Safian Investment Research
96 Brook Hills Circle, White Plains, NY 10605
Economic Analysis • Asset Consultant • (914) 697-9700 • Fax (914-)761-1011

A Sector Approach to Economic Forecasting
****
Since 1962

July 10, 2009

Political Notes

A recent trip to Washington to meet with folks showed lots of uncertainty, but plenty of busy people. While there were many insights and trends in thinking as to what policy will be, it is unclear to conclude what policy will be. Contained here are some thoughts and conclusions.

First, healthcare is now the big issue in the House and tax policy is being discussed at these meetings. The democrats decided to propose healthcare insurance benefits as a taxable item. Since unions are against such a program, it was then decided to propose higher taxes on upper income individuals in order to help pay for the government's higher healthcare costs. Which one of these, or none of these, will be in the final proposal is too early to determine.

It seems the reasons for no other proposed new taxes at this time are because the economy is too weak, the Treasury is not fully staffed to propose such a bill and discuss it with the various committees, and the Bush tax cuts are expiring in 2010 and 2011. Therefore, we would expect debates and various papers to be issued regarding healthcare policy and some bill which would be passed by the end of this year or the beginning of next year. While we are in favor of a value added tax, some folks with whom we met told us that the President and one of his key economic advisors are against such a method of taxation. But 2010 is a long off.

As far as the Dept. of the Treasury is concerned, it has made some progress in having new people come on board, especially the tax area. Individuals at the Federal Reserve and other places are helping out temporarily in doing the necessary work. The cap and trade proposals seem to be more complex than many believed which may cause greater delay in passing legislation in this area.

Finally, during meetings with some people in the regulatory area, an important point was raised of which some investors may not be aware. As many people know, hedge funds get a large part of their managed funds from retirement accounts. Therefore, if regulators want to contain financial excesses and speculation, some would like to restrict the use of speculative products by conservative investors. For this reason, an IRA account is not permitted to short sell a security. Following that theory, it would seem that most retirement accounts should not be permitted to go short and rather hold cash and quality interest bearing securities or, as is permitted, short against a position that the account holds. The theory being that these accounts should be more conservative in nature. Isn't it interesting that hedge funds marketed to pension fund managers that either had state and local government regulators and to college endowment funds and the like that also had other than federal regulators, to convince these potential clients that a more aggressive investment policy was prudent? For this reason, it is more difficult for federal government authorities to write legislation since a great deal of managed money is not under the same regulations. As our readers know, we believe the function of Wall Street is to help raise capital for businesses. A secondary and more important purpose is to provide an opportunity for individuals and institutions to participate in the success of American industry. That was the message that the “old” New York Stock Exchange gave, and its regulations were based on that thesis. The N.Y.S.E. is no longer a regulator, and it would be helpful if the current regulators would state what the purposes of the financial markets are and how the regulations meet those goals. One can not expect Congress to pass laws without knowing what the purpose and functions are of the new “exchanges” and “markets” that now exist. This point was noted at our meetings and some people in Congress believe they don’t have the authority and/or the ability to pass effective legislation.

One final point should be appreciated by both investors and the government. Business people like to know what the laws are and will be going out in the near future. Uncertainty causes them to delay their investments until they know the regulations and tax consequences. If the government does delay, we would expect business people to also defer their investment programs resulting in reduced or flat economic conditions. There is nothing wrong with waiting until 2010 or 2011 before new regulations take effect, but these taxes and spending programs should be agreed to or be debated so corporate managers can know what the likely direction of those new regulations will be.

As noted in our most recent reports, we believe a new era bull market is underway, but the rally reached a point where a long consolidation phase should be expected as was the case from 1933 to the first quarter of 1935. During that earlier period many new government programs were passed and some individual stocks performed very well. We would expect a similar type of condition, but no two periods are totally the same.

Ken Safian