

# MONEY NEVER SLEEPS

THE NEWSLETTER FOR THE INFORMED INVESTOR

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**VITO FINUCCI, B.COMM, CIM, FCSI**  
 Vice President & Director,  
 Investment Advisor  
 Associate Portfolio Manager  
 519-675-2011  
 vito.finucci@rbc.com

**JODIE FULLER**  
 Associate Advisor  
 519-675-2511  
 jodie.fuller@rbc.com

**GARY WEATHERUP, CFP**  
 Associate Advisor and  
 Financial Planner  
 519-675-2021  
 gary.weatherup@rbc.com

**SARAH SMITH, CIM**  
 Associate Advisor  
 519-675-2505  
 sarah.e.smith@rbc.com

**JESSICA BASACCO**  
 Administrative Assistant  
 519-675-2021  
 jessica.bassaco@rbc.com

Fax: 519-675-2020  
 www.rbc.ds.com/vito.finucci

RBC Dominion Securities  
 148 Fullarton St., Suite 1900  
 London, Ontario N6A 5P3



## STARVE THE BEAST

### Big Government Gone Wild: Deficits As Far As the Eye Can See

*“Andrew Cuomo in New York, Daniel Malloy in Connecticut and Tom Wolf of Pennsylvania, because every time they raise taxes, it’s basically a gift to Florida. More and more people are buying homes here and we get richer. It’s just incredible to me that these liberals keep pretending that taxes don’t matter.” - Florida’s Republican governor, Rick Scott, when asked who his favorite governors were in the USA*

The recent publication of the so-called sunshine lists reminds us on an annual basis of how unchecked government spending can go awry. Don’t get me wrong, there are a lot of good people doing things on those lists who deserve every cent and often more. But I find it hard to rationalize how 21 Toronto TTC ticket/token collectors can make over \$100,000 (National Post 3/24/16).

In the USA, the Commonwealth of Puerto Rico is already bankrupt, Illinois is not far behind. California has over \$428 billion in debt (usdebtclock.org), only surpassed per capita by our once fair province of Ontario. San Francisco had a \$1 billion deficit in 2012, but over the prior four years paid out over \$20 million per year in year-end bonuses to bus drivers, which were not based on merit or anything else for that matter (Wallstreet Strategies 12/13/12). In fact, in 2010, one bus driver made almost \$80,000... just in overtime.

It seems inconsequential to financial markets today, but the concept of big, bloated governments handing out cheques left and right while creating insurmountable deficits will soon have an impact, and we are not talking 20 years down the road.

In the USA, the numbers are huge:

#### Debt is Projected to Grow Faster than the Economy

Debt held by the public, 1790-2040



Source: Congressional Budget Office

Continued on page 2



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In Canada, the numbers may not be as big, but we also don't have a \$17 trillion economy:

### Canada Government External Debt



Source: [www.tradingeconomics.com](http://www.tradingeconomics.com) | Department of Finance Canada

In the USA, “Starving the Beast” began in the mid 1980s as a movement to limit government spending by cutting taxes in order to deprive the government of revenue, in a deliberate effort to force the powers that be to think hard and be more careful with taxpayers’ dollars since they would have less of them to waste on say pet projects, poor choices or just plain old waste and corruption.

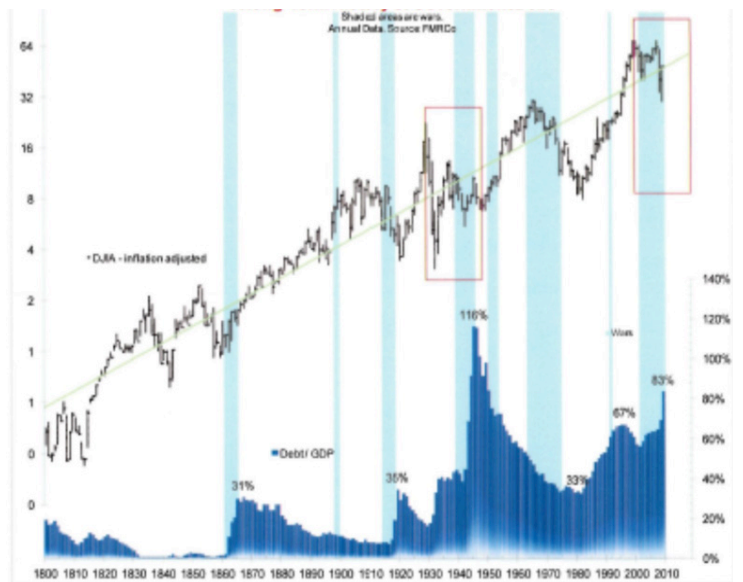
During the 1980 Presidential election, the “great communicator” Ronald Reagan foreshadowed the strategy succinctly: “We are told that first we’ve got to reduce spending before we can reduce taxes. Well, if you’ve got a kid that’s extravagant you can lecture him all you want about his extravagance. Or you can cut his allowance and achieve the same end much quicker.”

Milton Friedman, the arch-conservative economist, speaking of ways to limit or reduce the size of government, offered a similar prescription: “How can we cut government down to size? I believe there is only one way: the way parents control spendthrift children, cutting their allowance. For the government, that means cutting taxes. Resulting deficits will be an effective – I would go as far to say the only effective – restraint on the spending propensities of the executive branch and the legislature.

It is no coincidence that slower GDP growth results in times of excessive spending. The new political buzzword excuse for excessive spending is “infrastructure investment.” But of the \$1 trillion the U.S. Congress was convinced to pass in 2009, named the “American Recovery and Reinvestment Act”, only about 15% actually went to those “shovel-ready” projects the President went on tour to promote. The rest? Pet political projects and social programs.

In the case of California, which was once seen as a model for the nation, given its economic opportunities, social outlook and high quality public services and institutions, is no longer the progressive model. Thirty years ago, its schools had been among the most generously funded in the entire USA, and are now in the bottom

### A Long-Term History of Government Debt



Source: [www.thestockmarketwatch.com](http://www.thestockmarketwatch.com)

quartile in virtually every major indicator (physical conditions/ public funding/test scores) closer to Mississippi than New York or Connecticut. The state’s population has doubled since the 1960’s and has built some 20 new prisons in the past two decades but has not opened one new campus of the University of California for nearly three decades.

In Canada, Saskatchewan Premier Brad Wall—who just won 51 of 61 seats in the province with 63% of the vote for his third consecutive mandate—believes the Federal equalization program, which transfers \$17 billion a year from the “haves” to the “have not” provinces, is both dated and inefficient. That is especially so given the number of “haves” is rapidly dropping as Ontario and now Alberta join the “have nots.” Mr. Wall would prefer the money go towards national infrastructure projects and tax relief. Mr. Wall has a point, but it falls on deaf ears.

It is interesting that the last time Canada had its back against the fiscal wall (the mid 1990s) was when the country was basically broke and had a currency commonly referred to as the “Northern Peso.” Then Finance Minister Paul Martin solved the problem by reducing government spending by \$7 for every \$1 in raised taxes, and our country was back on its feet with a solid economy in three years. So why not keep that formula in place? One word: Politics. You can’t get votes anymore unless you give away a lot of “free” stuff.

The lingering economic anemia is astonishing, especially given the plummet in energy prices. To a considerable extent, the anemia has been enhanced by government behaviour. Since 2012 in the USA, there were 3,659 regulations finalized in 2013 and another 3,554 in

2014 ([www.fas.org](http://www.fas.org)). *The Economist* magazine reports that during the Great Recession of 2008-09, unemployment benefits were extended from 26 weeks to an average of 53 weeks. In December 2013, Republicans blocked further extensions. Now a study of 1000 U.S. counties shows that employment grew faster in the counties where there were the biggest declines in the duration of unemployment benefits.

In Statistics Canada's most recent update, it was reported that Canadians now have personal debts of 165% of their disposable income. That means for every \$100 they take home after taxes, they owe \$165. That 1.65 ratio, by the way, is now the highest it has ever been, and marches higher every new report.

Of course, not all debt is created equal. If you owe \$100 on your mortgage with a 2.50% interest rate amortized over 10 years, I say that's okay. But if you owe \$100 on a credit card at a 20% interest rate, I'd say that's really bad debt. Just because a bank is willing to lend money is no reason to be complacent about debt.

Past studies by the International Monetary Fund (IMF) have indicated that once government takes up to more than one-third share, the economy tends to grow less quickly. The reason? Politically-driven governments are not focused on their own productivity to ensure that they contribute to higher incomes per worker. Harmful income taxes stunt GDP growth as well. Fiscal prudence in Canada in place since the mid 1990s is now giving way to a new philosophy of growing bigger governments. The eventually higher deficits will unlikely be solved by only spending cuts. It will be necessary to raise taxes, fees, anything they can find (higher GST rate?). Canada is already one of the largest spenders on health care, yet report cards consistently put the return on that investment as mediocre at best. Public spending on health care will no doubt rise again without changing the culture.

Pocketbook issues affect all Canadians, so taxes and government spending will be under the microscope in the future and top of mind for most Canadians. And as the quote from Governor Rick Scott of Florida, quoted many months ago, began this issue, last week a real life situation confirmed his comment, as well known and regarded hedge fund manager David Tepper officially moved his home and company from New Jersey to Miami. Mr. Tepper earned \$6 billion over the past three years and paid \$500 million in state taxes, which New Jersey will no longer have at its disposal. New Jersey has the third highest tax burden in the country. Florida has one of the lowest, and no personal income or estate taxes. New Jersey gets 40% of its income from personal income taxes, a large chunk of which comes from the mega wealthy like Mr. Tepper. Even being off just 1% could mean a budget shortfall of \$140 million. So perhaps the "Beast's" action will backfire and it will simply starve itself in many cases.

Back to Saskatchewan for a moment. A decade ago it could be said the province's biggest export was not wheat, uranium or fertilizer, but its youth. Under Premier Wall's steady hand, that has reversed as the province prospers and creates real jobs.

There is no doubt insecurity grows rapidly when the economy does not. The government adds to that but then also exploits it as anxious and disappointed people are easily swayed by political rhetoric with respect to the allocation of wealth. "Free" this and "free" that become a mantra as slow economic growth becomes the "new normal" by that very government that wants more and more people dependant on them for political gains down the road. How else can one explain the popularity of someone like Bernie Sanders, a self-avowed proud Socialist, in the capitalist USA?

Time will tell, but the Beast grows stronger still.

## NOTES

The City of San Francisco has 28,660 people on its payroll, with an average compensation of \$179,000, including 2000 health workers, 1843 welfare workers, 2872 judicial and corrections officers, 1081 parks workers. This doesn't include 4,226 transit workers who work for the Bay Area Rapid Transit (BART). (Source: Washington Examiner 7/24/13)

Coldest temperature ever recorded? Yostok, Antarctica. On July 21, 1983, the temperature was -89.2 Celsius.

The world's fastest rollercoaster – the formula rossa at Ferrari Abu Dhabi – reaches an incredible speed of 240 km per hour. Not even close to a Formula One race car though, which can whip around at speeds up to 360 km per hour.



# AROUND THE GLOBE



## CANADA (SELECTIVE BUY)

- The commodity super cycle ended two years ago and Canadian equities have struggled since, but they are no longer trending lower, so time to take a look
- Recent budget with its deficits may scare foreign investment?
- Consensus expect GDP growth at about 1.0%

## U.S. (STRONG BUY)

- U.S. outlook has dimmed last couple of months, but recent lower dollar has helped
- Fed to proceed cautiously; yields will remain low for some time
- 2016 GDP expected at 1.75%-2.00%

## EUROPE (BUY)

- Britain's upcoming vote (June 23) on a "Brexit" from the EU is the focus so Euro politics will dim the shorter-term view
- Central bank is doing "whatever it takes as promised"

- Still a mess but getting better
- GDP expected at 1.50%

## ASIA (AVOID)

- China remains in top three concerns from global markets—question is if smaller problems will metastasize into full-blown financial crisis
- Japan is stimulating like never seen, but the economy continues to sputter (GDP 1.0% for 2016)
- Too many questions still

## EMERGING MARKETS (AVOID)

- If U.S. dollar bull is not done yet, then more pain could come
- We've been avoiding Latin America for years but Brazil may finally be of interest, down about 70%
- Russia and Brazil in second straight year of recession

## QUOTES

*"All of the fiery rhetoric of the Founding Fathers was directed at a "tyrant" who taxes his subjects at the rate of about 3 percent. Today, we in "The Land of the Free" are taxed at about 50% when you add federal, state and local taxes. What kind of government would do that?"*  
Doug Newman, Columnist

*"My reading of history convinces me that most bad government results from too much government."*  
Thomas Jefferson (American President, Founding Father)

*"Formula for success? Rise early, work hard, strike oil."*  
J. Paul Getty (American Industrialist)

## 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 via a nice dinner at one of the finer restaurants in London.

## PLEASE DON'T KEEP US A SECRET!

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, or would like a second opinion, we would be grateful if you passed on our numbers: 519-675-2011 or 1-800-265-5911. Thanks for keeping us in mind.

*Congrats, Ian C., our winner this quarter!*

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