

Elections Have Consequences

Washington is still playing political games with the December 31, 2010 expiration of the Bush tax cuts. On Saturday, Democrats forced a vote to extend the tax cuts for most, but allow them to rise on incomes over \$250,000. The vote failed. But don't let this legislative gamesmanship alter your outlook. We aren't.

As we wrote in August, Congress and the President are going to agree to extend all the income tax cuts enacted in 2001 for all earners, including the ones with the highest incomes. This agreement will also apply to the 15% tax rate on capital gains and dividends enacted in 2003. All rates will remain stable at least through the end of 2012.

The only issue is when this will finally pass. We lean toward a final vote before Christmas. But, it could be that it takes until early next year. Either way – and this is going to seem strange to many of us – because it is so late in the year, the IRS may temporarily increase withholding anyway. This could lead to even more confusion for employers.

It seems like the more congressional Democrats try to find a political edge, the more they are on the wrong side of the electorate right now. We have anticipated this, and assume President Obama wants to be president for two terms. As a result, he will move as rapidly to the center as possible on every economic issue *except for health care*. The only constraint is that he moves slowly enough to cut off any serious primary challenge from the left in 2012. In other words, on tax policy, before finally agreeing with the Republicans, he has to try all the other options before being “forced” to concede.

On other issues he seems to be willing to move more quickly. The White House proposal to freeze civilian

Federal worker pay is very positive step in the right direction. As is a free trade agreement with South Korea that the Obama team finalized last week and is now awaiting Congressional fast track approval. We expect other agreements later next year, with the leading contender being Colombia.

On the issue of federal spending – or rather *overspending* – the President knows he's vulnerable, and so we suspect that he will be surprisingly flexible about meeting the new Republican majority in the House on their goal of cutting back discretionary spending. One of the last things the President wants to do is get in a fight with Republicans about whether he is spending too much. The public is already inclined to believe he is.

Some policies are unlikely to change fast enough. For example, last week's jobs data – even though private payrolls were up for the eleventh month in a row – was disappointing because the increase was relatively weak and the unemployment rate rose to 9.8%. This will likely lead to an extension of the 99-week program for unemployment insurance, a policy that we believe is keeping the jobless rate artificially elevated and which is making it tougher for some employers to get the workers with the skills they want back on the job.

Washington has not yet become a bastion of libertarian thought, but elections have consequences and there is a huge shift in the direction of government policy underway right now. This shift is not yet as dramatic as the one following the 1994 elections, but it could become so given some time. This is great news for the economy and financial markets.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-7 / 2:00 pm	Consumer Credit - Oct	-\$1.0 Bil	-\$2.7 Bil		+\$2.1 Bil
12-9 / 7:30 am	Initial Claims - Dec 4	425K	430K		436K
12-10 / 7:30 am	Int'l Trade Balance - Oct	-\$43.7 Bil	-\$43.6 Bil		-\$44.0 Bil
7:30 am	Export Prices - Nov	+0.5%	+0.5%		+0.8%
7:30 am	Import Prices - Nov	+0.8%	+1.0%		+0.9%
8:55 am	U. Mich. Consumer Sentiment	72.5	72.0		71.6