

Stop. Turn around. Don't Head for the Hills

The Cliff Notes version of the U.S. stock market over the past 45 years goes something like the this: *As government interference in the economy grew between 1965 and 1982, the stock market remained stagnant with the S&P 500 rising just 1.4% per year on average; then President Reagan cut the burden of government and the S&P 500 grew by an annualized 14.3% between August 1982 and August 1992; the next two years were underwhelming as President Clinton raised taxes and tried to nationalize healthcare (the S&P 500 increased just 3.7% annually between August 1992 and December 1994); a mid-course correction by the Clinton White House led to a 5-year, 25% per year run for stocks; then the dot.com crash, the panic of 2008 and big government policies of Presidents Bush and Obama created what many call the "lost decade"; despite a 60% rally since March 2009, the S&P 500 has lost about 2% per year in the past 10 years.*

None of this is about politics, per se, it's about policy. Capitalism works, big government doesn't. And the Massachusetts Senate election today, between Martha Coakley (D) and Scott Brown (R) to fill the seat previously occupied by Ted Kennedy, is historic. We are not talking about Senate elections that turned out to be important *after* the fact. We're talking about an election – for only one seat, in only one state – upon which may hinge the fate of how health care – a full 16% of the economy – is funded and organized in the United States. This election may also influence equity values for decades to come.

The election alone will not decide the fate of health care. A Coakley win increases the odds of passage, but does not guarantee it. It is clear that this bill has become a lightning rod to many voters. The fact that the health care bill put the Kennedy seat in play makes it even tougher for Speaker Pelosi and the Obama Administration to spread pork and strong-arm their way to a House majority.

A Brown win reduces the odds of passage (well below 50%), but is not a certain death blow. If the House is willing

to rubber stamp the bill already passed by the Senate, the bill will become law. Or, a GOP Senator could change his/her vote, Democrats could stall the seating of Senator Brown, or the Senate could use the budget reconciliation process, and only need 51 votes.

But all of these options are fraught with political difficulty. Like 1994, voters seem angry. Populism is on the rise, but right now it seems to have a libertarian edge to it. It is a battle between the "don't tread on me" populists, and the "what are you going to do for me" populists. To see this happen in Massachusetts, of all places, is striking.

Although some investors worry about populism no matter the pedigree, the populist uprising of 1994 was a watershed event that pushed equity values sharply higher.

By 1994, many investors were convinced that the Reagan revolution had come to an end. But it hadn't. That election showed the American people are still willing to fight their way through tough times and, while they care for their fellow man, too much government (no matter what the reason) is something they abhor.

But voter complacency, crises and panic allowed more 1970s-style mistakes. At the end of his presidency, Bill Clinton regulated heavily and boosted spending. The Fed started making monetary policy mistakes. And President Bush expanded entitlements, boosted spending and then in a panic refused to change an accounting rule, but instead used trillions of taxpayer dollars to takeover banks and interfere in the financial system. So now, a decade later, stocks are below where they were in 2000.

No wonder we find ourselves at a political crossroads again. A recent Washington Post-ABC poll shows 58% of Americans favor smaller government and fewer services versus 38% who want bigger government and more services.

So instead of heading for the hills with your gold, canned goods and guns, maybe it's time to stop, turn around and come back. It's more likely that the stock market will be doing the climbing. Everyone should be onboard for that.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
1-20 / 7:30 am	PPI – Dec	+0.0%	+0.1%		+1.8%
7:30 am	"Core" PPI - Dec	+0.1%	+0.0%		+0.5%
1-21 / 7:30 am	Housing Starts - Dec	0.574 Mil	0.579 Mil		0.574 Mil
7:30 am	Initial Claims - Jan 16	440K	437K		444K
9:00 am	Philly Fed Survey - Jan	18.5	21.5		20.4
9:00 am	Leading Indicators - Dec	+0.7%	+0.8%		+0.9%