

Here are the election excerpts from our last two letters. They are 2-3 pages each in twenty page letters and meant more to provoke thought on the possible than to argue for the probable. Hopefully ends up as academic fun more than anything.

### **2Q20 Quarterly Letter**

There are also political risks under the surface. We're not talking of the potential that a Democratic sweep in the US presidential and congressional elections could usher in the higher taxes and added regulations that markets fear. That's run-of-the-mill election risk. We're concerned that the toxic brew of unsurpassed polarization combined with the pandemic and recession could lead to a full-blown constitutional crisis around the election.

As we write, Joe Biden, the presumptive Democratic Party nominee, has a comfortable lead over President Trump. What Trump himself might not yet know, however, is that nowhere in the US Constitution does it require the president to be popularly elected. Instead Article II Section 1 provides every state with electoral votes equal to the number of senators and representatives they send to Washington. To win the election, a presidential candidate must capture a majority, or 270, of these 538 electoral votes. This is how Trump won the presidency in 2016 despite losing the popular election by 3 million votes.

Now here's where it gets interesting. The Constitution leaves it to the state legislatures to determine how the electoral votes allocated to each state are chosen. Since 1876, all states have used a popular vote to appoint electors. That's why Americans tend to believe they have a right to vote for president. But it doesn't have to be that way. Assume for a moment that COVID has worsened into the fall and Trump is still trailing in the polls. Might the President ask states with Republican controlled legislatures to skip an election and award the electoral votes directly to him? After all, they could argue, the exigencies of the pandemic make voting in person far too dangerous. We're already seeing the groundwork for this in the President's consistent attack on the fairness of mail-in voting.<sup>1</sup>

There are 302 electoral votes from states with Republican legislatures. Eighty-six of those are from states with Democratic governors. And since every state has a law-making process that requires both legislative and gubernatorial sign off on new statutes, it would seem unlikely that the scheme could work. But the wording in the Constitution is highly specific: "Each State shall appoint, in such Manner as the *Legislature thereof may direct*, a Number of Electors." No mention of state law or of governors. The legislatures alone can textually act! Pennsylvania, Florida, Wisconsin, Michigan, Arizona—all swing states and all with Republican controlled legislatures. Might our troubled political times combined with the pandemic be ripe for this type of constitutional fire-alarm?

And things won't need to reach that crisis pitch to upset markets. What if the election turns on a state that used mail-in voting for the first time? Or if one candidate has a commanding lead on election night that then evaporates as an unprecedented number of absentee ballots are calculated? In Pennsylvania, for example, Donald Trump's final 2016 win in the state—the first for a Republican since 1988—was 23,000 less than what was initially tallied on election night. If it happens again and shifts the outcome, might there be a legitimacy argument that creates enormous uncertainty? Already we see that in minor elections, such as the Democratic Senate primary in Kentucky, the aggrieved losers are claiming election

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<sup>1</sup> See <https://twitter.com/i/events/1265330601034256384?lang=en>

fraud. The 2020 election has set a record for litigation and it is only July!<sup>2</sup> This is what happens when there is polarization in a post-truth era.

Historically, markets go on pause in the summer of an election year, as the uncertainty over the vote dampens the animal spirits. Once the tally is in, markets tend to rally to catch up from the quarter of uncertainty. Even in 2000, when the Supreme Court finally decided *Bush v. Gore* on December 12, markets held in because the candidates were considered so close on policy that Ralph Nader was able to mount a viable third-party candidacy. In today's clime of radically opposed policy agendas on everything from regulation to taxes to allies, a constitutional crisis on succession, or even prolonged doubt, would make it very hard for business as usual.

*As a postscript, on Oct 25 the Supreme Court [rejected](#) a Democratic attempt to allow mail-in votes, postmarked by Election Day, to be received up to six days after the election in Wisconsin. In concurrence, Justice Kavanaugh went farther to highlight the special role the Constitution grants state legislatures, in contrast to other branches of state government, in presidential elections. This, he says, means that state courts have a more limited role than usual in interpreting state election statutes. Some commentators are now realizing that this paves the way for the Supreme Court to step in early and prioritize the views of the legislature over the governor or the courts. How would Kavanaugh rule if the PA Governor and Legislature have a dispute about which slate of electors is official? Here is the full Kavanaugh footnote*

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<sup>2</sup> See <https://www.nytimes.com/2020/07/07/us/2020-election-laws.html>

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<sup>1</sup> A federal court's alteration of state election laws such as Wisconsin's differs in some respects from a state court's (or state agency's) alteration of state election laws. That said, under the U. S. Constitution, the state courts do not have a blank check to rewrite state election laws for federal elections. Article II expressly provides that the rules for Presidential elections are established by the States "in such Manner as the Legislature thereof may direct." §1, cl. 2 (emphasis added). The text of Article II means that "the clearly expressed intent of the legislature must prevail" and that a state court may not depart from the state election code enacted by the legislature. *Bush v. Gore*, 531 U. S. 98, 120 (2000) (Rehnquist, C. J., concurring); see *Bush v. Palm Beach County Canvassing Bd.*, 531 U. S. 70, 76–78 (2000) (*per curiam*); *McPherson v. Blacker*, 146 U. S. 1, 25 (1892). In a Presidential election, in other words, a state court's "significant departure from the legislative scheme for appointing Presidential electors presents a federal constitutional question." *Bush v. Gore*, 531 U. S., at 113 (Rehnquist, C. J., concurring). As Chief Justice Rehnquist explained in *Bush v. Gore*, the important federal judicial role in reviewing state-court decisions about state law in a federal Presidential election "does not imply a disrespect for state courts but rather a respect for the constitutionally prescribed role of state legislatures. To attach definitive weight to the pronouncement of a state court, when the very question at issue is whether the court has actually departed from the statutory meaning, would be to abdicate our responsibility to enforce the explicit requirements of Article II." *Id.*, at 115.

The dissent here questions why the federal courts would have a role in that kind of case. *Post*, at 11, n. 6 (opinion of KAGAN, J.). The answer to that question, as the unanimous Court stated in *Bush v. Palm Beach County Canvassing Bd.*, and as Chief Justice Rehnquist persuasively explained in *Bush v. Gore*, is that the text of the Constitution requires federal courts to ensure that state courts do not rewrite state election laws.

### **3Q20 Quarterly Letter**

September also witnessed the unusual continuation of the summer liquidity doldrums. We think this has something to do with the impending election, even if the slowdown doesn't usually start until October. Of course, this is no normal election. We talked last quarter about some of the extraordinary measures that could be taken, within the confines of the words of the Constitution, to change the normative way elections are won. Our warning that Trump might seek to upend the popular vote and ask Republican state legislatures in swing states to pass their own slate of electors is now a mainstream concern and apparently under consideration by the President's campaign.<sup>3</sup> We take no pride in having been amongst the first to tell you (maybe a bit), but it's also not the only source of potential post-election intrigue.

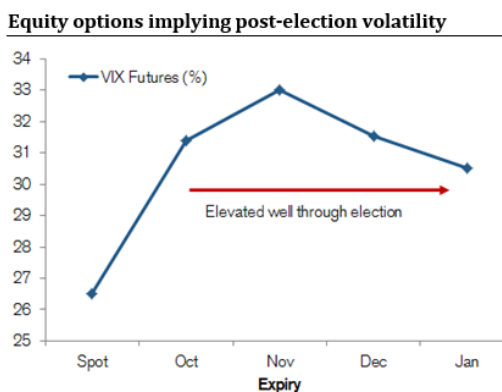
Imagine that litigation over the counting of votes creates such doubt over the outcome in some states that nothing has been settled by December 14, 2020, the date, by statute,<sup>4</sup> that electors must meet and send their tallies to Washington. In that case, the statute clearly allows the legislature of the questioned state—mimicking the Constitution's language—to choose a new slate of electors. But in states with Republican legislatures and Democratic governors, such as Wisconsin, North Carolina, Pennsylvania, and Michigan, this too would lead to litigation, leaving no clear winners. It could all come to a head on January

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<sup>3</sup>See, e.g., <https://www.vanityfair.com/news/2020/09/trump-campaign-election-coup-bypass-biden-win> and <https://fivethirtyeight.com/features/what-if-trump-loses-and-wont-leave/>

<sup>4</sup> See 3 U.S.C. §12, 13

6, 2021 when the newly elected Congress, people on the ballot alongside the presidential candidates on November 3, is supposed to count the electoral votes. If there are not 270 free-and-clear votes for any candidate, then the newly elected House of Representatives would choose a president. Easy enough, you'd think, as the House is controlled by Democrats and will likely not change this election. But not so. The House's vote for president would not be the standard one-member one-vote process by which they pass laws. Instead to win, per the 12<sup>th</sup> Amendment, a candidate would need a majority of state delegations, each state having conducted its own mini-election amongst its Representatives. In the current House, the Democrats have a large majority of members but Republicans control 26 states, Democrats 22, and two—Michigan and Pennsylvania (of course)—are tied. If litigation over the presidency denies us a winner, then it could come down to litigation over single House seats in states with close partisan splits to determine the election, the first, by the way, in the House since 1876. Electoral uncertainty after November 3<sup>rd</sup> is now a consensus view, with equity option markets implying prolonged volatility post-election. But it isn't clear that the market realizes that we could be dealing with dozens of lawsuits challenging not the presidential directly, but the congressional elections in individual House districts that could turn the entire state delegation vote and hence the presidential victor. This would be a free-for-all with newsflow shifting directions by the hour as the multiple cases move through state and federal courts. And people say markets hate uncertainty....



We have no edge on predicting how this would play out. We prepare with unconcentrated, fairly liquid books in both the Master and Dislocation funds and with watchlists of actionable names that continue to grow. Diameter always wants to play offense in a crisis, like we did in March. But if this is the first election with doubt as to whether the two sides will accept the result since Thomas Jefferson bested John Adams in 1800, then we think that a troubled transition could be the least of our problems. Over the last three decades, the American federal government has comfortably seesawed from extremes. We had the sloppiness and tax increases of Bill Clinton followed directly by the sobriety and supply side approach of George W. Bush. Barack Obama then campaigned and governed as a repudiation of nearly all of Bush's policies and then watched Trump return the favor, with a near opposite temperament. These elections were often close, spirited, and in the case of Bush, decided by the Supreme Court. So you might be thinking that if the country flip-flops again from Trump to Biden, even in a contested manner, that markets and the society will be fine, having experienced the sweeping regulatory, tax, and judicial changes in previous party switches.

Much has been changing, however, below the surface in American politics. American political parties used to be loose coalitions of overlapping personal identities. Catholics and Jews were usually Democrats,

no matter if they were secular or religious, workers or managers. There were northern Republican liberals and southern Democratic conservatives. If you were black in the south and could vote, you were likely with the Republicans, the party of Lincoln, even if you were a union member. The old divides from the civil war mapped out over the political coalitions in such an uneven manner that when Gerald Ford ran against Jimmy Carter in 1976, only half of electorate thought the Republican party was more conservative than the Democrats.<sup>5</sup> Thirty-percent told pollsters there was zero ideological differences between the parties. When your party lost it wasn't a repudiation of your personal identity because usually people had ways to associate with each side and the policy outcomes weren't that variable.

Today that's all flipped on its head. In fact, modern independents vote more predictably than party partisans did 40 years ago,<sup>6</sup> which is part of the great identity and party sorting that has taken place over the last decades. As explained by Ezra Klein in his book on the subject, aptly named, *Why We're Polarized*

Today, the parties are sharply split across racial, religious, geographic, cultural, and psychological lines. There are many, many powerful identities lurking in that list, and they are fusing together, stacking atop one another, so a conflict or threat that activates one activates all. And since these mega-identities stretch across so many aspects of our society, they are constantly being activated, and that means they are constantly being reinforced.

Why go into all this? Because it can be reassuring to look back to previous elections to assume that the market can ride through any political disturbances. After all, it took only a few hours for things to rally after Trump was elected, despite uniform concern before the vote about what his presidency would mean for markets. In 2000, there was no certainty of outcome from election day through the Supreme Court's decision in *Bush v. Gore* in early December, but the market only retreated 4%. ***We think that the base case has to be a normal election and a muted response to any turbulence. What matters for the markets is economic growth and the key determinants of that in the near-term will be the efficacy of the vaccine and the extension of stimulus.*** We think both are likely. But the point is that amidst a pandemic and recessions we're also in sharply different political and social waters than we've been any time in modern history. And past performance is no indication of future results.

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<sup>5</sup> [http://www.hoover.org/sites/default/files/research/docs/fiorina\\_party\\_sorting\\_and\\_democratic\\_politics\\_4.pdf](http://www.hoover.org/sites/default/files/research/docs/fiorina_party_sorting_and_democratic_politics_4.pdf)

<sup>6</sup> <https://onlinelibrary.wiley.com/doi/full/10.1111/ajps.12218>