

In this issue

**2008 Post Election
Economic Analysis**



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One of the more interesting elections in recent years has finally, and thankfully, ended. We are now left to ascertain what it means for investing and financial planning in the next two years.

The politics of the election were fascinating but at Praetorian Guard we are more interested in the implications for our clients and we will attempt to break down the significance into several areas: taxes, regulatory environment, financial reform international trade and health care. Each of these plays some role in setting the table for our investment outlook in the next few years.

TAXES

First up are the tax rates we will pay starting in January 2011. This issue will be dealt with by the lame duck session of Congress and we will see the 2001 and 2003 marginal tax rates extended for all taxpayers until December 31st, 2012. We believe this is the right move for an economy currently growing at a relatively meager 2% annual rate and not creating private sector jobs in sufficient numbers to bring down the unemployment rate.

Next up is the estate tax and this won't be dealt with until January and will be done so retroactively to the first of the year. We have consistently believed that the country would NOT return the estate tax rate all the way back to 2001 and we stand by that prediction.

Instead we expect to see the prevailing 2009 tax made permanent. This called for a \$3.5 million individual exemption along with a top marginal rate of 45%. This will move many of our clients out of the grasp of the estate tax but there is still a need for estate planning, trusts and related issues.

We hope that one point where the two parties can agree upon is to give a one year tax holiday for the repatriation of capital currently held overseas by US corporations. There is more than \$1 trillion outside the US and bringing that back home would allow for capital investment and help the economy significantly. We expect it will take place in the first half of the year.

Lastly we expect that the long term capital gains tax rate will rise to 20% as scheduled but be made applicable for all taxpayers. While this is an increase, it is not an issue that the Republicans in the house will select for their first battle.

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REGULATORY ENVIRONMENT

We expect this to be the point of friction that will keep partisan anger simmering for both parties. We believe the Administration will attempt to regulate some items they were unable to get through the 111th Congress and we anticipate that the House of Representatives will attempt to “de-fund” some of the more egregious (in their eyes) attempt at regulatory over-reach.

We presume that the life of the President’s Cabinet just got progressively tougher and they will have to spend more time “on the Hill” answering questions. Any bold regulatory moves will bring about an equal response from the House.

In general, this will be positive for firms and businesses. They have been hit with a great deal of new regulations in the last two years and this will provide time to digest, adjust their practices and expand.

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FINANCIAL REFORM

Look for the Republicans to force the spot light on Fannie Mae and Freddie Mac, which largely escaped the Dodd-Frank Financial reform bill that passed in the summer of 2010. We expect an overhaul of their operations to be on the table as well as discussion/moves to eliminate the implicit government backing for their debt. As a result, housing will continue to be a lagging sector of the economy, causing a drag on the construction industry.

We surmise that the Federal Reserve will come under increasing pressure after its recently announced second round of quantitative easing. We anticipate the \$600 billion of government bonds purchased will NOT have the desired impact and that we will see QE3 by early fall of 2011. We expect interest rates to come down a bit more and stay that way through most of 2011. This will have the effect also of further declines in the value of the dollar but will help our nation’s exports and that is a boost to GDP.

INTERNATIONAL TRADE

This is an area where we expect to see compromise between the House and the Administration. This is critical to getting a leadership role in international trade once again and we predict that trade agreements with South Korea and Columbia will pass before June 30th 2011.

China will continue to draw a lot of attention but the worst has passed. It will allow the yuan to further appreciate in the first quarter of the year (the Chinese NEVER do anything immediately when pressured) and that will help tone down the rhetoric.

HEALTH CARE

Repeal and replace made for a nice campaign slogan but it won't have a chance of becoming law until 2013, just about the time the legislation starts to kick into full gear. We see this is a place where the Administration will have to give some ground, the House will have to vote for full repeal for political reasons but it will die in the Senate.

Overall, we like the health care sector given split leadership in Washington. It will have time to digest the existing legislation and revamp operations to remain profitable in the future.

Lastly, we don't know about the pending lawsuits against the individual mandate. Watch these closely because if a court strikes them down and it is upheld on appeal, then we WOULD expect the remainder of the bill to be repealed.

INVESTMENT OUTLOOK

Overall the investment outlook improved as a result of the election. There will be few if any major legislative initiatives and business will be able to absorb the changes that have been significant since 2008. Bringing home capital currently held overseas combined with the load of cash firms have on their balance sheets will result in increased mergers and acquisitions, capital expenditures and dividend payouts. All will help to raise the stock market's level.

CLOSING COMMENT

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The single most important economic data point to watch in the next 18-24 months is the unemployment rate. If it remains high, which we define as 8% or more, going into the 2012 elections, then Barack Obama will be a one term President. If it drops into the sixes we will have a battle for the White House. Either way, this number will bear outsize importance in the mind of voters and politicians for the foreseeable future.

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