be, because spending bills, which have to start in the House, will be tough to pass (at least if they any more than simply keeping the government open). But Michael, what if the Republicans also win the Senate? Many Senate races that were toss ups or leaning Democrat have reversed to lean Republican in the past couple of weeks or so.

[MM]

Well even if that's true - and we all know polling data is not always accurate - there would need to be a Republican tsunami, rather than a wave, to produce a Biden-veto-proof two-thirds majority in the Senate. So, as a base case, we'll probably keep the status quo or move to a small Republican edge, but with that, there's not much implication for policy.

[RS]

Yeah Mike, you're right about the polling, and historically Democrats have been better at pushing voter turnout, so if it goes the other way, that is, if the Democrats expand their Senate control, then we could see many growth-threatening moves like killing the filibuster, an expanded or re-invigorated Build Back Better, more aggressive climate actions, higher taxes and spending. I think that's a rather low likelihood given current polling, which for the Senate is within the margin of error.

[MM]

So if the Republicans do take control of the Senate, it will probably be a result of three key races: Nevada, Pennsylvania, and Georgia. Any two of these three would bode well for them, assuming they prevail in the other races where they are expected to do well. Which one of these is the hardest to handicap?

[RS]

Well I think Georgia seems to be the toughest to call because of the peculiar run-off rule they have, requiring a clear majority. With a Libertarian spoiler in there siphoning off a few percent, it's likely neither Walker nor Warnock will walk away with more than 50% on election day so we'll have to wait until early December for the run-off.

So, what are the investment implications and opportunities for either of these scenarios, Mike?

[MM]

Well, let's unpack that. I think that if the Democrats increase their foothold, they will probably interpret the win as a mandate, and continue to do what they've been doing. I think we would probably continue to experience high volatility and perhaps higher rates.

On the other hand, I do think that gridlock, in the form of a Republican win in the House, could provide some stability in terms of fiscal actions like spending and tax policy. Although that stability may be more immediately helpful to equity markets, particularly in regard to taxes on corporations and stability of corporate profits, you could also make an argument that spending constraint could help Jay Powell and the team at the Fed cool inflation. Listen, we are still working off the "sugar high" effects of the \$2 trillion American Rescue Plan passed way back in March of 2021. Recall that Build Back Better started off as a \$3 trillion spending bill introduced only four months after the American Rescue Plan. Although the original [Build Back Better] plan didn't make it to law, several spin off bills did, so the spending continues. Powell's only lever, which is to crush demand, could work faster without Congress propping up the other side of the equation. We have talked a lot internally about remaining neutral in terms of duration relative to our benchmarks because of the high level of rate volatility – you could easily be whipsawed out of your winning trading position. If Powell and company get to the terminal rate sooner and perhaps at a lower rate than current expectations, volatility could subside. Using that logic to drill down into a few sectors, corporates would likely benefit the most, as companies could better plan for the cost of capital and future expansion. They would also benefit by the quieting of the view that, in order to tame inflation, Powell will need to create the next recession. Agency mortgage-backed securities, where we currently have an overweight call, would probably be positively impacted too, as lower volatility could help tighten spreads.

[RS]

If everything holds status quo or if the Republicans do take a slight edge, we always talk about the contentious issues

here, but what bipartisan issues might be able to advance? And again, what are the investment implications and opportunities of that?

[MM]

Politically, Infrastructure bills always seem to receive bipartisan support. Despite the fact that the latest infrastructure bill was passed in late 2021, and was \$1.2 trillion in size, the creation of a new one would likely give politicians on both sides of the aisle an opportunity to go back to their constituents and tout their successes before the general election. Though the size of any bill is infinitely important too – we don't stoke inflation higher relative to my earlier comments. But if such a bill were passed, that could potentially benefit industries like capital goods – think earth movers. And despite disagreement historically on defense and military spending, the war in Ukraine could create some consensus spending bills, again to show off to constituents. There are also some potential wildcards like a bill to take on China, on trade or for intellectual property theft, for example.

More generally though, if we see some stabilization of the macro view led by less fear of an economic slowdown, we may be more focused on pro-cyclical industries like retail, airlines, leasing companies, and of course insurance. We could move away from traditionally more defensive industries like utilities, railroads and the communications industry. Incidentally, we think banks are in a good situation regardless of the macro economy, as strong balance sheets, mostly boosted by enhanced regulation, would do well in a downturn, while higher net interest margins would benefit them in an expansionary environment as well.

So Rich, there has been a lot of chatter from Republicans about them taking up investigations and hearings, maybe even an investigation into the FBI itself. Any insight as to how things will play out and on a larger level? And is there another presidential impeachment in our future?

[RS]

Well Michael, House Minority Leader Kevin McCarthy, Republican from the 23rd district in California and the likely House Speaker if Republicans take control, recently disavowed any rumors of impeachment for political gain. Let's take him at his word on that. Many House and maybe Senate committees could launch investigations into all kinds of things, but as the Mueller and Durham efforts show, they'll probably amount to nothing more than a bunch of lawyers' fees.

[MM]

Without being a mind reader, Rich, and looking past the mid terms, does Biden run again in 2024?

[RS]

As far as Biden running again, I personally doubt it. But if he does, I'm sure former President Trump will want to challenge him in a rematch. But so much can happen in the economy and geopolitics between now and then – it's a long shot. Maybe we'll see a Democratic ticket like California Governor Gavin Newsome and Amy Klobuchar, the senator from Minnesota, versus maybe a Republican ticket of Florida Governor Ron DeSantis and Nicky Halley, the former governor from South Carolina.

[MM]

OK, last question: Are you confident in the fidelity of our voting system? In other words, should we all get out and vote regardless of party affiliation?

[RS]

Yes, we definitely should get out and vote if you haven't already. Early voting has been going on for weeks now, and only four states - Alabama, Connecticut, Mississippi and New Hampshire - don't allow early in-person voting, but these states, and others, have a lot of absentee and mail-in voting. Much has been done in these states to ensure the integrity of our election results, and one of less recognized but most important down-ballot posts regarding this topic, even more important than state governors, are the secretaries of state. They have enormous influence over local election procedures so get out and vote for those who will protect your rights!

[FADE TO MUSIC]

## SEGMENT 4 - CLOSE

[RS]

Thanks Michael, for an entertaining and enlightening conversation about a topic of intense national and global interest that affects every one of us.

We hope this information is helpful and we always welcome your feedback and questions. You can get messages to us through your relationship manager, your portfolio manager, or send them directly to us at [ConnText@Conning.com](mailto:ConnText@Conning.com) (that's ConnText w/ 2 Ns).

So that concludes our last Conning ConnText podcast for 2022. Join us early next year for our views on the impact of the actual election results, the new Congress, and the prospects for markets in 2023.

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