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ECONOMIC TALKING POINTS

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With The Election Over, A Deal To End The Fiscal Cliff Threat Is Now Likely

The excruciatingly long and often bitter presidential campaign is over – *finally*! That alone is worth uncorking Champagne bottles.

Yes, Barack Obama has secured a second presidential term. But overshadowing the celebration of Democrats and the electoral wounds of the GOP remains the reality that the country is another day closer to falling off the fiscal cliff.

Thus all eyes now shift to the lame duck session of Congress, which returns to work on November 13. **Their first order of business will be to prevent the US from slicing its own economic wrists.** With about 50 days left before the fiscal crunch begins, what happens in Washington in the coming weeks is crucial not just for the US, but also for Europe, Asia, Latin American --- indeed the global economy.

OK, what's next? With the election over, we believe much of the rancor and divisiveness that was so pervasive during the presidential campaign will diminish and set the stage for serious bi-partisan talks to postpone the fiscal cliff threat well into 2013. **In the final analysis, no politician of**

any worth will want to have blood on their hands for inducing another painful recession that ends up driving unemployment higher. Even the Federal Reserve has gone on record to warn Congress that the central bank will not be able to offset the economic shock that stems from the sudden sharp hike in taxes and federal spending cuts.

Our confidence is high that the two parties will find a pretext to change provisions in the Budget Control Act of 2011 that would cancel the $607 billion in tax increases and spending cuts beginning January 1, 2013.

What should business leaders and investors look for?

(1) We expect to see a meaningful shift in the political climate in Washington. Obama's low margin of victory in the popular vote shows how closely split the nation has become on economic and social issues. The President certainly cannot boldly proclaim a mandate from this election. At the same time, many Republicans now believe their party's sharp turn to the far right doomed their chance at victory.

What will follow in the coming weeks is a movement by key Democrats and Republicans to realign their parties away from the far left and far right, a process that should improve the political climate to tackle the tough issues of spending and budget deficits. If such bi-partisan talks to produce an agreement succeeds----even if it's just a preliminary framework to curb entitlement spending and raise tax revenues --- it would boost consumer and business confidence, increase spending, and encourage small and institutional investors to re-allocate their assets away from cash and into equities. That is, once the probability of a fiscal cliff plunge fades, we could see a cathartic release of resources by the once ultra-cautious private sector.

(2) Another reason we are optimistic is that history has shown that Presidents focus more on their legacy during their second term. Obama's first term has been largely characterized by acrimony, division and few genuine accomplishments. We believe Obama will now reach out to mainstream Republicans and show more flexibility, knowing such a move may be a prerequisite to further energize the economy, reduce joblessness, and to regain control of the nation's finances and debt. Step one will be to revisit Bowles – Simpson plan as a schematic guide to stop the fiscal bleeding. This implies a clear shift toward the political center for Obama, one that will undoubtedly upset his orthodox left base, but it's a price he will be willing to pay.

One other important dynamic here is Obama's political indebtedness to Bill Clinton. Clinton hopes his wife will make a run for the presidency four years from now. Hillary will be 69 in 2016 and she could well be victorious in a presidential run --- if--- President Obama can end his second term with a happier electorate. Thus, the next election may already be adding some gravitational pull that is moving the White House closer to the center.

(3) There will also be big changes to come from inside GOP. Moderate Republicans will blame the party's extreme right faction, including the Tea Party (which may now fade into history), for losing an election that should have been winnable. The uncompromising positions of the far right, the view that any deal with Obama should be condemned, and the often bizarre comments uttered on rape, women's health, immigration, and gay marriage have cost the GOP dearly. As a result, we see mainstream Republicans stage a revolt against the archconservative wing in an effort to reposition the party more toward the middle.

(4) With an Obama victory, the Federal Reserve will also continue its current accommodative stance and keep interest rates as low as possible across the entire maturity spectrum, so long as inflation expectations remain quiescent. Should Bernanke choose to step down early 2014, President Obama has several suitable candidates (Janet Yellin and Bill Dudley, for example) to head the Fed and keep in place Bernanke's overall strategy of increased transparency and low borrowing costs.

While today's sharp drop in the stock market does reflect real worry about the fiscal cliff, we view this anxiety as an opportunity to buy, not sell. Both the real economy and the stock market will be comforted by a continuation of current monetary policy as well as credible signs in the days ahead that the White House and Congress are making progress to avoid a fiscal cliff dive.