The Art of the Compromise: Washington Still Doesn’t Get It, and What That Means for Your Portfolio

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“Let us not seek the Republican answer or the Democratic answer, but the right answer. Let us not seek to fix the blame for the past. Let us accept our own responsibility for the future.”
— President John F. Kennedy

Some of life’s most powerful lessons are learned in childhood. That’s what makes the All I Really Need to Know I Learned in Kindergarten philosophy so relatable. Perhaps the toughest childhood lesson is that you can’t always get your own way. In the classroom, on the playing field, at work and with our families, we all have to give a little to get a little — you know, compromise. Apparently, the roughly 560 men and women who represent the US government in President Trump’s cabinet, US Senate and US House of Representatives never went to kindergarten! It’s hard to believe, but compromise has become a dirty word, perhaps the dirtiest word in all of Washington, D.C.

Mind the Gap

Before you put down your reading glasses and moan about yet another Trump-bashing article, please, I implore you to keep reading. Criticizing Trump and the Republican controlled Congress for their early missteps has become far too easy. While exploring that angle would likely bring great pleasure to some readers, it would infuriate others. And, that’s exactly the point. Yes, we know that compromise is necessary in all aspects of our daily life, a critical component to getting things done. Yet, when it comes to modern American politics, far too many of us — politicians and voters alike — refuse to compromise. And that shortcoming has our government hopelessly gridlocked.

Today, members of the House Freedom Caucus and liberal progressives, as well as politicians from Donald Trump to senators like Ted Cruz, Elizabeth Warren and Bernie Sanders seem to believe their strongest and most invested supporters don’t want them to compromise. The farther to the left or the right the politician, the more they wear never wavering as a badge of honor. Of course, this approach angers more moderate Americans who want their government to come together, compromise and tackle some very difficult problems and create sensible bipartisan solutions — more affordable healthcare, simpler taxes, responsible government spending and a thoughtful immigration policy.

Unfortunately, at a time when these substantial challenges demand that we work together, the nation appears acutely uninterested in bridging an increasingly wide political divide. (See Figure 1.) This situation isn’t a Trump problem, a Republican problem or a Democratic problem — it’s our country’s greatest challenge. Should Republicans and Democrats continue to fail to reach bipartisan agreements, expect an increasingly polarized political climate to lead to big changes in the 2018 midterm elections.

Figure 1: The Partisan Conflict Index Shows Political Disagreement on the Rise

Source: Bloomberg Finance LP as of 04/12/2017

The Partisan Conflict Index tracks the degree of political disagreement among US politicians at the federal level by measuring the frequency of newspaper articles reporting disagreement in a given month. Higher index values indicate greater conflict among political parties, Congress and the president.
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We’re in Control...What Could Go Wrong?

The new administration’s first 100 days have not gone as planned, but when the GOP won the presidential election and swept both houses of Congress, moderate Republicans figured they would easily control the legislative agenda. Of course, the illusion of control is one of the most potent and potentially dangerous cognitive biases. Under its powerful spell, we believe that we have complete control over the outcomes of situations that are decidedly out of our control. In our investments, this might lead us to over-invest in our company stock. On the family stage, helicopter parents expect that they can shape their children like blocks of clay. You get the picture; an unchecked illusion of control can lead to frustration and pain.

Today in Washington, the control bias combined with a disdain for seeking the middle ground is compromising the Republicans’ ability to push their agenda forward. Speaker of the House Paul Ryan certainly underestimated the deep intra-party divisions between his supporters and the ultra-conservative House Freedom Caucus who ultimately derailed the American Health Care Act (AHCA). The White House also has had to contend with plenty of personality clashes and palace intrigue. Reports continue to claim that Trump is frustrated by infighting among his staff. In fact, his chief strategist Stephen Bannon and son-in-law Jared Kushner met recently to “bury the hatchet” and pledge to work together.1

Judicial checks and balances have also chipped away at the Republicans’ winner-take-all power play. In mid-March, federal judges from Hawaii and Maryland issued a nationwide preliminary injunction prohibiting the enforcement of Trump’s 90-day ban against travelers from six mostly Muslim countries. This was the administration’s second failed attempt at enacting a temporary travel ban via executive order. And these “ham-handed immigration policy efforts,” to quote Ohio Governor John Kasich,2 have only served to make an already controversial issue more divisive, adding unnecessary fuel to the immigration policy fire and creating more gridlock.

To claw back a measure of control, after failing in early April to gather the 60 votes needed to overcome a Democrat-led filibuster, the Republican Senate voted to invoke the “nuclear option.” This bypassed the usual procedural mechanism and gained Neil Gorsuch’s confirmation to the Supreme Court. Not surprisingly, Senators voted straight down party lines on the rule change. Under the new rules Supreme Court nominees now require only a simple 51-vote majority. And although Democrats are squealing that the unjust new rule will mean an end to the Republic, remember that the Democrats first opened Pandora’s box in 2013 by voting to end filibusters for most presidential nominees, excluding those for the Supreme Court.

Voters Have a Nuclear Option, Too

In a quest for the right combination of elected officials to join forces to tackle America’s toughest problems, Americans have cast their voting net far and wide. As Figure 2 illustrates, since George W. Bush was elected president in November 2000, American voters have tried almost every conceivable combination of Republicans and Democrats to govern and achieve their goals.

In 2008, we elected Barack Obama, a young, charismatic Washington outsider with a “Yes, we can” agenda for change. After eight difficult years with a divided Washington that never quite lived up to the campaign hype, the movable middle, hungry for compromise and progress, searched in more distant corners of the political spectrum for leadership. This cleared an unexpected path for Bernie Sanders and Donald Trump. And, after early laughter from the political establishment, both did much better than expected. Yet, despite their naïve vanity, the ascendance of Sanders and Trump was much less about the exhaustion with gridlock and desire for real change.

Unfortunately, voters still haven’t gotten what they so desperately seek — a functioning two-party system that can compromise on solutions. And, as Figure 3 illustrates, our approval of the work Congress is doing is at a historic low. These dismal performance ratings should serve as a Trumpian warning to politicians and voters: If you are unable to cross the aisle and find solutions, you will be fired! The voters’ nuclear option is a simple one — end the gridlock or we will end your term.

Clearly, the appetite for real change is intensifying. And the emergence of factions like the House Freedom Caucus, moderate Republicans and progressive and moderate Democrats certainly threatens to end our two-party system.
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An article in The Economist recently described our two-party system as “tired, disunited and out of touch,” noting that if members of Congress were willing to learn the rules of coalition politics (as practiced in other countries) “an optimist might see opportunities for creative politicians to develop fresh alliances and solve some intractable policy puzzles.” However, thus far, few seem interested in learning a new game unless the first rule is “I always get what I want.”

Back to Kindergarten for Circle Time?

Perhaps a kindergarten refresher for our elected officials might inspire them to compromise and create solutions to America’s toughest problems! Listening too much to their most passionate and extreme supporters, politicians on both sides of the aisle are missing an opportunity to lead the movable middle forward with a progressive agenda. To deliver what America wants — better and more affordable healthcare, simpler taxes, less red-tape and tough but fair immigration policy — politicians need to turn down the noise from the extremes and tune in to a broader base with their best listening skills. It’s time to stop Republican and Democrat intra-party divisions and bipartisan attacks. It’s time to stop putting up obstacles to progress and begin tearing them down through thoughtful compromise.

Again, we all know that getting anything done in our own lives requires a healthy dose of compromise. However, for far too long US politicians, empowered by their most ardent supporters, have basked in a harmful pride over their ability to be uncompromising. Now, painfully tired of gridlock, voters are beginning to insist that our elected representatives operate differently. And the tide may be turning. House Speaker Paul Ryan, looking defeated and discouraged after pulling the AHCA vote, acknowledged that the healthcare failure “does make tax reform more difficult.” For his part, Trump told The New York Times he is considering attaching his $1 trillion infrastructure plan to a tax reform bill, because infrastructure is “so popular” among Democrats.

Without adjustments like this resulting in compromise, expect the extreme fringe of each party to amplify its message and for future political candidates to emerge from even further out of left field. I’m fearful that if a hardline trajectory continues, we will see major changes in the 2018 midterm elections. That will comfort some and upset others. Either way, as we continue to search for politicians willing to compromise, the nation’s challenges are getting bigger, not smaller.

What About Your Portfolio?

I attribute about one-third of the post-election equity market rally to Trump’s campaign promises for stimulus spending, deregulation and tax reform. While these policies have yet to be detailed, once they are, the administration has upwards of 500 staffers who will work primarily to push Trump’s plans for better healthcare, lower taxes and deregulation forward. For historical context, Franklin D. Roosevelt had just 6 staffers! If they can help achieve compromises, risk assets such as stocks may continue to rally and the bull market will endure. Compromises in Washington may mean the Trump reflation trade gets reinvigorated with higher growth and rising rates and inflation.

On the other hand, if gridlock persists or gets worse, we likely will see continued sluggish economic growth, rising inequality and greater debt. Washington’s failure to compromise will lead voters to keep searching for new leaders. And with slow growth, low rates and benign inflation, the stable, defensive, income-oriented trade may come back in vogue.

Until we get clear signals from D.C., our New Abnormal investment playbook is likely the best option. Seek income opportunities beyond traditional sources, ensuring the yield is worth the risk. Consider investments in real assets to make portfolios more resilient to any growing risk of inflation. And look to mitigate headwinds from episodic volatility with an allocation to gold and lower risk multi-factor smart beta strategies.

What else can you do? If you are not registered to vote, register. Stay informed on the issues and vote in local and national elections. And, above all, hold our representatives accountable for working together to solve the nation’s problems.


