

BCA Market Perspective © January 2010

A Slow Recovery Burgess B. Chambers

Last year's impressive stock market recovery signaled economic growth in the U.S. for 2010. Unfortunately, most of the current economic policies have so far had little impact on boosting economic activity. It was only a year ago that experts were discussing how far down the economy would contract. But today's debate centers around how much growth we will see in 2010. Sentiment has clearly improved. The stock market represents investor knowledge and expectations. The information pipeline is nearly infinite and operates today with a speed never seen in history.

Most past recessions were brought on by Federal Reserve money tightening and tax policy. The economy would respond favorably to any policy shift towards increased credit, reduced short-term interest rates or tax-based subsidies. Today's recovery will be different, since the root cause of the recession was excessive private debt. What is now clear is that businesses and households are shedding debt, while the U.S. Government issues it. This "crowding out" of capital will restrain the economic growth rate. The national debt ceiling was recently raised another \$2 trillion to \$14 trillion. Fiscal tax policy is needed to counterbalance the lack of private capital formation. Current conditions shine light on a slow recovery.

China is the largest foreign holder of U.S. Government debt and will soon replace Japan as the second largest economy. With the growing imbalance of trade and investment, the U.S. has become China's largest export partner. With the exception of aircraft and agriculture, U.S. prosperity suffers from this trend. Accordingly, tax based investment incentives are needed to counter this economic head wind. Tax policy must reach back to the 1970's and offer accelerated depreciation and credits to a wide range of businesses to stimulate investment and economic activity.

Positive Factors:

- Anticipated business tax credits will further investment
- Stricter environmental regulations will stimulate investment in plant and equipment
- Investment into energy saving technologies is considered part of national security
- Low dollar stimulates exports and foreign investment in the U.S.
- Anticipated business tax credits will further durable goods purchases
- Lending will improve as bank capital begins to rise
- Inflation is subdued
- Adjustable mortgage rates will remain low
- Low bond yields make equities more attractive

Negative Factors:

- Continued high unemployment
- Reduced consumer spending
- Tight credit
- Rising healthcare costs
- Rising Federal debt
- High foreclosure rate
- Foreign competition
- Declining education