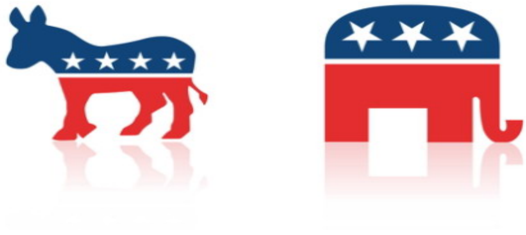
INVESTMENT NOTE

November 2012

Gridlock – Echoes of 2008

The US political stand-off will weigh on sentiment.

The S&P 500 index fell over 3.5% in two trading sessions in response to Obama's election victory. Primarily, this is due to concern that the stand-off between Democrats and Republicans threatens to send the US into another recession if a compromise cannot be reached over a looming round of tax hikes and spending cuts – the now famous fiscal cliff.



It's also worth remembering that the market reacted badly with a 5% sell-off the first time Obama was elected President in 2008, although that was in the midst of a crisis of different colour and nobody was quite sure what a new left-leaning President would do about it. Indeed, as we wrote at the time, there would be no quick fixes and it's unlikely to be any different this time around, particularly as the fiscal cliff is not the only issue to consider as the eurozone will now bubble to the surface again and things are lining up ominously in China, Syria and Iran.

Obama's comprehensive victory has left Romney and the Republican camp somewhat reeling and, as they reflect on what went wrong, it's perhaps understandable that they are in no mood for compromising on issues where they still feel they have given ground but where Obama hasn't budged. The election has also left the Republicans in control of the House of Representatives. In their view, this justifies the belief that the electorate has mandated them to hold a firm position on refusing to agree to an ending of the Bush-era tax cuts for those earning in excess of $250,000 per year.

One of the main thrusts of the Obama campaign was that taxes should rise for the rich. However, the exact level that he was targeting was never clarified beyond some rhetoric over private jets ownership – well beyond the $250,000 p.a. tax bracket. And so we believe there is elbow room on this issue and Obama even alluded to this in his victory speech with conciliatory overtones. This was, in tone, reciprocated in Romney's speech calling for "hands across the aisle" in the interests of the people and the economy.

In addition, the ball is now in Obama's court and he will be wary of starting a second term facing the prospect of a 4%+ fall in GDP as a result of a failure to agree a deal on the fiscal cliff. He will also be conscious that the longer the stand-off continues, the greater the danger that a rating agency, Moody's in particular, could downgrade the US credit rating citing a failure to "agree policies leading to debt stabilisation".

Until a deal is done, we accept that the risk to the economy and the bond market is real. But this was the case long before the election and not new news. Indeed, the situation with Obama in power but lacking the majority of upper house, and unable to easily carry policy, remains unchanged. However, the market is not in the mood for a repeat of last year's last minute deal on the "Debt ceiling". Complacency or a stubbornness to delay an agreement on the fiscal cliff will be punished by markets demanding clarity at a time when there is plenty else to worry about in the world. It could be a more volatile run in to year-end but we do not believe that Obama is going to risk a huge failure for his legacy by not striking a deal – how ever his brinkmanship plays out. We believe that the equity bulls will see yesterday's fall as an opportunity to add to portfolios; a belief and optimism that is shared by the TAM investment team.

For Further Information Contact:
TAM International Limited
7th Floor, Wing B, Cyber Tower
Ebene, Mauritius
Tel: (+230) 454 6400
Fax:(+230) 454 5413