



# Infomail

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## 2012 – The Three 'E's... The Economy, Egos, Election

*"If you want to encourage something, reward it. If you want to discourage it, punish it."*

Aristotle ~ Greek Philosopher 384 BC – 322 BC

There is no doubt this year's US election will be about the economy, jobs and debt, but I feel the tide may be turning on what values and principles voters hold dear as well. I think there is a growing understanding of how social issues are indeed connected to financial issues.

There has always been a promotion of anger and victimhood in our society, but these emotions seem to get elevated every recession, none more so than during the recent economic downturn where lines have been drawn between the '99%' and the '1%'. Leaders around the world need to put aside their partisan politics, be it Liberal or Conservative, Democrat or Republican, etc. and more importantly their egos, vanity and rigid ideology. Politics has become mean spirited, and seems more intent on punishment than promotion; none more so than the policies coming out of the White House. The unrelenting attack of successful individuals and businesses under the banner of fairness is the most disturbing. Of course, heading into a Presidential election, most incumbents run on their track record. Since he doesn't have one he can promote, this President has chosen class warfare. Perhaps a brilliant political move, but divisive to the nation. But hey, all's fair in the name of getting re-elected it seems.

I find it amazing that North America is leaning towards becoming a region of the world that punishes hard work and success but rewards sloth. Sure there are many cases of legitimate misery and hardship, maybe even some bad luck, but now you read many stories of how individuals refuse to take any job, holding out for the "right" job and sustain themselves on the taxpayer dime until the "right" job comes along. People are angry at CEO's and Exec's, and sure, in many cases they don't deserve what they make but I'm a Yankee fan, and Alex Rodriguez still made \$25 million+ going 1 for 18 in the playoffs. So the CEO of Bank America who employs 400,000 people and runs \$3 trillion in capital is evil for making \$10 million per year, but Justin Bieber (who was a street busker but three years ago) made \$56 million and that's OK? And how about all those Hollywood movie stars making \$20-\$30 million per movie and given some of the dogs I've seen at the theatres lately, no one is offering a refund.

But nobody is angry at lazy, unmotivated people, people who overextended themselves on credit, or bought a home too large, or for not bothering to get the education required to get a good job in this more than ever competitive global economy?

We've completely lost our bearings folks. We've lost our hustle and ambition and are encouraging contentment and punishing desire that leads to hard work. A lot of people are getting duped by the political rhetoric it seems.

I loved football coach Vince Lombardi. One of my favourite quotes of his was:

*"The only place success comes before work is the dictionary"*

Today, about 48% of all Americans do not pay ANY income taxes. So in other words, almost half take from the American government without contributing a dime. Barack Obama is the first US President whose election symbolizes the united efforts of half of society. He knows it and that's why since his inauguration his efforts have been directed towards redistribution. In effect it led to the explosive political movement called the Tea Party. In 1773, the Tea Party was a revolt against the British for taxation without political representation. The 2010 version of the Tea Party is essentially against political representation without taxation!

The sides being drawn have morphed the Democratic party into the party of non-taxpayers and less fortunate, plus a slice of the very wealthy (like Hollywood types) and the Republicans are becoming the voice of the taxpayers who are unwilling to have their earnings taken away from them. The demographics favour the Democrats.

Similarly, since its independence in 1947, India has been a society dominated by non taxpayers. Today, about 75% do not pay any tax at all and as a result, Indian politics have been dominated for decades by policies which distribute free services and goods, and which seek to distribute income and wealth. The natural result has been corruption, as businesses try to illegally hide income from tax collectors, corruption in the government agencies, and of politicians whose personal wealth rises immensely while in office. The worst hit is the middle class, who are unable to hide their income. But even there, the tide is changing because that middle class is now 150-300 million strong and strong enough to now bring change to the Indian government.

The irony of the 99%, is that the top 1% – not in Canada or the USA – but worldwide, an individual need only earn \$34,000 a year after tax (or \$68,000 per couple). There are 50 million people worldwide (out of 7 billion) that fall into this group of the "richest" 1%.

- 29 million (58%) are Americans
- 4 million (8%) are German
- France, Italy and England are at 6%
- Canada, South Korea, Japan and Brazil are 4%

(Gartman Report January 2012 – all numbers rounded)

So far, Obama's policies have yielded little but more despair and more divisiveness. It's been an avalanche of taxing and spending, and just last week presented another deficit budget of \$4 trillion (fourth one in a row after promising it would be balanced after his second year). It just never stops. We in Ontario are finally awaking to the smelling salts of what our Premier's taxing and wasteful spending have created over the past 8 years. Our debt to GDP is rapidly approaching 60%.

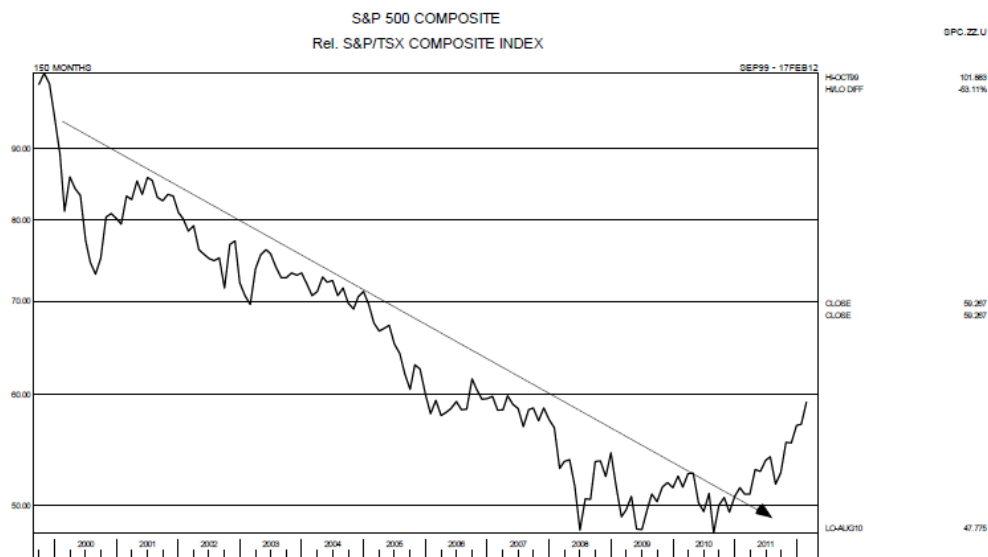
One only need to look at the balance sheets of the Euro nations which are in trouble and know where we are headed if nothing changes. Of the 18 counties that have defaulted on their debts since 1980, the average debt/GNP ratio has been 54%. Once a nation gets past 30%, it gets problematic. For some reason 54% has been the tipping point.

Now consider these Debt/GDP ratios:

Greece	143%
Italy	119%
Ireland	96%
Portugal	92%
Spain	60%

A Greek default is not a question of if but when. The numbers will not work and whether it's March 2012, or March 2013 or whenever, it is inevitable. As the austerity measures being imposed on them bite, it will make it even harder to get any economic growth.

While there is a growing realization (and acceptance) of a Greek default, I believe there has been a misplaced preoccupation with Europe for some time now. The situation has improved if only talk and timid response has turned into "shock and awe" type of action. Sovereign yields have come down as a result.



Meanwhile, valuations for US equities have been stuck below a five-decade average for the longest period (since Nixon was President!). According to Bloomberg (January 30<sup>th</sup>), analyst estimates for corporate profits are at the fastest expansion in 25 years since 2009, yet the markets don't reflect that.

The recovery since 2009 has been driven by three key supports:

1. liquidity injections by global central banks
2. improving economic momentum
3. strong corporate profits

Last week's Barron's cover story featured notable Wharton finance professor Jeremy Siegel who sees a strong likelihood the Dow Jones hits 15,000 in 12-15 months and 17,000 within two years. Bold call!

I've written many times already about how positive US election cycles have been historically. Since 1928, in 21 cycles, only three were losers (1940 with WWII looming), 2000 (dotcom crash) and 2008 (financial crisis).

S&P 500 Stock Market Returns During Election Years		
Year	Return	Candidates
1928	43.6%	Hoover vs. Smith
1932	8.2%	Roosevelt vs. Hoover
1936	33.9%	Roosevelt vs. Landon
1940	- 9.8%	Roosevelt vs. Willkie
1944	19.7%	Roosevelt vs. Dewey
1948	5.5%	Truman vs. Dewey
1952	18.3%	Eisenhower vs. Stevenson
1956	6.5%	Eisenhower vs. Stevenson
1960	.50%	Kennedy vs. Nixon
1964	16.5%	Johnson vs. Goldwater
1968	11.1%	Nixon vs. Humphrey
1972	19.0%	Nixon vs. McGovern
1976	23.8%	Carter vs. Ford
1980	32.4%	Reagan vs. Carter
1984	6.3%	Reagan vs. Mondale
1988	16.8%	Bush vs. Dukakis
1992	7.7%	Clinton vs. Bush
1996	23.1%	Clinton vs. Dole
2000	- 9.1%	Bush vs. Gore
2004	10.9%	Bush vs. Kerry
2008	- 37.0%	Obama vs. McCain
2012	?	Obama vs. ?

Overall, pessimism and fear remain high while expectations are low. I see and hear it daily. Investors are poorly positioned (both institutional and retail) should a huge bull market kick in. The charts are implying a technical breakout on many levels, economic data has improved on many levels, and central banks have promised market friendly interest rates for some time still. And volatility, so far in 2012 anyway, has been greatly reduced.

I remain unabashedly bullish and wrote many months ago we could see all time highs in the S&P 500 and TSX in 2012. I still believe that, and the action so far in 2012, supports that belief.

Stay Tuned,

Vito Finucci  
Vice President & Director  
Private Client Division

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