

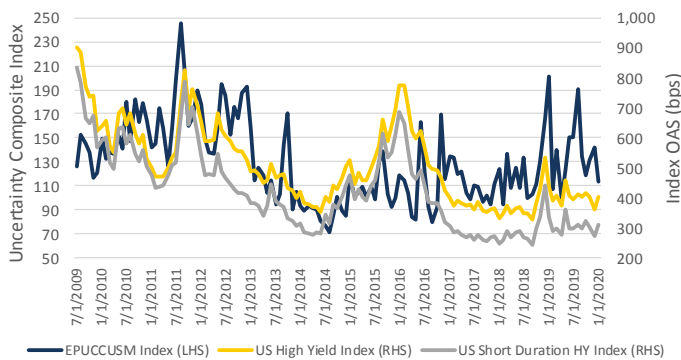
Weekly Briefing

SKYView: Iowa

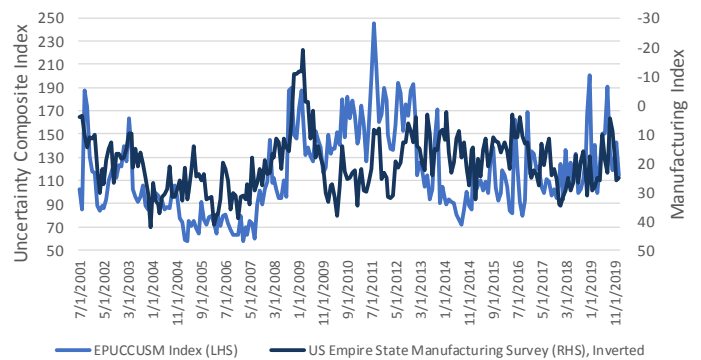
The Democratic primaries are now underway, with results out of the Iowa caucuses (nearly) complete. As mentioned in our *2020 US High Yield Outlook*, vast differences in politics and ideology between President Trump and the leading Democratic contenders are likely to provoke heightened interest in the election, as various measures of policy uncertainty can have meaningful impact on the pricing of risk assets. In this *Weekly Briefing*, we discuss the primary process, examine Iowa results and gauge the impact (if any) this first round of voting may have on the market.

Historically speaking, **changes in policy uncertainty tend to be positively correlated with US high yield spreads**, as demonstrated in the chart at left below. This dynamic makes sense intuitively – in general, when there is heightened uncertainty with regard to the source and direction of policy decisions, both consumers and businesses delay spending. The decline in spending, whether through a reduction in personal consumption or in business investment, ultimately leads to lower growth, as demonstrated in the right-hand chart below. As growth fades, risk assets are repriced, and declines in investment, output and employment can compound. For these reasons, the tracking of policy uncertainty is critical from an investment perspective.

US Economic Policy Uncertainty Composite Index vs. US High Yield
monthly data, current cycle (July '09 to Present)



Uncertainty Composite Index vs. Empire State Manufacturing Survey
monthly data, current cycle (July '09 to Present)

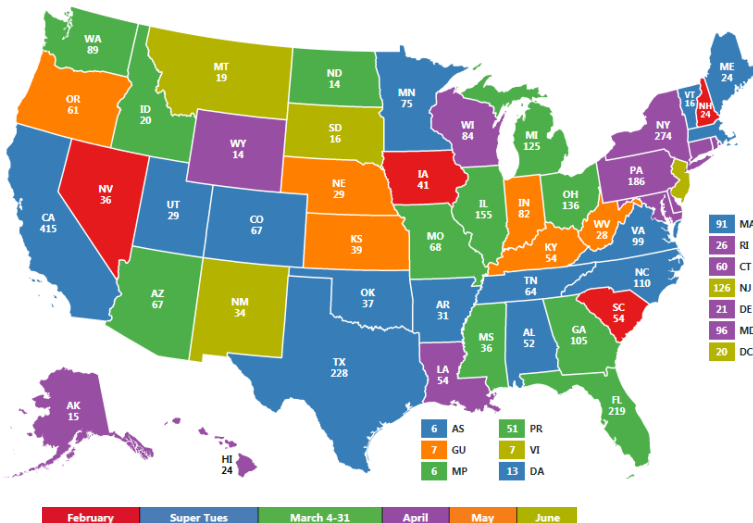


Source: SKY Harbor, ICE BofA Indices, Baker, Bloom, & Davis, Federal Reserve Bank of New York

Before proceeding, an incredibly brief primer on primaries. The election process begins with a series of primaries and caucuses, both of which serve to narrow the field of challengers for president down to one nominee per political party. President Trump is expected to win the Republican nomination without serious challenge. On the Democratic side, the outcome is still to be determined. In 2020, there are ~ 3,979 Democratic delegates up for grabs in their party's nominating process (allocated on a state-by-state basis), with a candidate needing at least 1,990 to win the nomination on the first ballot. Because a candidate must receive at least 15% of the vote in any contest to be awarded delegates, the process often accelerates campaign suspension for poor performers. Ultimately, **the Democratic party is seeking to identify the best candidate to run against President Trump in the 2020 general election** by the time their convention takes place this July. An overview of the delegates each state will send to the Democratic convention, along with a listing of early primaries/caucuses, is presented below.

2020 Democratic Delegate Map

available delegates



Source: SKY Harbor, 270twin.com, Predict It

Near-Term Contests

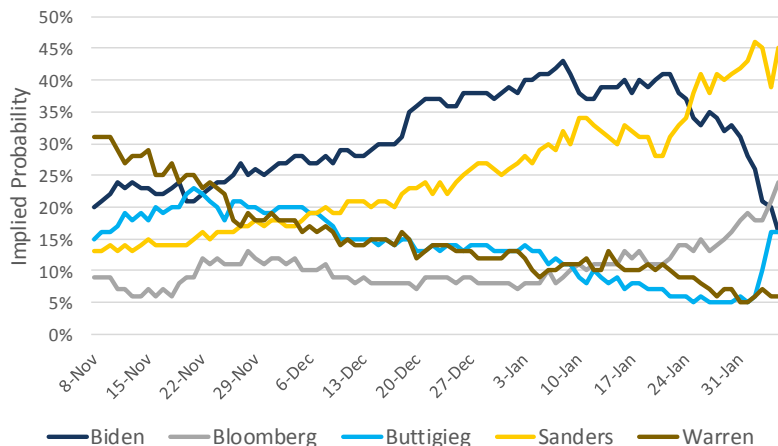
delegates up for grabs in the next month

| Date | State | Type | Favorite |
|-------------------|--|---------|--|
| Monday, Feb. 3 | Iowa | Caucus | Sanders |
| Tuesday, Feb. 11 | New Hampshire | Primary | Sanders |
| Saturday, Feb. 22 | Nevada | Caucus | Sanders |
| Saturday, Feb. 29 | South Carolina | Primary | Biden |
| Tuesday, Mar. 3 | "Super Tuesday" (Alabama, Arkansas, California, Colorado, Maine, Massachusetts, Minnesota, N. Carolina, Oklahoma, Tennessee, Texas, Utah, Vermont, and Virginia) | Primary | depends on state, but Bloomberg has campaigned heavily |

At the time of writing this piece, ~97% of Iowa Democratic caucus votes had been counted: Mayor Pete Buttigieg is narrowly ahead of Senator Bernie Sanders. Vice President Joe Biden appears to have performed below expectations, receiving fewer votes than Senator Elizabeth Warren and finishing fourth overall. While certainly early in the process (Iowa is the first caucus and has few delegates), most pundits believe **these results imply a prolonging of the primary process**. A win by one of the leading contenders (Sanders or Biden) could have narrowed the field more quickly, shortening an often expensive and contentious process and allowing the presumptive nominee to focus time and resources on the general election. Instead, Buttigieg, once thought to be a longshot, is likely to carry some momentum into New Hampshire and Nevada, increasing uncertainty in what had been assumed to be a three-way race (Biden, Sanders, and Bloomberg) by capturing some of the moderate vote.

Market Implied Probabilities for Democratic Nominee Have Shifted...

daily data, trailing 3 months



Source: SKY Harbor, Predict It, The Associated Press

Buttigieg (Likely) Upset Winner in Iowa

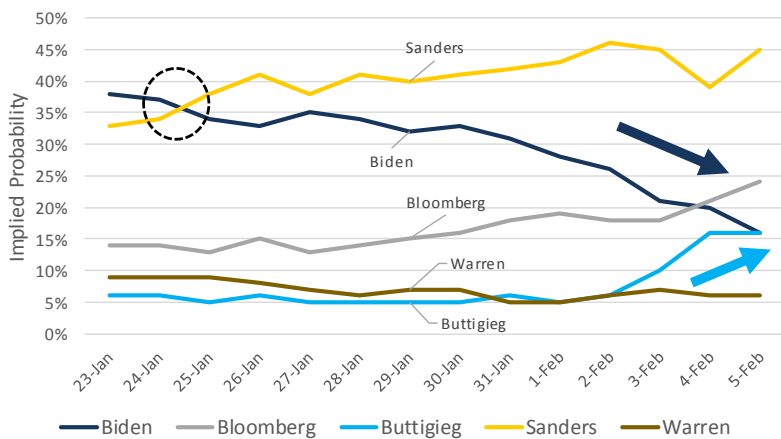
polling data as of 3:03pm Feb 6 (96% reporting)

| Candidate | Delegates | Vote % |
|-------------------|-----------|--------|
| Pete Buttigieg | 11 | 26.2% |
| Bernie Sanders | 11 | 26.1% |
| Elizabeth Warren | 5 | 18.2% |
| Joe Biden | 0 | 15.8% |
| Amy Klobuchar | 0 | 12.2% |
| Andrew Yang | 0 | 1.0% |
| Michael Bloomberg | 0 | 0.0% |
| Other | 0 | 0.5% |

Prediction markets also highlight material changes in the Democratic race over the last week. Buttigieg is on the rise and carrying momentum while Biden has tumbled from favorite (until Jan. 25) to a tie for fourth. Sanders, according to implied probabilities, is now the frontrunner, and has increased his lead over the field. At the same time, **policy uncertainty appears to have partially receded**. A rise in President Trump's approval rating to 49%, the highest of his career¹, has coincided with victories on the trade front, a stabilizing economy and exoneration from impeachment. Coupled with a reshuffling of Democratic contenders, Trump's chances of re-election appear to have improved given superior head-to-head polling projections against Sanders and Buttigieg (candidates on the rise) while Biden (perceived to be Trump's toughest competition) fades.

Buttigieg Rising, Biden Falling, Sanders Favorite Post Iowa

daily data, last 2 weeks



Source: SKY Harbor, Predict It, RealClearPolitics (RCP)

General Election Polls: Head to Head

RCP Average, Jan 15-Jan 20 (most recent)

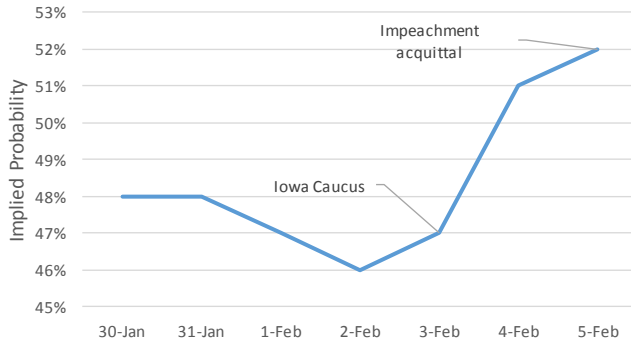
| Race | Favorite | Spread |
|---------------------|----------|--------|
| Trump vs. Biden | Biden | +5.4 |
| Trump vs. Sanders | Sanders | +3.7 |
| Trump vs. Buttigieg | Trump | +0.3 |

Tax policy uncertainty, which is perhaps the most relevant issue with regard to market sentiment, appears unchanged. Sanders, the Democratic frontrunner, supports a comparatively onerous tax plan relative to President Trump, which on the surface would portend heightened levels of economic uncertainty. The legislative branch, however, is likely to drive any changes in tax policy in the coming years. Current polls (included below) show a strong likelihood for Democrats and Republicans to maintain control of the House and Senate, respectively. Under this scenario, which would preclude a unified government regardless of who sits in the White House, **sweeping changes to tax policy appear unlikely**.

¹ Jones, Jeffrey (2020, February 4). Trump Job Approval at Personal Best 49%, Retrieved from <https://news.gallup.com/poll/284156/trump-job-approval-personal-best.aspx>

Prediction Market Probability of Trump Winning

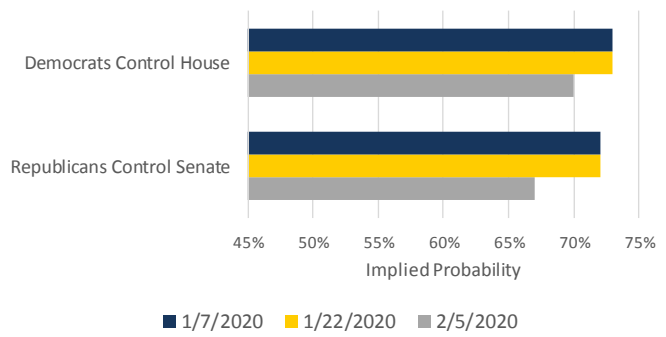
daily data, last 7 days



Source: SKY Harbor, Predict It

Control of Congress

point in time polling



In conclusion, we remain cognizant that trends in economic policy uncertainty can impact the directionality of high yield spreads. Despite surprises in Iowa, policy uncertainty measures actually appear to have somewhat receded, as the combination of Trump’s rising approval rating and more favorable head-to-head matchups in a general election (Biden, now on the decline, polls as a more difficult competitor than Sanders or Buttigieg, who are on the rise) tipped his likelihood of securing a second term above 50% in prediction markets. While these events support the risk-on sentiment that has prevailed thus far in February, we would caution that the road to the Democratic National Convention is likely to be fraught with twists and turns, and liable to present investment opportunities along the way.

On the Calendar

Occurred

| Event | Release Date | Period | Survey | Actual | Prior |
|------------------------------|--------------|--------|--------|--------|-------|
| Durable Goods Orders | 28-Jan-20 | Dec | 0.3% | -2.4% | -2.1% |
| Conf. Board Consumer Confid. | 28-Jan-20 | Jan | 128.0 | 131.6 | 126.5 |
| FOMC Rate Decision (upper) | 29-Jan-20 | 29-Jan | 1.75% | 1.75% | 1.75% |

Source: SKY Harbor, Bloomberg

Upcoming

| Event | Release Date | Period | Survey | Actual | Prior |
|--------------------------|--------------|--------|--------|--------|-------|
| CPI MoM | 13-Feb-20 | Jan | 0.2% | | 0.2% |
| Import Price Index MoM | 14-Feb-20 | Jan | -0.2% | | 0.3% |
| Retail Sales Advance MoM | 14-Feb-20 | Jan | 0.3% | | 0.3% |

Recommended Reading

Jones, Jeffrey (2020, February 4). Trump Job Approval at Personal Best 49%. *Gallup*, Retrieved from <https://news.gallup.com/poll/284156/trump-job-approval-personal-best.aspx>

Wei, Lingling (2020, February 6). China to Cut Tariffs on \$75 Billion of US Goods. *The Wall Street Journal (subs. req.)*, Retrieved from <https://www.wsj.com/articles/china-to-cut-tariffs-on-75-billion-of-u-s-goods-11580967540>

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