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Money
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The Newsletter for the Informed Investor – www.rbcds.com/vito.finucci

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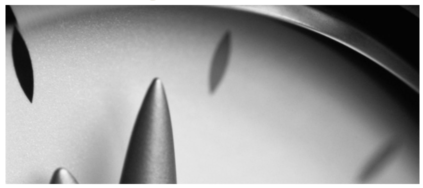
The big Picture



Taxing a Nation to Health

(At Least Nero Fiddled While Rome Burned)

"There is one certain way to kill capitalism… by taxes, taxes and more taxes."
Communist Karl Marx

Who will pay the Freight?

One year after global financial markets hit rock bottom, one must admit that the doomsday talk of depression seems to have let up. The legendary Warren Buffet made headlines a year ago by saying the U.S. economy had "fallen off a cliff" and was engaged in the economic equivalent of war. The Dow Jones was at its lowest level in 12 years and the value of U.S. equities had dropped from a peak of $22 trillion to $9 trillion, a staggering loss of wealth.

We now know that March 9th, 2009 was the bottom of what will be known in history as the Great Recession of 2008-2009. Most North American markets are up 50-60% from their lows, but still remain 30% below 2007 highs.

The value of U.S. equities now stands at $16 trillion. And while recovery, as fragile as it may be, seems to be gaining traction, the political uncertainty in Washington gives the bears hope.

In the last few weeks, the Obama administration has proposed two dramatic legislations which will make sweeping changes in both the financial sector and healthcare. If one has been paying any attention, these things are for sure:

- higher taxes are coming
- those tax increases will be borne by more people than Obama promised
- intrusive regulation will kill innovation (always has)
- a jobless recovery will remain just that, if Obama has his way
- economic problems around the world will hurt America

The U.S. Senate, days after talking of spending freezes and fiscal responsibility, voted to raise the U.S.'s debt ceiling to $14.3 trillion. The Republicans weren't angels by any mean, but many of them were smart enough to fight back against the insanity. It seems in this Democratic caucus no one can disagree with the party line without facing lash backs. The nation's population is up 134% since 1940 but the debt is up 12,000%. The sad fact is the debt per American just since 2000 has doubled from $21,174 to $46,278. America paid $383 Billion in interest in 2009 just to service that debt.

It seems the Reagan Revolution which brought prosperity and respect back to America has been repealed by President Obama. The Reagan Revolution had been the best thing that had happened to equity investors since World War II.

Mr. Obama has denied he has revolutionary intent … or that he has an interest in governments controlling the auto industry, or the banks, or healthcare … but the facts seem to state otherwise. Big government is back.

We already know about the dollars which went to GM and Chrysler and how the Obama administration removed the CEO of GM, a publicly traded company. We know how the new banking proposals create a lot of regulation (and government jobs), but none address the problems of what caused this recent financial crisis. And now they want the public to believe they will now give free healthcare to an additional 30 million Americans, do it better and cheaper than the current system, and do it without raising taxes?

In his election, the President promised he would not raise taxes on the middle class (remember only those making over $250,000 were going to pay for all this?). From an economic perspective, it is utter nonsense as the math simply does not work. Even recent televised comments by the Treasury Secretary himself, Tim Geithner, when asked the question directly did not hold back any doubt that all taxes were going up. So not only "the rich" are going to shoulder a greater share, but now taxes are going to rise upon the middle class as well. So those in the top quarter of income brackets (and still only ¼ of the voters!) will pay the price, while ¾ of the voters of the USA can count upon others to pay for the programs which benefit only them. Brilliant Politics. Idiotic Economics.

So who will pay the freight? The people who already do.

Read the facts from most recent available numbers from 2005 (from the IRS):
• Top 1% of U.S. Taxpayers paid 38.4% of all taxes
• Top 5% paid 58.8%
• Top 10% paid 70%
• Top 25% paid 85.6%
• Top 50% paid 96.8%
• Bottom 50% paid 3.2%

So despite the left-wing and social reformers' claims that the wealthy and upper-class do not pay their fair share, the facts support otherwise. And despite all the supposed unfairness of the Bush tax cuts. Don't get me wrong, "fair" share is fine, but I will root for right over wrong every time. I will debate governments taking hard earned dollars from legitimate businesses because they supposedly make too much. I will argue against the notion business "A" has to pay for the shortcomings of business "B". The same would apply to individuals. To punish those who have done all the right things for many years to subsidize those who have not … is plain and simply wrong. It is a dangerous game and it will back fire in many ways. History is loaded with examples of why it won't work. Does the USSR from 1940 to 1985 ring a bell?

Another example would be the last time a President declared war on a specific industry. In 1979, Democrat Jimmy Carter pounced on U.S. oil companies pushing through the Crude Oil Windfall Profit Tax Act. It was considered a tax on profits but turned out to be an excise tax that punished oil companies on the difference between market prices for oil versus the 1979 price, and factored in inflation plus state taxes. Just as President Obama is suggesting now, President Carter suggested then too, the tax would help pay for the deficit. Instead, the plan forced U.S. oil companies to retrench and refocus their businesses.

Since the tax was on domestic production, there was a shift from exploration into refining. The result is American dependence on foreign oil surged and hasn't stopped since. The Carter team at the time projected $393 billion in tax revenues between 1980 and 1990. The real figure collected was $80 billion. Domestic production dropped an estimated 320,000 to 1.2 million barrels per day. That Act was a disaster by any measurements.

How about the curious case of California? When you think of the land of milk and honey, one thinks California. After all, with Hollywood, Agriculture, Defense Industry and a cultural melting pot, it's hard not to. So rich, so much promise, however California has been going backwards and has become the land of spilt milk and dried honey. More jobs continue to move to less taxed states and the supposedly richest state is surviving by issuing IOU's to make ends meet. How could this happen you ask? The tax and spend crowd, draconian regulation, businesses leaving to flee high taxes, and a massive invasion of illegal immigrants looking for (and often getting) free social programs. Wealthy people and rich companies don't get that way by accident, and they understand they have rights and choices as well. Their easiest right and choice is the right to flee. So tax revenues go down while the spending doesn't stop.

California has a budget deficit of over $26 billion and that rises by $25 million per day. The state now has the lowest bond rating in the nation.

The idea of taxing a nation to health and prosperity is preposterous. But right now it's the game plan in the USA, the UK and France (among others, so far Canada has resisted!). There has been massive exodus out of high tax states like California, Michigan, New York and New Jersey to low/no tax states like Texas and Florida. California has a 10.55% income tax; Texas has no earned income tax.

This happens not just regionally, but globally. Switzerland had 1200 companies move their headquarters there in 2009 alone. The tax rates start at 16% and can move as low as 10%. And where did they come from? High tax nations like France and the UK. US companies like Yahoo, Kraft and McDonalds are three examples that made the move in 2009.

On a micro level it doesn't make sense to tell a person who paid their mortgage that they are now responsible for paying their neighbours' as well, but come to think of it … that is exactly what is happening. Those who have worked hard to do the right thing are being asked to foot the bill for those who didn't. It doesn't work on an individual level and certainly doesn't make sense on a corporate level.

It may be a politically brilliant move but will have a negative impact on the economy. Taxes hurt the bottom lines of companies, which in turn either lay off or hire less to make up the difference. Taxes mean higher costs, which get passed on to customers. Taxes mean less money moving in the system as spending, loans, etc…– the "velocity of money" all economies need to grow. Capital serves as the main foundation of success in a free-market democracy. Without it, things don't get done. Capital flows determine winners and losers.

Even the most financially illiterate understand the rags to riches story, and they know that doesn't happen when industry is nationalized. Banks are frozen and afraid to go out on a limb. They won't lend until they know the rules. Healthcare service will decline, not increase. Innovation and research will suffer. So until they know what the rules are, these industries are in a bunker mentality and have shut down the spigots of cash. Capital isn't getting to Main Street, which has been the main casualty of the War between Wall Street and Washington.

- The government has created so much uncertainty with its daily attacks on the financials and banks.
- The opposition is so intent on gaining political power as opposed to solving the nation's economic and financial problems.
- No one can say for sure how far this will go.

The good news for us as Canadians is that if we stay the course and continue to be fiscally responsible, our economy should benefit from a higher currency, better debt levels, and an overall higher standard of living. More companies will relocate to Canada if tax rates are lower.

I hope this period of insane spending, higher deficits and much higher taxation will end without recreating another financial crisis and recession. As a believer in the system and capitalism I remain optimistic. I worry about what kind of mess our kids and grandchildren will inherit. If the current path continues, it may take decades to fix.

If it is any consolation, a year ago, at the market's nadir, even Warren Buffet had not lost hope: "Everything will be all right" he predicted then, "We do have the greatest economic machine that man has ever made." I agree with him 100%.

The Little Picture

(But perhaps, the **Real** Big Picture)

On July 6th-7th, we will be hosting the Children's Hospital Golf Classic at Sunningdale Golf and Country Club. It is the 21st year for this tournament, which has grown to be one of London's premiere charity events. Last year's proceeds pushed our aggregate total to over $2.2 million (net). I am proud to be the major sponsor for all these years. If you would like to contribute in any way either through a donation, products or services for a live/silent auction, please forward to:

Jill Osborne c/o Children's Health Foundation
345 Westminster Ave., London, ON N6C 4V3

Or let us know here at 519-675-2011. Any amount is gratefully accepted. Help us help the kids get better!

Portfolio corner summary

Given the rally the markets have experienced in the past 12 months, one can safely assume the "easy" money has been made. The financials in Canada seem fairly valued, but some U.S. and even European banks still remain well off old highs. Pengrowth Energy (PGF.UN) has been our biggest buy in Canada, given an attractive yield (7% +) and new management. The commodities via materials, energy and agricultural sectors should continue to do well as long as China and India keep growing. In the U.S. we still love technology, for patient investors the financials, and some deep cyclicals like chemicals, and the shipping stocks, but you need to think 18 – 24 months out.

Notes

On March 9th, Cisco Systems (CSCO) announced their newest network system capable of 322 Terabits per second. This means nothing to most of us until we learn that means it can:
- Download every movie ever made in 4 minutes
- Transfer more than 4 billion MP3's in a minute
- It can let everyone in China make a video call at once
- Transmit the entire DNA sequence of over 56,000 people in a second

(OptionMonster March 9, 2010)

When will tax and spenders learn?
The UK enacted an 18% excise tax on beer last year which has had a devastating impact on the industry:
- 1.7 million fewer pints of beer sold this year
- Beer sales down 8%, pub sales down 6.3%, supermarkets sales down 11.0%
- 20,000 jobs lost in the sector
- 2,000 pubs closed
- Estimated 75,000 more jobs at risk

Higher taxes are never the answer. They end up hurting the very people the politicians claim they are supposed to help. *(Wall Street Strategies July 27, 2009)*

President Obama thinks the government can do a better job of running pretty well anything compared to the private sector. The US Postal Service lost $5.3 billion in 2007, $2.8 billion in 2008 and approx. $6.6 billion in 2009; this, while UPS and Fed Ex still make money. If the proposed government healthcare insurance will be allowed to run like this, it's unlikely private insurers will be able to compete? How many jobs will be lost?

Japan's Population Going to Zero?
Demographics tell us everything we need to know about an economy; almost 16% of men older than 50 have never been married. No where else in the industrialized world is that figure > 10% (it's 7.2% for females). It seems as if the Japanese have simply dropped from the marriage and birthing pools.

Around the globe

Canada (STRONG BUY)
- Canadian $ has been on wheels showing investors' appetites for stronger economies
- Interest rates will go up but will still be historically low
- Canada could have one of the best GNP growth figures in G20

* **Easy $ made in banks, buy energy, commodities, insurers**

U.S. (BUY SELECTIVELY)
- Main economic issue is how self-sustaining is this recovery?
- U.S. job market remains weak, excess housing inventory overhang clearing
- Will consumer spending recover to "normal" levels?
- Fed not expected to hike until second half of 2010

* **Focus on banks, technology, global players/multinationals (especially those who sell in Asia)**

Europe (HOLD/AVOID)
- Has begun to crawl out of recession but risk remains with "PIIGS" – Portugal, Ireland, Italy, Greece and Spain and default rumours
- UK having fiscal problems and at the worst time possible adding higher taxes & regulation
- The question remains is the bad news from PIIGS already discounted?

Asia (BUY)
- China humming again, with expected growth of 9-10% - Japan barely moving
- Asia benefitting from attractive combination of excess liquidity, low inflation, and strong demand from China
- Many cries of "bubble" beginning to be heard

* **Best way to play Asia is via an ETF or mutual fund**

Latin America (AVOID)
- Except for Brazil, rest of economies beginning to show the results of extreme socialist governments and corruption, led by Venezuela which recently devalued, Chilean earthquake has hurt short-term prosperity, drug-related violence in Mexico, Columbia, etc… No thanks!

Quotes

"Liberty means responsibility. That's why most men dread it."
George Bernard Shaw

"When plunder becomes a way of life for a group of men living together in society, they create for themselves in the course of time a legal system that authorizes it and a moral code that glorifies it."
Political Economist Frederic Bastiat 1850

"Democracy is the worst form of government except for all the others that have been tried from time to time."
Winston Churchill

"I told my psychiatrist that everyone hates me. He said I was being ridiculous – everyone hasn't met me yet."
Rodney Dangerfield

A special welcome to all new clients who have joined us.

Thank you especially to clients who have mentioned our name to people they know. As a sign of gratitude, four times a year we'll randomly select a client who has introduced our services to a friend for special acknowledgement with a nice dinner at one of the finer restaurants in London.

Congrats, Jonathan G.

Our winner this quarter!

PLEASE DON'T KEEP A SECRET FROM US!

We are very happy and proud of the clients we serve in our practice and we are always open to serve more clients just like you. Should you be talking to someone who is unhappy with their current advisor, we would be grateful if you passed on our number: (519) 675-2011 or 1 (800) 265-5911. Thanks for keeping us in mind.