

A NEW PARADIGM

March 9, 2009

A mere two weeks have passed since my last strategy piece. In that piece, I said that the stock market focus had moved from the dismal financial and economic environment to discounting the new course of government. I also suggested that “the jury was still out with regard to government policies and the ideological resilience of newly elected leaders.”

Well, the jury has returned and the verdict is not good. The ideological resilience of our leaders has become very apparent. The plans outlined in the State of the Union Address and the subsequent budget releases are beyond the scope of Keynesian economics and into a redistribution of wealth agenda. Government is spending at unprecedented levels and intends to have the most successful American corporations and individuals pay for it. This is why “blue chip” multinational stocks have been falling at a much faster rate than the broader averages.

Targeted for new taxes and regulation are all multinational companies, oil companies, pharmaceuticals, banks, insurance companies, and any raw material producer or manufacturer with a “carbon footprint”. Clearly, utilities, steels, coppers, papers, coal producers and aluminum producers will also come under pressure if the new program is enacted. Spending for defense will also be curbed, so defense companies are also in a free-fall. This is stuff that no free market economic school of thought would advocate.

Additionally, the tax on dividends and capital gains for individuals will be increased by 33% and the itemized deductions for individuals in the upper two brackets will be cut by 20% for one year, and then 30% thereafter. Approximately 60% of small business owners will be affected by these tax changes and you can expect them to react by cutting expenses at a time when profits are falling and tax rates are going up. This is significant because the majority of Americans are employed by small business.

Schools, churches and charitable organizations will suffer once the deductibility of charitable giving drops. Perhaps there is one more good year of giving before it hits. Local real estate tax and mortgage interest deductions will be partially disallowed as well, adding to the lack of affordability of homes for many. Perhaps the “high end” will finally fall.

If these programs take effect, we anticipate more layoffs and a continued drop in consumer confidence. Corporate cash flow and profits will likely fall further as will the dividends of those affected corporations. All this in the name of growth? All this in the name of repairing our economy? At what level will the stock market finally discount all the ramifications of this change? At what level will our leaders be willing to listen to what the stock market is saying? Do they even care?

Attempting to write a market commentary in this environment is tantamount to a navigator “shooting the stars” in a hurricane. We are still advising everyone to stay below and keep the hatches securely tightened. Unfortunately, we can’t anticipate when this storm will blow over. When it does, there will be a wonderful opportunity for those with cash. **At that time, common stocks should be the asset class of choice as tax rates for common stock returns are scheduled to be 50% lower than returns derived from other asset classes.** One piece of advice at this point is to consolidate your assets and get your cash ready!

In the meantime, inflation protected treasuries, and gold continue to be good portfolio enhancers along with cash and short-term treasuries. Stocks will remain at a minimal level and in well-researched companies that will be somewhat immune to the new government regulations and taxes. Above all, avoid debt when at all possible. We will be in touch...

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Harlan J. Cadinha
Cadinha & Co., LLC