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Market Note

I feel compelled to write a note on the current fiscal situation, popularly called the Fiscal Cliff. First, I want to note that this is not some crisis that needs to be dealt with by our politicians in Washington D.C. It is not as if some emergency has occurred, and we are waiting for their wisdom to deal with the aftermath.

Rather, the current crisis *is the plan*. The fact that the current tax rates are expiring and that significant spending cuts will all occur at the same time is the plan that our leaders designed. It is what they intended given their purposes and plans. There is a lot of rhetoric flying around. I thought I would cover some facts.

Through the history of our country, up until January of 2009, the accumulated federal debt held by the public had grown to $6.3 trillion dollars. Less than 4 years later it has grown an additional $5.2 trillion and now stands at $11.5 trillion dollars. To grow our publicly held national debt by 82% in four years is impressive. I suppose that is an opinion.

Some might think that the stimulus proposed and passed by President Obama and Congress early in his term was a temporary item. Actually, that higher level of spending has been baked into succeeding yearly spending since then. Consider the following table of federal spending.

Year	Federal Outlays (In Billions)
2007	$2,728
2008	$2,982
2009	$3,517
2010	$3,456
2011	$3,603
2012 est.	$3,795

The TARP and American Recovery and Reinvestment Act of 2009 spending created higher spending in 2008 and 2009. Spending has remained at these higher levels through 2012 even as war spending has declined. It seems that Washington decided to grow the size of government by 39% from 2007 levels, and to grow it further from there.

Our economy has begun to recover from the Great Recession. Tax revenues in 2012 are expected to be 96% of what they were in 2007, before all the fun began. Despite the recovery, there is no apparent intention to shrink the government. When I give my dogs a bone, I typically do not try to take it back either.

I don't remember a lot of discussion on the merits or implications of a larger government taking place during the election. From 1940 through 2008, (excluding 1942 – 1945), government spending as a proportion of the economy was 19%. It is now 23%. That may not sound like a lot, but 4% of $15 or $16 trillion adds up, especially since Washington needs to take this money from someone before they can redirect it.

As I said, there is no apparent intention for Washington to give back any of this power, influence and money. If you go the White House OMB website, it has estimates showing spending increasing to $4.5 trillion in 2017. Over this timeframe it *only* assumes another $3.4 trillion of debt accumulation because it assumes the economy will grow by over 5.3% per year over that time frame.

5.3% annual economic growth is pretty nifty. I heard the descriptive label 'fairy dust' used this week. I think that this term could be used to describe 5.3% annual GDP growth assumption (that is another opinion). Especially since this 5.3% GDP growth is assumed to occur during a period when tax revenues are assumed to increase 58% (over the five years). Pardon my sneeze.

We have not experienced this version of government for the last 70 plus years, I think it is fair to say that none of us really know what to expect. None of us, unless we have lived in Europe, really know what we are in for.

Perhaps we will find that when we give more money and power to our leaders in Washington to direct as they see fit, we will find ourselves in a better America. Since this is the same Washington that planned the situation we find ourselves in today, I do not hold out much hope for this.

One more point of reference to frame the current discussion: 2012 Federal spending is estimated to be around $3.7 trillion. Over ten years, then, if this rate did not grow at all, 10 year spending would be $37 trillion. These harsh plans you hear about today that call for $1.4 trillion of taxes or spending cuts over 10 years amount to less than 4% of total spending. The dog is growling. Let go of the bone.

Our job is to attempt to generate real rates of returns for our clients through our investment activities. We will continue to strive for this in this new environment.
I expect that a greater presence of the government (through taxes, spending and regulation) will make the investment exercise more difficult in the years ahead.

Fortunately for us, investment capital is quite fluid. We are not forced to invest in economies that are lackluster. There are some domestic companies that will be able to grow and there are economies around the world that are moving towards more freedom and efficient capital investment. We will continue to search these out, keeping in mind the volatility that each of you and/or your plans can tolerate.