

A MIDTERM ROUT RESUSCITATES THE GOP

Not all votes have been counted, but the election outcome is clear. Washington will be a much more conservative place in 2011 than it was in 2010, and the President is forewarned he is in deep political trouble before he faces the voters in 2012. For now, Obama has lost the American people. Fifty-four percent told the Gallup poll in mid-October that he does not deserve to be re-elected. A CNN poll has found that both Mitt Romney and Mike Huckabee would defeat Barack Obama if the election were held today <http://www.cnn.com/ELECTION/2010/pollcenter/>. It could not improve the President's mood that Republicans also captured his old Illinois Senate seat, and took over four Illinois House seats as well on Tuesday, despite his three personal appearances during election season to prevent it. While the GOP gained House seats in 35 states, they did especially well in the three considered pivotal for winning presidential elections – winning 14 seats in Pennsylvania, Ohio, and Florida.

Republican control of the House of Representatives is bad news for two sectors – managed care and the largest banks. CAN's investment recommendations follow our discussion of Election 2010.

The House of Representatives Forecast: Red For at Least Four Years

The voters have spoken, and a majority cast ballots for Republican candidates for the House. Since voters must renew the mandates of all 435 House members every two years, they expressed their ire by handing a President his worst mid-term rout since 1938. Republicans took 67 seats from Democrats two days ago, and lost only 3 to them. With a few races still too close to call, the GOP House majority for the 112th Congress is expected to be 243-192, the largest since 1947 when Republicans held 246 seats in the 80th Congress. So far, Republicans definitely have picked up 22 seats in the Midwest, 22 seats in the South, 14 in the Northeast, and 8 in the West. In ordinary years, Democrats would need to take back 26 seats in 2012 to reclaim the House. This is always possible, but the task is harder than it appears. Due to “redistricting” and “reapportionment,” however, the de facto Democratic hurdle will be 43 seats, not 26.

After every census, the Constitution requires states to redraw their internal boundaries so that every congressional district has an equal number of citizens. With few exceptions, governors and state legislatures draw these lines, and when the same party controls both branches, partisan gerrymanders are the result of such redistricting. After governor and state legislator election gains achieved on Tuesday, the GOP will be able to gerrymander 174 seats in sixteen states they now dominate. Meanwhile Democrats can write partisan maps for 59 seats they monopolize in eight states. When today's maps were drawn in 2001, Democrats had a 121 to 95 mapping advantage.

The GOP's better control of the pencils should net them another dozen House seats in the 2012 elections – theirs to hold until 2020.

The 2010 census documented population shifts during the last decade that will “reapportion” the 435 seats in the House of Representatives, adding to the states that gained population, and taking from the states that have fewer residents. Eight states will gain a total of 12 seats while another 10 states will lose 12 due to population shifts between states. Texas, for example, will gain four seats. Reapportionment between states should lead to another five seats going to the GOP.

Adding a future 17 seat census-driven GOP gain to the GOP's expected 25 seat advantage, Democrats will need their own 43 seat "wave election" in 2012 to reclaim control 218-217. Today, a “reverse wave” of such magnitude seems highly unlikely.

Outlook for the Senate is Fading Blue in 2012, then Red in 2014

Senate Democrats formally remain in control, 53-47, because only 37 Senate seats were contested last night, with the GOP winning 24 of them. Republicans have another chance to take formal control of the upper chamber in two years, by winning four or more seats than when 23 Senate Democrats and only 9 Senate Republicans face the voters. The Democrats' five biggest 2012 worries – Kent Conrad (D-ND), Ben Nelson (D-NE), Joe Manchin (D-WV), Jon Tester (D-MT), and Claire McCaskill (D-NE) – come from states John McCain carried in 2008, even while losing nationally by 6 percent. Bush also won these states by wider margins in 2004. The two GOP Senators with serious 2012 trouble are Scott Brown (R-MA) and Olympia Snowe (R-ME). Both will have to face "Tea Party" threats to get nominated and if successful must win re-election in blue states.

The GOP Senate election advantage in 2014 is even greater than in 2012 when 23 Senate Democrats and 10 Senate Republicans will be up. In four years, eight Democratic Senators – Mark Begich (D-AK), Mary Landrieu (D-LA), John Rockefeller (D-WV), Mark Pryor (D-AR), Max Baucus (D-MT) Kay Hagan (D-NC) Jim Webb (D-VA), and Mark Udall (D-CO) – must run from red states, while only Republican Susan Collins (R-ME) must run from a blue state.

Formal Democratic control in January 2011 is different than ideological control. The thirteen Democrats identified above who must run in 2012 or 2014 from red states frequently will vote with the 47 GOP Senators out of self-preservation, starting next year. Obama has lost ideological control of Congress.

Boehner, Not “To the Manor Born,” will Build His House with Unseasoned Material

When John Boehner (R-OH) becomes the 61st Speaker of the House, he also will become the national leader of the Republican Party. It will be up to him and the House Republican majority

to fashion a coherent strategy for getting America back to work, to cut the deficit, and to repair the battered balance sheets of American households.

So who is John Boehner? He turns sixty-one in two weeks, having grown up in a large Midwestern family as the second oldest of twelve children. A high school football linebacker, he was the first of his family to go to college, attending Cincinnati's Xavier University, where he studied with other pro-life, practicing Catholics. He was a small business owner before becoming an Ohio state rep at 35 in 1984. In 1990, he ran for the House and won. He has represented Ohio's 8th congressional district for the last 20 years. Boehner's district borders Indiana, starting north of Cincinnati but taking in the Dayton suburbs. It is a safe Republican seat. George W. Bush beat John Kerry in 2004 by almost 2-to-1. He is considered a solid fiscal conservative and hawkish on defense.

Boehner was a Newt Gingrich lieutenant in the 1990s, and he helped draft the 1994 "Contract with America." His reward was to become Chairman of the House Republican Conference, the fourth ranking leadership position, behind House Speaker, Majority Leader, and Majority Whip. He lost his leadership position in the House GOP leadership shakeup that followed Gingrich's resignation after the 1998 elections, when the GOP fared poorly in President Clinton's second mid-term election. Speaker Hastert (R-IL) helped restore Boehner to power in 2000, supporting his bid to become Chairman of the Education and the Workforce Committee. Boehner completed his rehabilitation in 2006, when an indictment forced Majority Leader Tom DeLay to resign. Boehner won a three-way fight to replace him. When the GOP lost the House in the 2006 elections, Denny Hastert withdrew from the leadership, and Boehner became the House Minority Leader in January 2007.

As a committee chairman, Boehner proved he was not an inflexible ideologue. He was a deal maker, working with the Bush Administration, ranking committee Democrat George Miller (D-CA), and Senator Ted Kennedy (D-MA), who chaired the Senate Health, Education, Labor and Pension Committee to pass the "No Child Left Behind Act." The House passed his bill 381-41 and the Senate concurred 87-10. Chairman Boehner also secured final passage of bi-partisan pension legislation requiring corporations to better fund defined benefit plans as a precaution against further Pension Benefit Guarantee Corporation losses. Speaker Boehner's negotiating skills will be tested just keeping the large House GOP caucus unified. Eight-three of the 243 House Republicans will be freshmen. Many have never held office previously.

Boehner's Foremen for New House Construction: Committee Chairmen

Chairmen of House Committees get their jobs under a two-step process. First, they must be nominated by the House Republican Steering Committee. Second, the full GOP Conference must ratify each choice made by the Steering Committee by majority vote. Seniority plays an important role in the Steering Committee recommendations, but it is not the only consideration. Under Conference rules, there also is a six-year term limit general rule on serving as chairman, or "ranking Member" when in the minority. This rule also is flexible.

Twenty-eight House Republicans serve on the Steering Committee. All have one vote, except the Speaker and Majority Leader. The Speaker has five, and the Majority Leader has two. It takes 17 votes to prevail in the Committee. The Speaker sometimes does not get his way.

Status of Key House Committee Leadership Contests	
<u>Committee</u>	<u>Status</u>
Ways and Means	David Camp (R-MI), uncontested
Appropriations	Jerry Lewis (R-CA) vs. Hal Rogers (R-KY)
Financial Services	Spencer Bachus (R-AL) vs. Ed Royce (R-CA)
Energy and Commerce	Joe Barton (R-TX) vs. Fred Upton (R-MI) vs. Cliff Stearns (R-FL)
Judiciary	Lamar Smith (R-TX), uncontested

Four Investor Takeaways: Taxes, Deficits, "Too Big to Fail," and Obamacare Pushback

Taxes: Despite the dramatic outcome, the mid-term election did nothing to clarify what will happen to individual income tax rates, and the rates on long-term capital gains and dividends. This issue will resurface during the lame duck Congress, and if a decision is made this year, it is expected to take place in December. Senate Minority Leader Mitch McConnell (R-KY) has proposed that these "Bush tax cuts" be extended to everyone for two years as a compromise. Democrats are weighing their response with some open to extending them for one year, some to making the cuts permanent for those earning under \$250,000 and temporary for those above, and a third school wanting to make them permanent for those making up to a higher thresh hold, even \$1,000,000. Until President Obama agrees to modify his position that the Bush tax cuts for those earning over \$250,000 must expire at year end, the game of chicken will continue. Expect a compromise closer to the GOP's position, either in December or next year. Otherwise, Obama will face re-election as the President who raised everyone's taxes.

The Commission on Fiscal Responsibility: Speculation is growing as the Commission works to meet its target reporting deadline of December 1, 2010. The most interesting thing is what has not happened. Although six partisan Congressional Republicans and six partisan Congressional Democrats are on the Commission, no one leaked proposals before the election! The easiest way to kill any controversial legislative idea is to say just before an election the opposing political party has confidentially asked you to pass it. The accusing party stands with the angels while the accused party must deny it ever suggested such a thing. After the election, neither party can touch the idea for a year. The lack of leaks augurs well that the Commission will issue a consensus recommendation. The scope remains unclear. It could be very significant or offer only modest steps to reducing the deficit. Investors should stay on alert.

Previously, Erskine Bowles, President Clinton's former chief of staff, and the Commission's Chairman, announced that any recommendation will consist of two-thirds spending cuts and one-

third revenues increases. The voting public will like that concept. A broad report could: Reduce or eliminate Social Security's \$5.4 trillion unfunded liability; Freeze spending on domestic discretionary and also military spending; and Target tax deductions and credits for limitation or repeal while leaving tax rates alone, or even lower tax rates in exchange for adoption of a value added tax.

Congressional adoption of such a grand compromise would end the question of whether a left-of-center President and a right-of-center House can work together, with benefits to both President Obama and Speaker Boehner. It might also provoke a dollar rally, and drive down long-term U.S. interest rates. Fed Chairman Bernanke is certain to like that, and it would give him justification for making QE II larger.

Ending "Too Big to Fail" Bank Bailouts: One thing that unites the "tea party" and the left is hatred of large bank bailouts. The House GOP has vowed to end them, targeting for repeal of ambiguous language in FinReg that would permit a sympathetic Treasury Department to reduce the losses of favored creditors. When Bank of America, CitiGroup, JP Morgan, and Wells Fargo shareholders and bondholders realize that these companies will be downgraded after such a law passes, they will wish they had sold before it happened.

"Repealing and Replacing" ObamaCare: While President Obama will veto any legislative frontal assault on essential elements of his health care reform package, he would have to bend to a different foe, the federal courts, if the mandatory purchase of health insurance is struck down as unconstitutional. The case is before Roger Vinson, a senior federal judge for the Northern district of Florida appointed by Ronald Reagan with 20 states suing, claiming the mandate is illegal (see http://msnbcmedia.msn.com/i/MSNBC/Sections/NEWS/A_Politics/healthcare.pdf). If the mandate is ruled unconstitutional, then what is left of ObamaCare, including "must issue" rules for pre-existing conditions with no revenue source to pay for it, will bankrupt health insurers.

Separately, the Congressional GOP wants to allow citizens the right to purchase health insurance from companies in other states. This escape valve would allow citizens of New Jersey, for example, to buy much cheaper and thinner policies issued in Wyoming. Industry revenue and profit would fall significantly. It will be very hard for Obama to fend this idea off.

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