



economics + finance + investment risk

The Daily Capitalist

The State of the Economy 2010

By Jeff Harding
February 9, 2010



I have been poring over current economic data, year-end reports from various sources, and current or proposed legislation. It leads me to conclude that my views of the economy's future have not substantially changed.

I think it still comes down to the real estate market, deleveraging, organic business cycle recovery, changed consumption patterns, and taxation and regulation. Layer on top of that the Fed's options.

It still is not pretty.

The basic question you have to ask is: *what will drive the economy forward?*

Right now the answer is capital. And here I am not talking about money the government spends to stimulate the economy.

I am referring to private capital supplied by merchant banks from new savings or accumulated capital. I am talking about investment capital from savings directed into various conduits such as hedge and venture capital funds, various private lending sources such as

factors and leasing companies, investment banks, pension funds, insurance companies, the securities market.

If consumer spending is the bedrock of our economy, then consumer spending without the juice that makes capitalism flow equals slow or no growth.

As we all know, the juice has dried up. And the reason for it is that there is still a substantial amount of debt on the books of financial institutions and individuals that needs to be liquidated or paid off. *Deleveraging*. Until that happens the economy will stagnate. At this point there is not much more the government can do; their attempts to “cure” the problem are making things worse.

There is another overriding factor to consider: This is the biggest financial crisis the world has ever experienced. The bubble reached unprecedented highs in a vast portion of the planet and debt levels have never been as great on a worldwide basis. It is a mistake to think this is just another recession, as most economists do. While the impacts of such financial crises have been similar throughout [history](#), one must fully appreciate the scope of this one.

Fundamental Considerations

Last year I wrote “[Economic Megatrends That Will Drive Our Future](#).” These “megatrends” as I called them represent fundamental changes to the economy:

Megatrend No. 1. The culture of consumption is broken and won’t return to former levels.

Megatrend No. 2. Consumers will continue to increase savings to prepare for retirement.

Megatrend No. 3. Declining U.S. consumer demand will continue to negatively impact the world economy.

Megatrend No. 4. Deflation will continue for some time.

Megatrend No. 5. Home ownership rates will decline to more historical levels of, say, around 66%, down from the high of 69% during the boom, which will keep a lid on home prices.

Megatrend No. 6. Government stimulus and recovery programs only delay recovery and deepen the pain for workers.

Megatrend No. 7. Massive federal deficits will double the national debt, result in higher taxes, and will act as a permanent drag on the economy.

These conditions will continue to hold back GDP growth for some time. Many economists predict that things will go back to “normal” though perhaps slightly less robust as before. They are wrong.

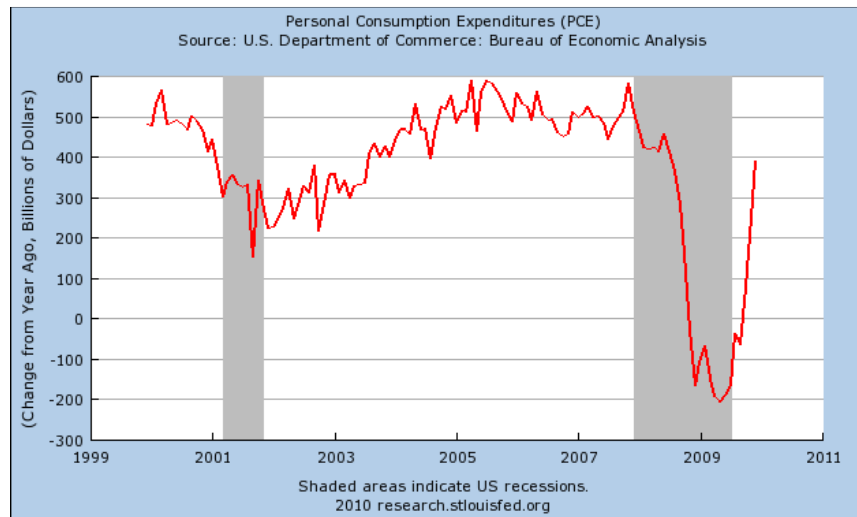
What we can conclude from these megatrends:

1. Consumer spending will be subdued especially among the biggest spenders: the Boomers.
2. Households will reduce debt and increase savings.
3. Housing demand will decline.
4. As the government becomes a larger factor in the economy as a percentage of GDP, economic growth will decline.
5. Higher taxes will be needed to pay for increasing deficits which will also subdue economic growth.

These are facts, not guesses.

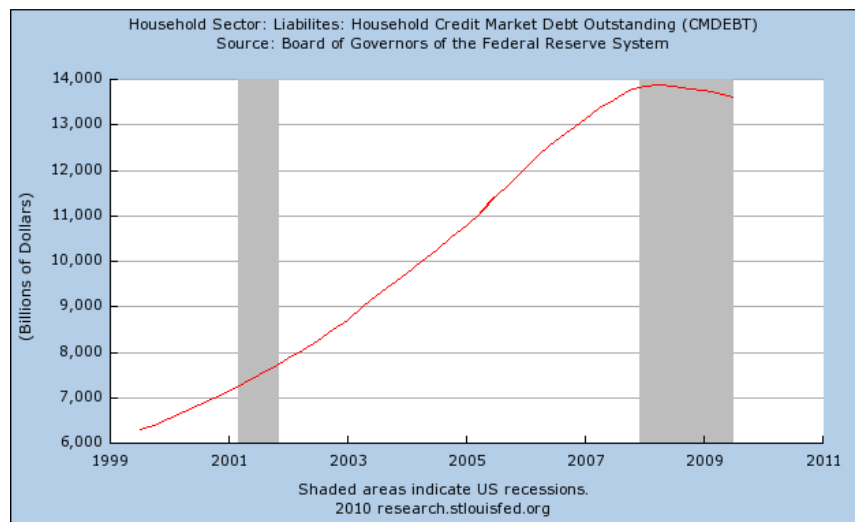
The Consumer

Personal Consumer Expenditures (PCE) have accounted for about 70% of the economy. PCE does include Medicare expenditures for individuals so it's a bit skewed.



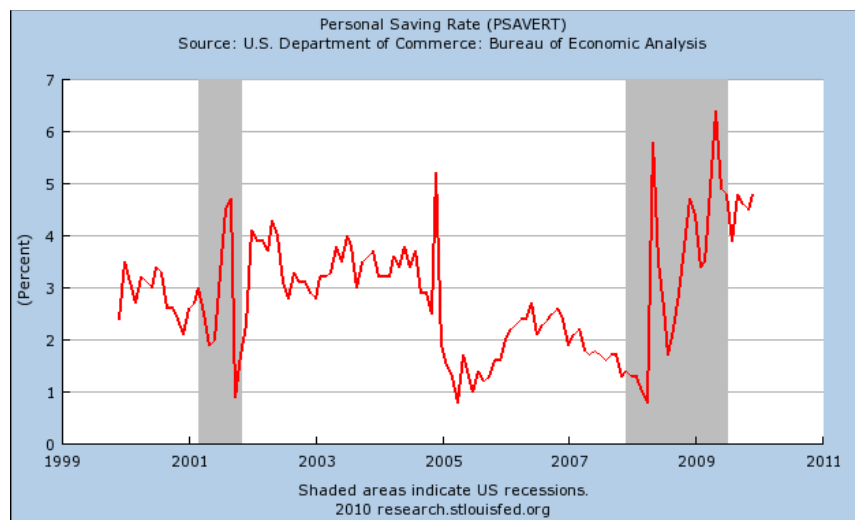
What you can see from this chart is a rebound in consumer spending as a result of fiscal stimulus, mainly from Cash for Clunkers (See the [durable goods](#) section of GDP), and from holiday discount sales. Consumer spending increased in November for the [sixth time](#) in seven months. Retailers increased sales 3.3% in January. The biggest rise was in apparel retailers.

Then there is the reduction of household debt:



Note in the above household debt chart, how debt exploded after 2000. Rising home prices was the asset base for the debt. The boom was credit financed: consumers borrowed rather than saved.

And now the personal savings rate is growing rather dramatically:



As you can see, consumers are reducing debt and increasing savings (4.8% per latest numbers). You will note savings decreased a bit at year end. That is where the cash for the blip in consumption came from. You will also note that saving is resuming its climb (4.8%).

Consumer credit has tanked. In November, the latest numbers, consumer credit fell by \$17.5 billion. "The series of 10 straight declines was the [longest since record-keeping began](#) in 1943. ... Consumer credit outstanding decreased at a seasonally adjusted annual rate of 8.5% to \$2.465 trillion ..."

Banks are reluctant to lend, credit card debt has declined, and consumers, worried about the economy, debt, and retirement, are saving.

Unemployment

Unemployment hasn't improved much, and as the [recent employment numbers](#) reveal, while the rate of unemployment is slowing down, the actual numbers of unemployment remain high, at 9.7%, although down from 10%.

[Presently U-6](#) unemployment is still very high: 16.5%, but down from 17.3% in the prior month. U-6 is: "Total unemployed, plus all marginally attached workers, plus total employed part time for economic reasons, as a percent of the civilian labor force plus all marginally attached workers." This includes about 2.5 million workers who aren't even looking for jobs anymore.

Wages and income are at [all-time lows](#):

Wage and benefit costs, both before and after adjusting for inflation, grew more slowly in 2009 than in any year since the U.S. government began tracking data in 1982, as double-digit unemployment weakened workers' ability to command higher pay.

Adjusted for inflation, wages and benefits fell 1.3%, after rising 2.8% in 2008, the first year of the recession. The inflation-adjusted cost of wages and benefits at the end of 2009 stood just 1.1% higher than at the end of the previous recession in 2001, the Labor Department said.

In his January 29 report, [David Rosenberg noted](#), "In Q4 aggregate private hours worked contracted at a 0.5% rate. Never happened in last 50 years with GDP growth at 5.7%." He questions the robustness of GDP. The other side of this is that [productivity output per worker](#) increased on a "seasonally adjusted annual rate of 6.2% in the October-to-December period." This says that employers have streamlined production and operations, are lean and mean, and are reluctant to hire until they are sure demand has really improved.

Without rising incomes, you can't have increased savings *and* reduction of debt AND increased consumption. Savings defers consumption. Incomes are flat, as shown above.

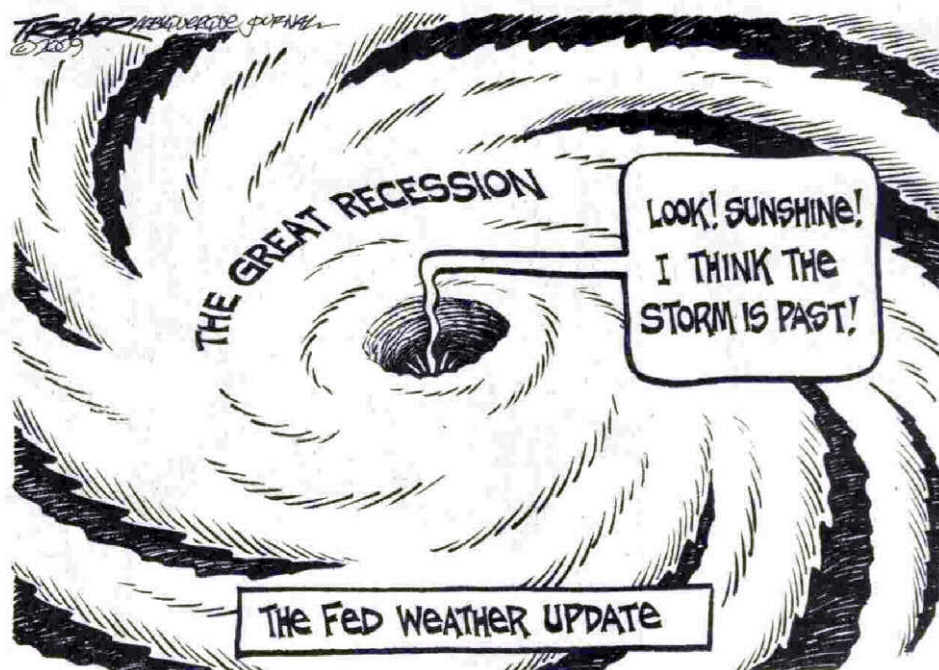
Fiscal Stimulus

Christina Romer told us when unemployment was 8% we needed fiscal stimulus to stop unemployment from going to 9%. At 10% we are told we need even more stimulus. The Administration is trying to claim that fiscal stimulus has been a big success. But they have [only spent \\$58 billion](#) of \$200 billion in federal contracts, grants, and loans *awarded* out of a total of \$275 billion *allotted* for such expenditures. Not, as Paul Krugman keeps reminding us, sufficient (according to Keynesian theory) to revive a \$14 trillion economy.

It is true that fiscal stimulus has an impact on GDP, so it is unfair to say such stimulus cannot create any economic activity. The problem is that it doesn't create wealth which is the foundation for true "organic" economic growth. Stimulus is really just a transfer payment: taking money from one person and giving it to someone else to spend on something the government wants. There is absolutely [no evidence](#) that Keynesian stimulus is working now or

has ever worked where employed. And, no one ever asks the person whose money funded such stimulus what he/she was going to do with the money--how much private economic activity was lost as a result?

Regardless, despite calls for more stimulus, there appears to be little political will for it. It is no coincidence that we are hearing talk of "fiscal responsibility" and "worrisome debt" from the Obama Administration. Obama realizes that runaway spending and rising deficits jeopardize his ambition for expensive social programs such as "free" health care and "free" college education. They have given up on stimulus and are focusing on a jobs bill that they hope will reduce unemployment before the next election. Thank you, voters of Massachusetts.



The Importance of Debt

The Fed, the Obama Administration, and a Democrat-controlled Congress are doing everything they can to prevent a recovery by delaying or preventing the liquidation of debt on the books of financial institutions.

In a credit-induced business cycle, such as this one where the Fed pumped vast amount of money into the economy (1.0% Fed Funds rates), some asset goes crazy. This time it was real estate, residential first and then commercial real estate. It led to an unprecedented explosion of debt--worldwide. This fake money expansion directed capital into bad investments as we've sadly learned.

There is a reason banks have tightened credit: they are worried about their capital base because they have too much bad debt on their books related to real estate. If they lend the money out, they worry that they might need it to cover their existing bad debt if things get even worse, so why take the risk and lend, they reason.

The Administration is doing everything they can to prevent debt write-downs because they fear the ongoing debacle in commercial real estate and its impact on the banking system. Last year they approved new FASB Rule 115, a de facto [suspension of mark-to-market](#) accounting for loan portfolios which artificially inflates a bank's Tier 1 capital base. Banks are undercapitalized; ignore the ([not so stressful](#)) stress tests.

Recently the FDIC adopted new "[extend and pretend](#)" rules that say if the lender believes that the borrower can still pay the loan, regardless of the value of the asset relative to the amount of the loan, they can ignore valuations and not have to reserve for the loan. This gives lenders no incentive to write loans off, so they remain on their books. Ever optimistic real estate investor-borrowers are happy to extend in order to avoid huge income tax hits as a result of debt relief.

The Big Freeze

The Fed has tried to induce liquidity by buying GSE residential mortgage backed securities, a \$1.25 trillion program that will end in April. The net effect was to [take about \\$1.55 trillion](#) of RMBS out of the market. In essence, private debt was off-loaded to the public. A side effect is that they have [monetized Treasury debt](#) yet they have not improved the credit markets. At some point the Fed will have to sell them back to the market in order to tighten credit (a part of the so-called "[exit strategy](#)").

None of these programs have loosened bank credit. The vast majority of small(er) business banking in America is not done by the giants, but rather by regional banks. And the regional banks are the ones holding most of the bad commercial real estate loans. They are facing massive write-offs, a deteriorating capital base, and so they hold their capital close.

The point here is that banks will restrict lending until their loan portfolios and balance sheets are cured. The cure will be to raise more capital in order to improve their Tier 1 capital ratios and write down debt.

This explains why banks are sitting on large "excess" reserves and why we don't have inflation.

This is the Monetary Base/M1 conundrum: the Fed has opened the monetary sluice gates ([Monetary Base](#)) to combat the credit crunch, yet [money supply](#) (M1) is declining. Why? Because there is [nothing "excess"](#) about these reserves: they are held by banks for business reasons--as a reserve against future problems. The result is that banks aren't lending and credit is not reaching the economy and money supply is declining. This is an [international phenomenon](#).

This won't change until banks deleverage.

Deleveraging

In a [recent report by McKinsey](#) Global Insight, "Debt and Deleveraging: The global credit bubble and its economic consequences," they conclude that deleveraging will start about now in the U.S. In their study of 32 world financial crises since the Great Depression, the average period of deleveraging lasts about 6 to 7 years. The biggest GDP slowdowns are in the first two or three years of deleveraging and the average hit to GDP is 25%. (See chart and more, below.)

What this means is that without deleveraging, we will catch the "[Japanese Disease](#)": economic stagnation.

Banks are now realizing that commercial real estate is not getting better. I don't believe lenders will wait too much longer in spite of the government's effort to prevent it. We need to carefully watch bank balance sheets, credit conditions, and money supply.

Commercial Real Estate and Liquidity

Commercial real estate is [killing regional banks](#).

Unpaid loans on malls, hotels, apartments and home developments stood at a *16-year high of 3.4 percent in the third quarter and may reach 5.3 percent in two years*, according to Real Estate Econometrics LLC, a property research firm in New York. That's a bigger threat to regional banks, which are almost four times more concentrated in commercial property loans than the nation's biggest lenders, according to data compiled by Bloomberg on bailout recipients.

"Community and regional banks basically became real estate banks in the past 25 years, and now real estate is on its back," said Jeff Davis, an analyst at FTN Equity Capital Markets Corp. in Nashville, Tennessee. "The largest banks have other areas where they can make money, be it consumer lending, capital markets and asset management."

A new [report by Standard & Poor](#) said:

Even though most highly exposed banks with weaker balance sheets are already rated below investment grade, more downgrades are possible; indeed, *approximately 75% of the rated banks with the largest exposure to CRE carry negative outlooks ... We see no reason to believe the impact of this credit cycle in CRE will be less severe in terms of losses banks incur than that of the 1990s. ...*

About 40% of rated banks' CRE loans are made for construction, acquisition, and development purposes, of which 22% (or 8% of total CRE loans) are for residential construction ... nonperforming loans in the homebuilding sector to rise to 18% as of Sept. 30, 2009. Homebuilder-related net charge-offs rose steeply to an annualized run rate of 4.8% for third-quarter 2009.

Non-residential commercial construction loans have gone sour as the fundamentals in those markets deteriorated ... office vacancies reached 17.3% as of third-quarter 2009, and C.B. Richard Ellis (CBRE) estimates they will go to 19.5% in 2010, higher than the peak of 18.9% in 1991. Likewise, retail vacancies, currently at 12.3%, are headed to 12.9% per CBRE estimates, versus 11.3% in 1991. Multifamily vacancies are at 7.4%, versus 7.0% in 1991. Nationally, rents for offices are down substantially more than in 1991--by 15.7% versus 9.4%. This time around, a particular trouble spot is the hotel sector, especially the casino hotel sector, where overbuilding has been a factor. The occupancy rate for this asset class is a low 60.9%, a level last seen after Sept. 11, 2001. Nationally, rents for offices are down substantially more than in 1991--by 15.7% versus 9.4%.

And,

A whopping \$585 million of CMBS loans [were liquidated in December](#), the largest monthly volume of liquidations ever. Special servicers, facing growing workloads, have become far more active in disposing of the loans they're handling. Meanwhile, CMBS delinquencies continued to climb, *hitting a rate of 5.22 percent*.

And,

The FDIC recovered \$497.3 million, or [only] 29.6% of the face value of commercial real estate loans it sold during the third quarter. ... That's the [lowest recovery rate](#) the agency has had since its whole-loan sales program got into high gear late last year ... In contrast, the agency's recovery rate was 54.7% for the 2,487 loans sold in the second quarter, according to FDIC data.

I don't mean to beat this issue to death, but from a report prepared by [Property and Portfolio Research](#) (PPR):

"Due to government intervention, the concept of distressed selling and buying did not materialize anywhere in North America [in 2009]," said Mark E. Rose, chairman and CEO of Alison Young in Chicago. "The U.S. government put money into the major banks, which in turn extended every loan they could to avoid realizing losses. The Securities and Exchange Commission watched from the sidelines and allowed the impacted lenders to postpone the inevitable."

PPR predicts that by Q2 2010 lenders will more aggressively write off "distressed" CRE loans. That will attract lots of deal capital waiting on the sidelines. If so, then deleveraging will have begun.

Residential Real Estate

Residential real estate [gets the award](#) for "Most Bubbly Asset of the Great Recession!" This is where the river of Fed credit flowed, aided by loose lending standards encouraged and institutionalized by Congress, Fannie, Freddie, and the FHA. Wall Street, using [faulty risk models](#), wrapped it up and sold it worldwide. They fooled themselves for years until they realized they couldn't spin dross into gold.

Rising prices fed the bubble, debt skyrocketed, homeowners pulled cash out and went on a spending spree. This spawned the boom in retail which spawned the boom in shopping centers. Which has collapsed. The boom was fake; hundreds of thousands of residences built were a hugemalinvestment of capital. This is when the [damage was done](#). The bust is the cure.

The residential real estate market is still deleveraging, price deflation goes on, and [sales are up](#): "For all of 2009, there were 5.16 million home sales, up 4.9% from 4.91 million in 2008. It was the first annual sales gain since 2005." Much of that increase was due to the first-time buyers' tax credit which some say was responsible for 400,000 of sales. Starting in November, sales have tanked (down 16.7% in November for previously owned homes).

Regardless of sales, prices keep falling. People may be motivated by tax credits, but mostly I believe they are driven to the market by falling prices. Political reports say that the tax credit will not be extended. The most recent [Case-Shiller 20 cities](#) report showed prices declining 5.3%. Some areas are stabilizing (Dallas, Denver, San Diego and San Francisco) but Las Vegas was down 25% taking the average down.

I believe bargain hunting will continue to occur and sales will continue to rise. Here in California, housing supply has shrunk to a [5-year low](#) (3.8 months). The GSE's and the FHA are providing massive amounts of credit to the mortgage market and I don't see this stopping anytime soon.

What will prevent a new bubble, and cap prices, for at least this year is the shadow inventory--potential foreclosures. About [1 in 4 homeowners](#) is underwater:

The proportion of U.S. homeowners who owe more on their mortgages than the properties are worth has swelled to about 23%, threatening prospects for a sustained housing recover. ... Nearly *10.7 million households had negative equity* in their homes in the third quarter, according to First American CoreLogic, a real-estate information company based in Santa Ana, Calif. Home prices have fallen so far that 5.3 million U.S. households are tied to mortgages that are at least 20% higher than their home's value, the First American report said.

There could be 3 million foreclosures this year, up from last year's 2.8 million.

Here are a few more points to consider:

[US 2009 foreclosures shatter record despite aid](#)

[More Homeowners Struggling As Option ARMs Reset Higher](#)

['Shot in the Arm' or Shot in the ARM?](#)

[US Prime Jumbo RMBS Delinquencies Nearly Triple to 9%; CA Drives Trend](#)

This is threatening the [financial integrity](#) of the FHA:

In last year's third quarter, the FHA insured 25% of mortgages, according to *Inside Mortgage Finance*, a trade publication.... FHA-insured mortgages made in 2007 and 2008 are largely responsible for the agency's precarious position, with default rates approaching 24%. ...

The government's plans to help beleaguered homeowners is falling flat because they aren't requiring lenders to write down [mortgage principal](#), or require a renegotiation of secondary [home equity](#) mortgages. It takes homeowners about 3 seconds to figure out that even with lower payments, there is no point paying for a home when the value is less than the amount of the loan.

If there were 5.16 million home sales in 2009, without the boost from a tax credit and with a substantial shadow market, expect prices continue to fall moderately. Sales will continue to increase as people search for bargains. The FHA and the GSE's will provide ample credit for the mortgage market. The government [announced in December](#) they were giving Fannie and Freddie unlimited guarantees for the next three years; they have thus nationalized them.

There is one more factor to consider about residential real estate: homeownership rates are declining (Megatrend No. 5). At the end of 2009 the homeownership rate fell to 67.3% from the high of 69%. "Between 2007 to 2009, nearly four million homes were lost to foreclosure. And home ownership rates are now moving closer to the level that was [common in the 1990s](#)."

A recent study from the [NY Fed concluded](#), "This [negative equity] situation is likely to put downward pressure on future homeownership rates, and has potentially important implications for the maintenance of the housing stock, the stability of neighborhoods, and future household saving behavior.

The residential real estate market is deleveraging and the government can do nothing to prevent it.

The Consequences

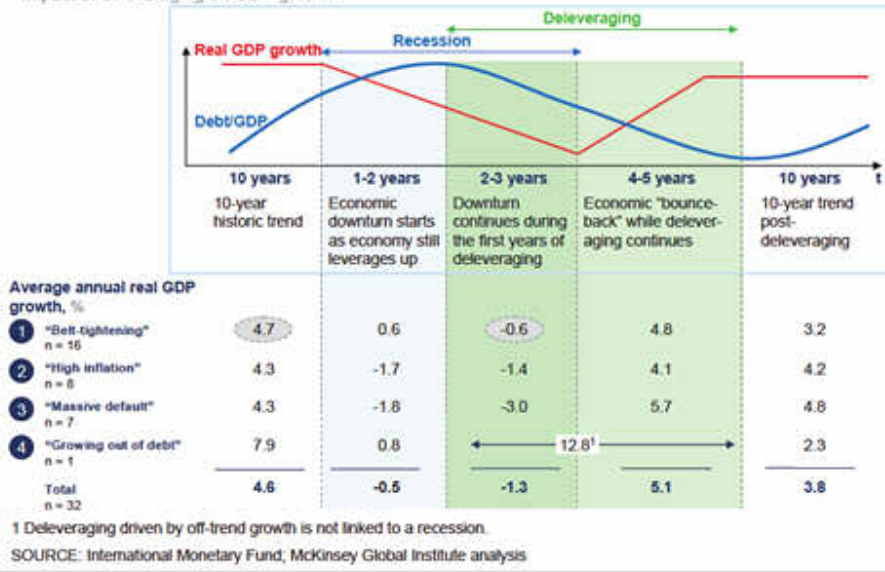
The Impact of Deleveraging

The economy is still a mess and structural problems will act as a brake on economic growth.

McKinsey has an interesting chart showing the average deleveraging time frames of 32 U.S. financial recessions since the Great Depression.

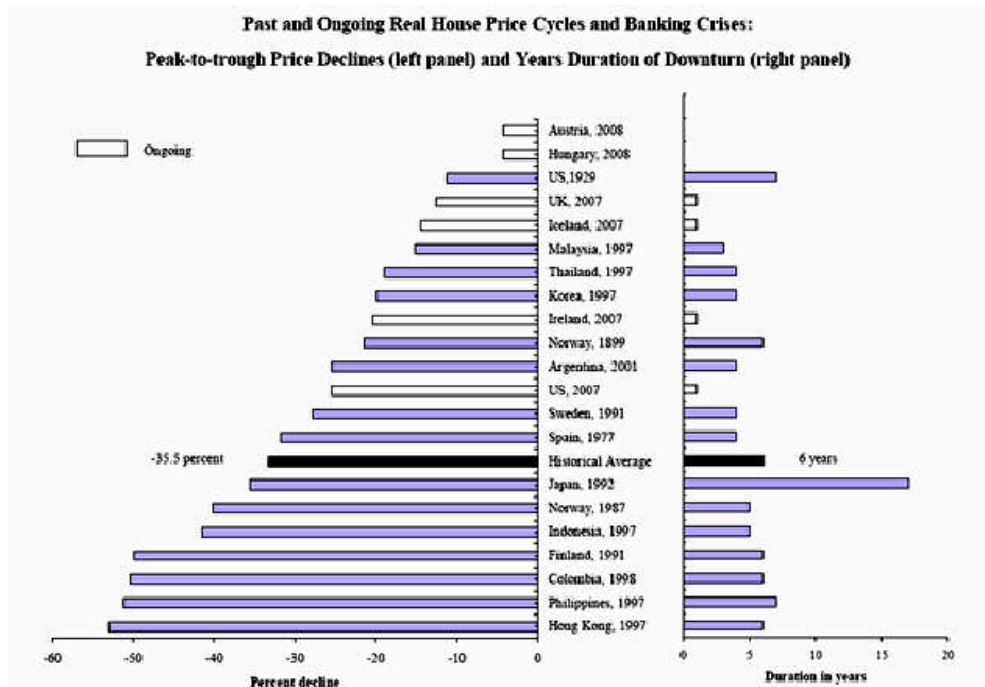
Real GDP growth is significantly slower in the first 2-3 years of deleveraging

Impact of deleveraging on GDP growth



We are in the "belt-tightening" form of recovery (No. 1). GDP averages are negative to low growth for the first 1 to 3 years, with growth resuming thereafter in years 4 to 6.

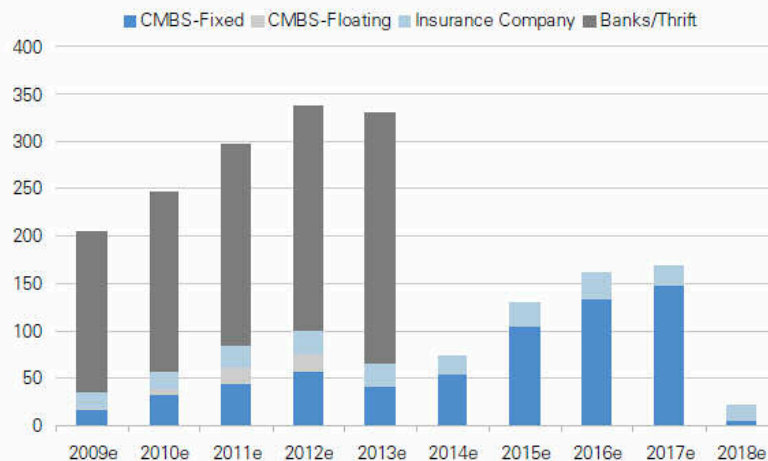
The research by Reinhart and Rogoff I mentioned above measures business cycle timelines on a worldwide basis--average 6 years:



It appears we have another 12 to 24 months of deleveraging of bank and household debt if you believe history will repeat itself.

CRE deleveraging will commence in earnest this year. There is about \$3 trillion of CRE debt to private borrowers. Here is a CRE refi chart done by [IREI](#):

Chart 5: Estimated Maturity Profile of US Commercial Mortgages in CMBS, Bank and Life Company Portfolios



Source: Deutsche Bank; Intex; Trepp; Mortgage Bankers Association; US Federal Reserve, April 2009
e= estimate

If the default rate tops out at 6% this year, then expect \$15 billion of defaults this year increasing to about \$20 billion in each of the next three years. There is a great deal of capital waiting for CRE to collapse and they will set a floor on prices competing for foreclosed projects. This will prop up the market and help the deleveraging process.

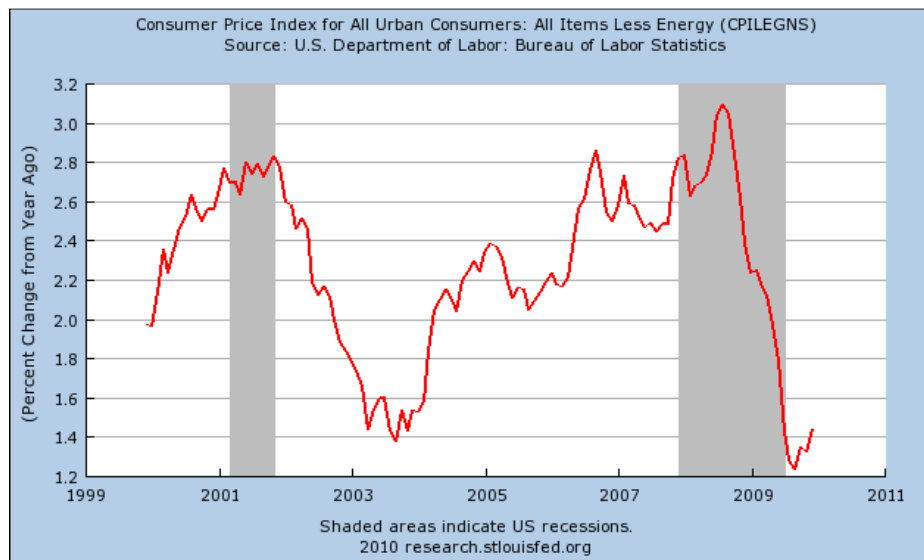
There are too many "ifs" to put a date on this period, but as shown in the historical data above, this could last two to three years. I often say that this cycle is unprecedented and past history is not necessarily a good gauge of the future, so take that into consideration.

There is a question of the FHA continuing its easy credit because of its financial exposure to the mortgage market. They are facing calls from some in Congress to continue to ease credit standards and others who demand fiscal responsibility. On the other hand, Fannie and Freddie are loosening loan standards. If credit tightens, then prices will fall. Regardless, residential real estate lenders will continue deleveraging.

Assuming easy federally-induced credit, residential real estate prices will slowly stabilize despite supply from the shadow market.

Inflation/Deflation

Deleveraging points to continuing deflation. On the face of it, CPI, less energy, is starting to rise:



What the CPI doesn't measure is real estate: deflation will occur in commercial real estate, and to some extent, residential real estate. The deleveraging process will continue to restrict credit, which in turn will suppress M1. When the banks become healthy, then "excess" reserves become a problem.

The Fed now believes that they have saved the world and that the economy [is in recovery](#) and they are starting to talk about their "exit" strategy. That would involve paying interest on "excess" reserves as an attempt to sop them up.

If you believe the Fed that we are in full recovery mode, then why aren't banks lending? Why is credit continuing to collapse? If you believe that we aren't in full recovery mode, then you know why banks aren't lending. In either case, the banks have no incentive to give up their reserves until they have deleveraged sufficiently to believe they have weathered the storm.

Even if we assume a recovery is well on its way, and the banks believe this, then why would banks *not* lend to their customers? One could argue that they would rather service customers and rebuild their commercial loan business than receive interest from the Fed on reserves. After all, that is what banks do to make money.

Recovery: Yes or No?

The Fed is in a quandary. Too much tightening and the economy could, in their view, collapse (the dreaded "double dip"). Too little and we could see substantial inflation.

The economy is in recovery but not for the reasons the Fed and the Administration believe. I have been saying for some time that all economies repair themselves unless the government interferes with the process. Bankruptcies, unemployment, management's drive for more

efficiency, and debt reduction are all part of the process that goes on despite the government's policies to prevent it.

But policies of the Fed and the government miss the most important thing necessary for a recovery: deleveraging.

They have been trying to re-inflate the housing market, prop up banks with bad loans, pump massive amounts of credit into the system, bail out financial companies, and spend tomorrow's wealth on wasteful stimulus projects. When the stimulus spending wears off, the economic effect wears off as well. Their pursuit of these Keynesian fallacies has accomplished nothing other than to increase federal debt and bail out their Wall Street cronies who should have failed. It appears, fortunately, that there is not much political appetite for more stimulus spending other than as proposed in the Administration's jobs bill.

Almost all of the improvements in the economy are the result of the normal organic business cycle repair process. We see margins improve as companies strive for efficiency and lower costs, but sales have declined as well putting pressure on earnings. For example, Coca Cola's growth comes from foreign sales (79%) whereas U.S. sales are down (4%). Ditto Levi Strauss, Tyson, Burger King, Kellogg, Sara Lee, etcetera. Many companies (ex. financials) are seeing improvement from better margins, not sales growth. This is more of a one-time event in the business cycle: how much more can they cut? The future will depend on sales growth.

The good news is that deleveraging will continue and the government can't stop it. But they can delay it which would be bad for recovery.

Whither 2010?

What is most likely to happen in 2010:

1. Personal consumption expenditures will remain constrained.
2. The household savings rate will remain high.
3. GDP will, on a real inflation-adjusted basis, decline to near zero by Q3 or Q4.
4. Deflation will continue in real estate, especially CRE, as banks repair their balance sheets and deleverage.
5. Inflation will remain low.
6. Unemployment will stay high, probably over 9% for the year.
7. The fear of sovereign defaults will support the dollar.
8. The Treasury will have no problem selling debt to U.S. investors (rising savings) and foreign investors (seeking safety).
9. China, Japan, and the UK (the Big 3 creditors) will continue to buy U.S. Treasuries.
10. Interest rates will remain low.
11. Any attempts by the Fed to tighten credit will be abruptly reversed as economic weakness is seen.
12. Exports will be sluggish as the world's economies struggle.
13. Taxes will increase modestly this year (an election year).
14. A VAT-type tax will be formally proposed next year.

15. China's credit tightening will burst their new real estate bubble and harm domestic consumer demand.

Caveats

The problem with any kind of economic forecasting is that the world has a tendency to do things economists don't see coming. I am humble enough to recognize that. Here are some things to think about that could change my scenario:

- The government panics (again). Stagnation is not something Chairman Bernanke foresees happening. He's hoping for a straight-line recovery. I am aware that he always covers his Delphic statements with caveats, but I think he, Larry Summers, and Tim Geithner think "We did it! We saved the world." When the double-dip hits, it is hard to predict what they'll do. In their Keynesian-Monetarist world view, they will be compelled to do *something*.
- A taxpayer rebellion alters the power structure in Congress. Mind you, I don't have much faith in either party, but if a tea party backlash shows up at the polls in November, it could slow down some of the social legislation the Democrats propose. It makes more likely the possibility of tax cuts instead of more spending. Less legislation equals less change which creates more certainty in the minds of business people about their future.
- I find that I have very little insight into what drives the market from day to day, so I'm not giving stock market advice. Of course I'm not alone. I think most stock market analysis is mere guess work. For what it's worth, the rally starting last March is a faith-based rally. I think most traders believe in the conventional wisdom on government intervention in the economy. I would buy David Rosenberg's view that the market has been overpriced. If you want market advice there are many other places to look.
- Catastrophe. The bad Black Swan. It's always out there: an EU credit collapse, stock market crash, al Queda, Iranian nukes, Israeli-Iranian war, massive earthquake in California, Pakistan falls to the Taliban. Use your imagination here.

Last Thought

I am very aware that it is easy to always be negative or positive because of one's view of the world. It is quite difficult for me as a free market advocate to be positive. I try to fight my tendencies and be wary of this trap. I try to see things as they are, not as I would wish them to be. So I want to end this survey on a positive note.

I believe the U.S. is still the world's most dynamic, entrepreneurial country. Our capital and financial markets still give big rewards to successful companies. Every day I see people come up with new ideas for businesses and they risk everything for their dreams of success. These are the people who will rescue us. Now, if only the government would get the hell out of their way and let them do their thing.