



Do As I Say, Not As I Do?

"I contend that for a nation to try to tax itself into prosperity is like a man standing in a bucket and trying to lift himself by the handle."

Winston Churchill

Global equity markets have had a decent upward move the last four to six weeks. But usually, in modern history, with few exceptions, the first five to seven months after a re-elected President has tended to be perfectly fine for markets. Why? Mostly because markets hate uncertainty and the two year culmination of an election lifts a huge weight off investors' minds. Coupled with the much hyped Fiscal Cliff, investors simply had less to fret about.

Generally, throughout US history, their national wealth was never the result of a politician. No, far from it. Generally it came from the much defiled 1% of the population and their dedicated followers of capitalism. People with names like Andrew Carnegie, Andrew Mellon, JP Morgan, Sam Walton, Bill Gates, Steve Jobs.....all capitalists who were ultimate wealth creators, paid a lot of taxes and more importantly.....created a lot of jobs which help raised living standards for many others. It was voluntary, free-will entrepreneurship that ultimately creates national wealth and power, not government dictations to decide who will be the winners and losers.

President Obama's speech at his most recent inauguration, a forum where speeches are usually about highlighting similarities and which usually speak of unity for a common cause, seemed to be more of an adversarial, inflammatory tone.

Americans have historically been people of aspiration. Throughout their history, they have fought for every inch of what they have achieved, right from the American Revolution (to separate from Britain), to their Civil War, two great Wars, and so on. They have a history of risk-taking which accepts the hit-or-miss nature of that innovation; they have always had a profound belief in self improvement, and a self confidence that often borders on arrogance. All these have enabled their people to discover and develop their talents to the fullest, and where yes, even a child raised in poverty could become The President.

This view of the USA was personified by Ronald Reagan, the icon of the right and even President Obama has tipped his hat to him many times in speeches. Reagan had an uplifting and inspiring persona rooted in a profound believe of basic goodness, strength, generosity and the exceptionality of American people. In the last couple years, I've had the honour of being able to talk to people who worked in the White House during Reagan's Presidency, and the feedback was unequivocally the same across the board: He was a great President and human being, and one who believed the notion of individual and national progress is uniquely American. Each generation believes the next can have it better, much like the

hopes and dreams of my parents when they left a war-torn Italy, who could have just as easily settled in the USA.

It's no wonder the USA continues to attract ambitious immigrants, where their children become true "Americans."

The contrast between President's Reagan and Obama is stark. The latter, as confirmed by his own words, has a western European style vision for the USA. He is taken by the socialist environment of Western Europe where dynamic markets are scorned and feared, and where people strive to work less hours per week, retire as early as possible with the fullest benefits possible, and where security and predictability trump risk taking and innovation.

Taxes keep going up, government spending continues to go up, regulation and rules proliferate and dependence on government is encouraged. Equality is more important than liberty and entrepreneurship.

But ironically, President Obama is completely different than Senator Obama. In the run-up to the 2008 election, then a swiftly rising junior Senator Obama from Illinois, stood on the Senate floor in March 2006 where he stood openly against spending increases and stood against the continued raising of debt ceilings:

"I rise today to talk about America's debt problem. The fact that we are here today to debate raising America's debt limit is a sign of leadership failure. It is a sign that the U.S. Government can't pay its own bills. It is a sign that we now depend on the ongoing financial assistance from foreign countries to finance our government's reckless fiscal policies. Over the past five years our federal debt has increased by \$3.5 trillion to \$8.6 trillion...and over the next five years between now and 2011 the President's budget will increase the debt by almost another \$3.5 trillion...

Our debt matters internationally. My friend, the ranking member of the Senate Budget Committee, likes to remind us that it took 42 Presidents 224 years to run up only \$1 trillion of foreign held debt. This administration did more than that in just five years... Increasingly, America's debt weakens us domestically and internationally. Leadership means that "the buck stops here." Instead, Washington is shifting the burden of bad choices today onto the backs of our children and grandchildren. America has a debt problem and a failure of leadership. Americans deserve better [and] therefore I intend to oppose the effort to increase America's debt limit."

Senator Barack Obama

His own comments stand on their own in light of the astounding deficits his administration has piled up which dwarf, indeed embarrass, those "puny" Bush administration deficits. So now we have a President demanding an extension to a debt limit he himself had voted against. And yet he claimed Romney was a flip flopper.

On top of that, the "pork-barrel" bills which were attached to the recent Fiscal Cliff bill (the cost of these additional tax breaks will cost US taxpayers over \$63 billion in 2013 alone):

- Tax breaks for offshore loans (Section #322 of the bill)
- Tax breaks for offshore jobs
- Luxury condos for Wall Street (Section #328)
- Boxcars of free railroad money (Section # 306)
- "Special Expensing" rules for Hollywood (about \$266 million)
- Mine rescue team training (Section #45N)
- Temporary increase in limit on cover-over of rum excise taxes to Puerto Rico and Virgin Islands (Section #7652F)

- American-Samoan economic development credit (Section #119)

Giveaways of taxpayer money? Wasteful government spending? You bet! All to improve the middle class? Hope and change in Washington? Not even close! The public has spoken and reelected the Democrats on a platform of tax increases. The British have learned the lesson of higher taxes and it is a lesson the US will soon be learning. Back in 2009, Her Majesties Revenue raised the marginal tax rate on those earning more than EUR 1 Million/year from 40% to 50%, and lo and behold, there were 16,000 individuals who earned more than EUR 1 million, but a year later there were but 6,000. Ten thousand of them literally disappeared and so did the tax revenue with them. The government honestly believed, using as all governments do the simplest of baseline forecasts, that raising the rate to 50% upon those 16,000 would raise tax revenues appreciably. In reality, the EUR 13 billion raised from them in 2009-10 fell to EUR 6 billion. The sum of tax revenues actually fell from 9.0% of the total to 4.4% in 2010-11.

So now, Prime Minister Cameron, having seen the error of his ways, has reduced the marginal tax rate back to 45%. I would suspect we will see some of those "lost" millionaires return.

To this end, when George Bush Sr. signed in effect a tax increase in 1990, the Congressional Budget Office (CBO) estimated tax revenues would raise \$1.6 trillion over 3 years and that they would average 9% of GDP. In actuality, the take was \$140 billion less than the forecast. Similarly, Bill Clinton's first two years, he raised taxes as well, only to find tax revenues were \$10 billion below the CBO projections and actually fell as a percentage of GDP. When the Republican Congress cut taxes back in 1997, revenues taken in by Washington were \$356 billion more than had been forecast by the CBO.

There is a lesson to be learned in these four examples, and President Obama is soon to learn it as well (as the French are learning, and the Brits, etc.). President Obama used the election podium to brainwash many into believing that the economy is a zero sum game, with winners and losers.

American political satirist and journalist P.J. O'Rourke summed it up best recently:

"Mr. President, the worst thing that you've done is that you sent a message to America in your reelection campaign that we live in a zero-sum universe.

There is a fixed amount of good things. Life is pizza. If some people have too many slices, other people have to eat the pizza box. You had no answer to Mitt Romney's argument for more pizza parlors baking more pizzas. The solution to our problems, you said, is redistribution of the pizzas we've got – with low-cost, government subsidized pepperoni somehow materializing as the result of higher taxes on pizza-parlor owners.

In this zero-sum universe there is only so much happiness. The idea is that if we wipe the smile off the faces of people with prosperous businesses and successful careers, that will make the rest of us grin.

There is only so much money. The people who have money are hogging it. The way for the rest of us to get money is to turn the hogs into bacon. The evil of zero-sum thinking and redistributive politics has nothing to do with which things are taken or to whom those things are given or what the sum of zero things is supposed to be. The evil lies in denying people the right, the means, and, indeed, the duty to make more things."

American history, as I commented earlier, was always filled with the assumption that upward mobility was possible. But American society was never egalitarian. It was always accepted that there would always be substantial differences in wages and wealth. In fact,

progress was often driven by a desire to emulate the wealthy. What the current policies are doing is a structural shift which will reduce the middle class standard of living. They will not be able to consume the products they produce because they will not be able to afford them! Obviously this creates a massive political debate, and in political debates someone must be blamed.

The USA was built on the assumption that a rising tide lifts all ships. That has not been the case for the past 20 years. The left would argue the solution is to introduce laws to transfer wealth from the rich to the middle class. That may increase consumption, but would longer term reduce capital and incentive to invest. You can't invest what you don't have and you won't accept the risk of investment if the payoff is transferred away from you.

The right will argue that allowing the free market to properly function will fix the problem. The free market however doesn't guarantee social outcomes, merely economic ones. The most significant actions made by government tend to be unintentional. Government programs frequently fail to fulfill even minimal intentions while squandering scarce resources.

Next week will discuss what I see for 2013. Didn't want to make this Infomail any longer!

Stay tuned,

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Vice President and Director
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