

THE GOVERNMENT AS CAPED CRUSADER

Economic releases, the world over, have carried a dreadful message for weeks now. Home values continue to fall, and equity markets remain wobbly. The global business sector fights to protect its cash flow-generating capabilities and in doing so, is aggressively liquidating inventories, thereby adding to the slowdown. Governments are the sole entity with the power to spend in an effort to counter these powerful headwinds. The leader in this regard is the U.S. This edition of the Marker reviews the U.S. economic stimulus program.

A PLAN FORMULATED AT LONG LAST...

The Obama Administration had hoped to have a stimulus plan ready for the President's seal of approval on the day following his inauguration in mid-January. Instead, the necessary negotiations and compromises lasted until a full month later, when a law was adopted on February 17. One cannot underestimate the potential impact of well-timed and directed government spending on a severely challenged American and global economy. Monetary policy tools have been exhausted. Only public spending and fiscal policy can help prevent the economy from drifting further into contraction.

WITH SIZE IN ITS FAVOUR...

Supporters and opponents appear to agree on only one facet of the stimulus program: it involves a great sum of money! At \$800 billion, the plan amounts to 6% of GDP, except that spending will be spread over several years (see table). In fact Empirical Research Partners estimates its impact on 2009 GDP at +1.2 - +2.2%, with a contribution to growth of +2% to +3.5% in 2010¹.

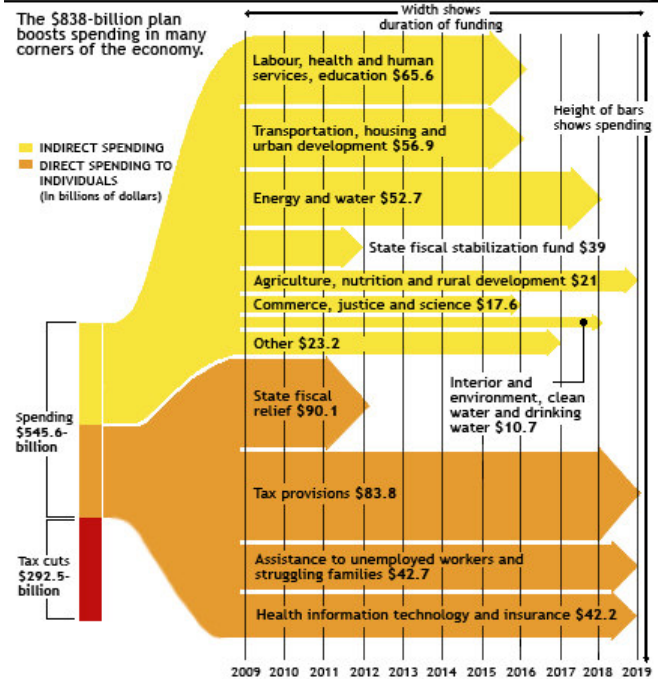
...AND MUCH LESS PUNCH THAN MEETS THE EYE

There are few absolute truths in life, but one such truth is that politicians love to spend. As should therefore be expected, about two-thirds of the plan's resources are channelled into additional government expenditures, and 53% are indirect, i.e., they go to government-controlled spending, rather than being placed in the hands of individuals to allocate. Much has been made of spending on infrastructure. A generous estimate places such spending at a maximum of 20% of the total, while independent researchers point out that what will spent could occur too late to have a meaningful effect. Over half of the \$80 billion in direct tax cuts is in fact earmarked to remediate technical aspects of the tax code (Alternative Minimum Tax for middle income tax payers), and get voted into the budget every year! The fastest acting type of tax cut is a reduction in payroll taxes. In the current plan, those amount to \$7.69 per pay in 2009, and \$13.00 in 2010².

TAKING A WAIT-AND-SEE APPROACH

One cannot underestimate the degree of difficulty of the government's task in righting this economic ship. Yet, the proposed policy action resembles the budget of a first-year government determined to usher in party policies much more than one with the desire to inject strong medicine to a feverish patient.

Slicing up the Senate's stimulus bill



NATCAN MARKER

The economic backdrop remains difficult. Governments must come to the table with countercyclical spending, and the monetary policy has been exhausted. The proposed stimulus plan appears to be lacking in many regards. Yet, equity markets have shown early signs of stabilizing after one of their worst starts on record. Could good old Mr. Market be sending a message that private forces will in the end - through the resumption of risk taking - ensure a reversion to more normal economic circumstances?

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FINANCIAL MARKETS

RETURNS AS AT MARCH 20, 2009 (%)	MTD	QTD	YTD	RATES AS AT MARCH 20, 2009
S&P/TSX	4.97	-4.56	-4.56	CAD/USD
S&P 500	2.01	-12.78	-12.78	CAD/Euro
S&P/TSX Small Cap	1.23	-5.92	-5.92	US Treasuries yield 10-yr/30-yr
Russell 2000	0.36	-18.11	-18.11	GOC bond yield 10-yr/30-yr
MSCI EAFE	3.22	-14.13	-14.13	Fed Fund Rate (target)
MSCI World	2.69	-13.55	-13.55	
DEX Universe Bond	1.75	1.47	1.47	

Note: Returns in Canadian dollars, London 4h exchange rates. Source: Datastream, PC Bond, MSCI-Barra, and Bloomberg. PC-Bond, a business unit of TSX Inc. Copyright © TSX Inc. All rights reserved.

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¹ Empirical Research Partners, January 20, 2009
² The High Tech Strategist - February 18, 2009, issue 256