New Stimulus Won’t Cure Economic Woes

13 July 2009

President Obama’s $787 billion February stimulus packet is likely to suffer the same fate as President Bush’s stimulus. If you recall, our “No Quick Fix” white paper, dated 28 January 2008, discussed why President Bush’s proposed $168 billion stimulus was likely to fail. At that time we expected a lengthy recession, as we said “The reduction of debt in the system will take time, leading to a recession which may be prolonged.” Our study was correct, but it took another 10 months before the official NBER declaration that the recession had started in December 2007.

The basic problem with this administration’s plan is not that it lacks good intentions or is wrong sized; it is that government is so inefficient it will have little impact. Our previous research shows that it takes $7 in government spending to equal the benefit of $1 in private investment. Today only $60 billion of the authorized $787 billion has been spent, a mere pittance in a $14 trillion economy. In addition, a lot of money is being wasted on pet projects, or will go to cover state funding shortfalls. Furthermore, in a major blow to stimulus spending, consumer savings increased by $161 billion last month, almost three times the stimulus payments.

Adding to Washington’s woes, the public is losing patience. VP Biden admits errors of judgment. USA Today suggests that $69 per person has been directed to counties around the country that favored Mr. Obama, against only $34 for Mr. McCain’s counties, which does not restore public confidence. On average, those laid off now take 22 months to find new jobs. Lastly, commercial real estate and credit card failures have yet to gain much attention, but they will.

There are new rays of hope (not green shoots) that will yield benefits in the more distant future. Spending by the public has been curtailed; consumer credit has now decreased in seven of the last eight months. Consumer savings have increased from zero in April 2008 to almost 7 percent of disposable income, replenishing reserves and now available for future purchases. Personal income has been increasing, even as GDP falls. Declining commodity prices are taking oil and gasoline prices lower. The export picture is brightening a bit, relief for some manufacturers of technology and other capital goods. The biggest positive change for the long term may be the changed attitude of bankers and the public, who are now shunning excessive debt and leverage.

What kind of investing approach will work in a weak/nonexistent recovery?
1. Avoid heavy equity exposure. Valuations have not yet hit bargain levels.
2. Favor high quality bonds and dividend paying stocks. In recessions, both inflation and interest rates tend to decline.
3. Sovereign bonds and precious metals offer future opportunities in a falling dollar environment.

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