



CLEAR HARBOR
ASSET MANAGEMENT, LLC

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Aaron J. Kennon
Chief Executive Officer

Clear Harbor Flash: The Presidential Race — Don't Change That Channel

At Clear Harbor, as at many companies across America, our team is watching the presidential contest unfold from a range of ideological perspectives. As private citizens, several of us have personal commitments to House, Senate and presidential candidates of both major parties, and our water-cooler debates certainly become more spirited during the campaign season.

But as professional investors, we share a common focus on the substantive nexus between the public and private sectors, and how any change stands to affect our clients. For example, our models that weigh the benefits of a Master Limited Partnership against those of a high-yielding stock must anticipate likely scenarios for tax and regulatory policy.

As is typical of our contrarian approach, we question our industry's widespread reliance on election forecasts provided by popular political commentators or buzzy prediction markets, all of which project a comfortable margin of victory for the incumbent. We believe a deeper look suggests a much closer race than what many market participants expect.

In fact, after reviewing polling data and other important inputs not adequately represented in mainstream polling data, our model concludes that the Electoral College race is now dead even, with 269 votes for both President Obama and Governor Romney. Such an outcome would lead to a tie-breaker in the U.S. House of Representatives, with a Republican House expected to name Gov. Romney our next President.

How do we reach a conclusion so at odds with mainstream news organizations, pollsters, and market-based barometers such as Intrade? Several factors, ranging from statistical anomalies to accidents of the calendar for voter registration and campaign spending, may prove more influential on the outcome than is commonly recognized.

1. Gov. Romney's supporters appear more likely to vote. Current polling typically samples "registered voters" rather than "likely voters." Indeed, the most recent CNN poll, which found an 11 percentage point lead for President Obama — the most significant among recent major polls — went so far as to include unregistered voters.

When limiting the sample to registered voters, the President's lead in the same CNN poll falls to 7 percent. And an analysis of national polls from the last three months by Real Clear Politics shows a lead of 3.65 percent among registered voters, dropping to less than one percent among likely voters.

After Labor Day, most pollsters will make a customary shift to a tighter "likely voter" screen. We believe this change in methodology will capture a much closer race from that point forward.

2. Poll weightings are based on an historical outlier. The samples used in most public national polls are weighted off of voter turnout in the last presidential election in 2008, in which Democrats enjoyed a 7

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percentage-point turnout advantage as measured by exit polls. However, this reflects statistical convenience more than contemporary reality. Indeed, 2008 marked the high point of the last four elections for Democratic turnout, with the party's advantage just 2 percentage points in 2006, and null in both 2010 and 2004.

Many would agree that the 2008 election was an extraordinary historical event unlikely to generate similar levels of advantageous turnout in 2012. But pollsters are reluctant to reweight their models, considering it safer and more credible to use the most recent presidential election as their statistical guide.

If one instead assumes an electorate that is 2 percentage points more Democrat than Republican — in line with the average of the last four elections, rather than assuming a straight repeat of 2008 patterns — one would find Romney ahead by 4 percentage points nationally.

3. Polling indicates approximately 10 percent of the electorate is undecided. History suggests that a majority of the undecided vote shifts to the challenger. The last time a Republican challenger defeated a Democratic incumbent was in 1980. That summer, polling indicated that President Carter would win another term; facing economic woes and perilous developments abroad — both familiar themes today — voters ultimately awarded a landslide victory to Governor Reagan.

Bear in mind that the polling data referenced above is national. When we hone in on state-by-state data, our conclusion is that the race is a complete dead heat at the Electoral College level.

4. Independent voters are shifting away from President Obama. In 2008, Pres. Obama won the independent vote by 8 percentage points. According to the highly regarded George Washington University / Battleground Poll, the President is now losing this important constituency — particularly where it is most likely to decide outcomes.

Gov. Romney currently leads by 10 percentage points among independent voters, and by 22 percentage points among “ticket-splitters” who have cast ballots for both parties. Critically, these trends are pronounced in the battleground states we have analyzed, with the President underperforming among independents by 8-18 percentage points. And while some independents who voted for the President in 2008 will simply stay home, others are committed voters and could very well break toward to the challenger.

5. State voter registration trends favor Romney. Net Republican voter registration efforts have outpaced Democrats by 10-to-1, according to Third Way, a center-left policy organization. The advantage for the GOP was particularly evident in the following battleground states: Colorado (+2.3% versus net Democratic registrations), Florida (+5.4%), Iowa (+15.9%), Nevada (+0.7%), New Hampshire (+12.4%), New Mexico (+4.6%), North Carolina (+3.4%) and Pennsylvania (+2.3%).

Several of these gains (e.g., Iowa and New Hampshire) are a result of the competitive early Republican primary season, in which several candidates mounted significant registration drives while Democratic organizations had no corresponding primary to prepare for.

6. The battleground states are closer than in 2008. Current battleground state polling suggests a much smaller margin for error for the incumbent than he enjoyed in 2008. Take a look at some recent polling compiled by Real Clear Politics and how it compares to the final vote in 2008:

	Final 2008	Today	Obama 2012 vs. 2008
Colorado (9 EVs)	+9%	+1%	-8%
Florida (27)	+3%	+1%	-2%

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Iowa (7)	+10%	+1%	-9%
Nevada (5)	+13%	+5%	-8%
New Hampshire (4)	+10%	+3%	-7%
North Carolina	+0%	-1%	-1%
Ohio (20)	+5%	+3%	-2%
Pennsylvania (20)	+10%	+7%	-3%
Virginia (13)	+6%	+1%	-5%
Wisconsin (10)	+14%	+5%	-9%

President Obama currently trails his final 2008 result across the board, and most noticeably in New Hampshire, Nevada, Iowa and Florida — early Republican primary states where voters had the opportunity to get to know Romney. Also, many of these recent polls sampled registered voters; nonpartisan polls of likely voters in battleground states suggest an Electoral College tally of 280 for Gov. Romney 280, to 258 for Pres. Obama.

7 Spending will be even this time. We do not expect to see a one-sided advertising battle as we did last cycle. In 2008, according to media tracking data from Kantar/CMAG, Senator Obama outspent Senator McCain by nearly a 4-to-1 margin. This year, it is becoming clear that resources will be much more evenly matched — particularly when those of allied independent groups are included.

8. The Fair Model: One of the most reliable quantitatively driven models for predicting the outcome of Presidential elections is produced by Yale professor Ray Fair. Prof. Fair’s model has successfully predicted all but one election over the last 30 years.

The Fair model incorporates economic data — most importantly GDP — and assumes a high correlation between the state of the economy and the prospects for the incumbent. Prof. Fair describes this year’s race as “too close to call,” but projects Gov. Romney edging out the President by less than 1 percentage point — considerably lower than the 3 percent margin of error.

9. Job Approval Drag: Perhaps the most telling data point at this point in an election is the incumbent’s job approval. No president has been re-elected with a pre-election job approval rating under 48 percent. Pres. Obama’s latest Gallup job approval stands at 45% and, in all the battleground states listed above except Pennsylvania and Wisconsin, is below 46%.

In short: investors should resist allocations premised on a strong conviction that the President’s re-election is assured. This is not 2008. And regardless of one’s political persuasion, one should take care

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before assuming the political climate is more stable than the economic one. For in truth, they influence one another as much today as at any time in our history.

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