

October 26, 2020

The Election of 1876: Part II

Last week, we outlined the history of the presidential election of 1876. This election was disputed and required a special commission to resolve. This week, we will begin with a discussion of our current procedure for electing presidents and the impact of partisanship on the existing environment. We will use last week's historical foundation to compare and contrast the 1876 election to the current turmoil and offer insights on how the 2020 election might unfold. We will also examine the international implications of an uncertain election; in other words, what could happen if the world's hegemon doesn't have a clear commander in chief? As always, we will conclude with market ramifications.

The Current Procedure

One of the strengths of democracies is their ability to adapt. Authoritarian regimes tend to ossify over time, which often undermines them and eventually leads to their downfall. At the same time, while democracies do show they can change, it doesn't mean it's pleasant to watch.

After the 1876 and subsequent lesser disputes, the current election apparatus was reformed and adapted. It remains quite similar to what was in place in 1876 but there have been changes. For example, the issue of "faithless electors," who vote against the popular vote of the state, has been partially resolved. In *Chiafalo v.*

Washington, the Supreme Court ruled that states can penalize such electors.

After election day, the secretaries of state in the voting units (states and districts) go through a process of certifying votes and selecting electors. Each unit needs to have Certificates of Ascertainment, signed by governors who attest to the electors' identities and how the voting units voted. Although these certificates must be sent by December 14, as long as the certificates are sent by December 8 then the certificates received by that date are considered valid even if there are controversies.

On December 14, the electors meet and vote, filling out paper ballots called Certificates of the Vote and comparing those with the Certificates of Ascertainment. Six copies are made, with one sent to the president of the Senate (VP Pence), two to the individual secretaries of state from the voting units, two to the archivist, and one to the judge of the District Court where the electors meet.

On December 23, the certificates are delivered. If any certificate is not available to the president of the Senate, or the archivist if the former is not available, there will be a request for one copy from the secretary of state from the individual voting unit.

On January 6, there is a joint session of Congress to count the vote. The president of the Senate opens the certificates and presents them to four tellers who read and record the returns. If a candidate receives

270 votes, he is declared president, along with his vice president.

[If there is an objection](#) by at least one senator and representative, then the joint session is suspended, and the two Houses meet separately for two hours to decide the path forward. In general, there are two general issues that develop. The first is an objection to a faithless elector who votes differently than how his/her state voted. The aforementioned *Chiafalo v. Washington* precedent does allow states to implement penalties for doing such things, but [only 33 states](#) have such binding elector laws. So, it is possible that electors could thwart the will of the voters of their state. Members of Congress do have an opportunity to object but need a majority of both Houses to change or remove that vote.

The other issue is what we observed in 1876, where multiple certificates are sent to Washington. There are essentially three accepted outcomes. The first is to follow the safe harbor rule, which means that if a certificate is sent by six days before the electoral college meets (December 14 this year), then [that is what is counted](#). The second is to follow the certificate from the rightful issuer of such documents in that state, usually the secretary of state. In the third instance, when there is no determinant of who is the rightful issuer, then the majorities of both Houses must decide which one to accept (and they can choose to reject those votes). If there are no majorities, then the electors certified by the governor are accepted.

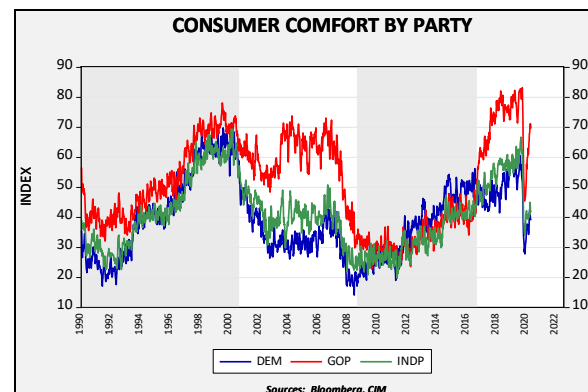
The Controversy

The first level of conflict will be at the state and local level. The American election process is far from precise. States are uneven in their treatment of voting, and no state has an unlimited budget for voting.

Lists of eligible voters are often in dispute. Voting facilities can be inadequate. A fair reading of history suggests there is always some element of skullduggery; at the same time, there is also the persistence of human error in place as well. Unfortunately, it is difficult to know with certainty what issue is caused by malice and what is caused by oversight. In a partisan environment, it is hard to tell the difference. But it is highly likely that partisans will blame simple mistakes as an attempt to steal the election.

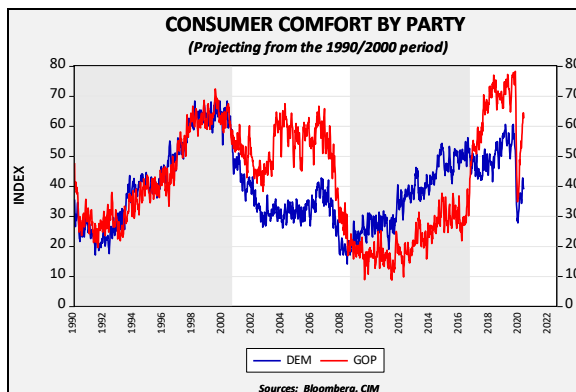
Both sides have been building legal teams and accusing each other's planning as evidence of nefarious activity. The [Transition Integrity Project](#) ran simulations that "gamed out" what could go wrong in the transition process. Although four of the eight members were Republicans, they were all considered to be opposed to President Trump. [Some have suggested this was a conspiracy](#) to pull the election away from the incumbent, although it was a conspiracy in broad daylight.

The country has been heading down this path for a while. Note the impact of party on consumer comfort.



This is weekly data starting in 1990; gray areas are when the Democrats occupied the White House. Although Republicans tend to have a higher level of consumer comfort, in general, the degree under different

administrations is stark. Republican comfort is clearly affected by the party in power; that was less evident in the 1990s. Meanwhile, under Obama, Democratic sentiment tended to exceed that of Republicans. To highlight this further, we regressed Democratic consumer comfort for the period under Bill Clinton, when the differences were not all that pronounced.



Note how much Democratic comfort rose relative to Republicans during the Obama era.

Given sharp partisan differences, accusations of irregularities are almost certain. The question is, will they impede a peaceful transfer of power? If voting is close in a few key states, [court challenges are likely](#). President Trump has not indicated he will accept a negative outcome, which is unusual. But it is hard to ascertain how much of this threat may simply be bluster.

Compare and Contrast

So, what does 1876 tell us? First, under conditions of high partisanship, the election will be tense. In our analysis of that earlier election, virtually every decision fell along party lines. This level of partisanship wasn't due to the candidates themselves. Neither one was a firebrand. Hayes's political career was partly based on being everyone's compromise candidate. Tilden was not

controversial either. That isn't the case in 2020. President Trump is especially divisive, although elements of the Democratic Party raise worries, too.

The 1876 election was held during a period of economic turmoil under the lingering effects of the Civil War. Although the U.S. is currently divided, it probably isn't at that level of division. At the same time, the 2020 election is being held under conditions of economic stress, similar to 1876. The major difference is that the government has countercyclical tools it can use to reduce the impact.

Second, even though the resolution fell on party lines, President Grant, as an outgoing incumbent, was something of a stabilizing figure. There were times when he threatened to send troops in to quell violence against Black Southerners and did help in setting up the special committee to resolve the vote issue. That figure is missing in this election, where the incumbent is fighting for another term. That circumstance complicates the way forward.

Third, although the outline we provided in this report does seem to be orderly, in reality, our legal system is based on precedents. In other words, the way we work out what the law means is by testing it in the courts. These procedures weren't legally tested in 1876 but could be now. We suspect the Supreme Court will do everything it can to avoid getting involved in order to avoid the taint of partisanship. But that outcome may be unavoidable.

Fourth, there was a bargain waiting in the 1876 election. Southern Democrats wanted to return to some semblance of the antebellum economy and wanted to be allowed to do so. The deal was reprehensible; it effectively reversed the

outcome of the Civil War, but it did prevent another Civil War. At this point, such a deal isn't obvious, but without one, barring a difficult-to-dispute outcome, conditions could become hard to manage.

In general, regardless of the result, somewhere between 40% to 45% of the population will be deeply disappointed with the outcome of the election. So far, no political figure has been able to unify the country in a manner that addresses these divisions. Until that figure emerges, the current divisions will continue to affect the political system and the economy. We doubt this election will resolve them.

The Geopolitics

If the worst case emerges, where there are two claimants to the White House and no obvious path to resolution, the question becomes: can either candidate act as commander in chief? What would our adversaries do?

China: Beijing is probably the most significant risk. It is not inconceivable that China may decide to forcibly retake Taiwan. The U.S. military would have to decide how to respond without clear leadership in Washington. The risk to China is that Japan may decide to act. China may not be able to fend off the combined forces of Japan and Taiwan. This action would be quite risky, but if President Xi is contemplating such a move, the timing would be attractive. A more likely response would be to step up island-building activities in the South China Sea.

Russia: Although Moscow probably doesn't want to absorb the problems of Belarus, President Putin clearly harbors ideas about rebuilding the Soviet Union. If he simply decided to invade, we doubt the West would stop him. A distracted U.S.

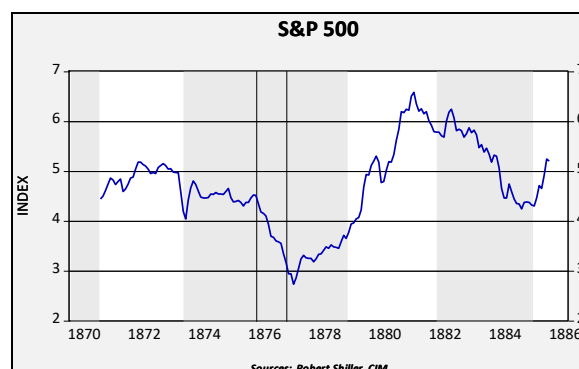
would almost invite an annexation of Belarus. Although it might be tempting to also absorb the Baltic States, that would involve NATO and might be more risk than Putin wants.

Turkey: How about Cyprus and all its oil and natural gas? Although the EU would protest loudly and Greece's military isn't a pushover, none of these would likely prevent such action. And, given that this contest would be within NATO, it isn't obvious how the organization would respond.

Iran: Although Iran might try to disrupt Persian Gulf shipping, about all that would do is harm its neighbors and drive up oil prices, but it wouldn't necessarily improve its situation. And, the U.S. Navy would likely meet any aggression, although without a president, retaliation would be less likely. Iran might make incursions into Iraq, but it tends to avoid such overt actions.

Ramifications

The disruption of presidential succession would likely be bearish for risk assets. However, investors must consider the context of such an outcome. In 1876, the impact on equities was significant.



This chart shows the S&P 500 during this period. The gray bars indicate recession. We have put vertical lines showing the period from March 1876 to March 1877. As

the election issues evolved, equities fell over 30% during this period. And, they didn't achieve the level from March 1876 for over three years. If an investor was anticipating a similar reaction, major portfolio adjustments would be recommended.

However, it is important to remember that countercyclical fiscal policy was unheard of and there was no U.S. central bank.

Financial markets were “on their own.” That isn't the case now. Although there would be no discretionary fiscal policy without a president, the Fed would likely act aggressively to counteract volatility. In other words, the worst-case outcome — an uncertain transfer of power — would likely lead to a selloff in stocks; the decline could be deep but probably would be short in duration. The problem isn't getting out, it is devising a plan to get back in.

The geopolitical complication is an additional risk factor. However, it should be noted that Russia was able to attack Georgia in 2008 and annex Crimea in 2014 without military retaliation. It is important to remember that the broader context is that the U.S. is reducing its hegemonic role, so adversaries can make incursions and get away with it as long as they don't affect what the U.S. views as core interests.

Accordingly, other than our usual allocation to gold and fixed income in less aggressive accounts, we are not recommending any special actions in front of this potential risk event. Prudent portfolio construction always has some element of diversification that protects from short-duration negative events. But, beyond that, we doubt it makes sense to apply special allocations.

Finally, the issue of a disputed election has moved from something only a few were discussing in March to being in the mainstream media. In general, surprises are what affects financial markets the most — an outcome that is mostly unexpected. These are, in a sense, “tail risks” — events that are unlikely but potent. Once an issue starts being discussed, financial markets tend to discount them, and the overall impact lessens. The Y2K situation is a classic example. We are less worried about a disputed election now because, for the most part, it is widely feared. That development likely reduces the potential effect.

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October 26, 2020

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