

In this issue

2008 Post Election Economic Analysis



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WHERE ARE WE AFTER NOVEMBER 4TH?

On the bright side, the two-plus year election cycle is over. Additionally we can expect 12-18 months of election free coverage before it once again returns as a daily part of the news cycle.

The last four to six months have seen a significant deterioration in the US economy. As the financial sector's problems boiled over to engulf Washington's focus it led to government intervention in the private sector on a scale not seen in several decades.

We remain in a recession, but this will *NOT* lead to the coming of the Second Great Depression. The Federal Government's aggressive action through the Treasury, FDIC, and Federal Reserve is necessary for the immediate stabilization of the financial sector and the economy as a whole. Coupled with the action by most major economies and high level coordination, the world will avoid a self-inflicted economic catastrophe.

The Democrats will control all branches of the Federal Government for the first time since 1992-1994. In this issue we will try to look into our crystal ball and analyze what may occur during the first two years of the Obama Administration.

ECONOMIC STIMULUS— ROUND TWO

We expect that by the end of February 2009 (at the latest), Congress will pass and the President will sign a second stimulus package. It may happen in two steps: one in the lame duck session and then a second portion after the organization of the 111th Congress.

This legislation will at least have the structure of spending on infrastructure in a significant amount (perhaps \$75 to \$100 Billion), as well as an extension of unemployment benefits and related transfer programs.

Any real economic benefit will be in the infrastructure portion, but will be too small in dollar amounts to make a immediate impact. Expect that the Big 3 US automakers will get some form of economic lifeline that will avoid a bankruptcy filing. In our view this is necessary and ultimately unavoidable.

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TAX POLICY

It is no revelation that we expect tax rates to go up. In light of the perceived state of the economy, we believe that there is at least a 20% chance that the new administration will elect to forego any specific tax hikes during 2009. Instead, we think they may just let the Bush tax cuts of 2001 “sunset” (read expire) as they are legislatively set to do in 2010.

This would be politically astute to avoid a tax hike as a top priority AND have the benefit of delaying the “economic drag” those hikes will place on the economic recovery. Watch to see how President Obama handles those in his party who will push for an increase sooner. This is one of our “observation points” to see which end of Pennsylvania Avenue has primacy in the initial months of 2009, and will set the stage for the balance of power within the Democratic Party.

We do expect that as part of the stimulus, the enactment of some of Candidate Obama’s refundable tax credits will be put into law by late spring of 2009. Again, these won’t have much immediate impact in the short term since they won’t be enacted in the lame duck session and the 111th Congress can’t legislate them earlier than January 1st, 2009.

FINANCIAL REGULATORY REFORM

Within the financial sector, the scope of issues the Congress will address is large. These include a reform of short-sale rules, an overhaul of credit-rating agencies, an elimination of mark-to-market accounting, and additional executive compensation regulations. Meanwhile, financial services firms will be both trying to influence the debate AND carve out niches that will allow them to grow in the future.

We believe that banks and bank holding companies will emerge in the strongest positions. Hedge funds will be brought under mandatory SEC registration. Finally, there is a long shot at a unified regulatory regime that combines multiple overlapping agencies (similar to the way the Department of Homeland Security consolidated some 16+ departments and functions following the 9-11 attacks).

We expect this reform discussion will be the second highest priority following the stimulus package and will *NOT* be completed in an overarching bill but rather piecemeal (or it may die of its own complexity). This is our second “observation point” to see if Congress’ focus is to restructure to prevent future problems or punish firms and selected individuals for their role in the latest financial crisis.

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Trade Policy

Perhaps the most cloudy area of economic policy will fall under the broad heading of international trade. The weaker dollar over the majority of the Bush Administration's tenure helped to fuel a large increase in exports during 2005-2008 and added to the nation's GDP. It is critical to our long-term economic growth that trade continue to expand.

There were statements made on the campaign trail that we seriously hope were just political rather than indicative of Obama policy initiatives. Specifically, comments regarding renegotiating NAFTA and the recently passed Korea-US Trade Agreement are, we believe, just that.

We don't think the administration will place trade at the forefront of its economic policy. This would cause a battle with Congress that will side track the stimulus bill and create significant tension with Unions. For that reason, we won't expect to see either the Columbia Free Trade Agreement be voted upon nor any serious efforts to restart the Doha Round of Global trade negotiations. This is economically short-sighted and is our third "observation point."

On a positive note (regarding trade), the G-20 nations all understand that restricting trade was a major contributing factor to deepening and lengthening the Great Depression and the fear of a repeat will keep the worst ideas of protectionist forces at bay.

Health Care

This will be a casualty of the cost of the financial sector rescue package, the time to change the financial sector regulatory regime and will not happen in the 111th Congress. This is our final "observation point" for the next 2 years: The Republican party may find its voice as the loyal opposition on this issue as they did in 1993-1994.

Labor Legislation

Unions will proactively seek to enact their agenda, which include changing the voting mechanism for forming unions and moving to a "card check" rather than secret ballot. This passed the House in the 110th Congress but was blocked in the Senate. Depending upon the outcome of the few remaining Senate races and recounts (Georgia and Minnesota), which we expect will remain in Republican control, this will also die in the Senate and will be a major issue in the mid term elections in 2010.

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