

Key Points

- ◆ Curing a debt problem with more debt
- ◆ Bernanke is just a new bartender keeping the economy drunk on debt



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**A \$145 billion Dollar Cup of Irish Coffee
 A Look at the Government's Economic
 "Stimulus Package"**

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It is apparent even to the most optimistic sycophants on the financial channels and on Wall Street that we are slipping into recession. (Make that have gone into recession.) It is of our own making. The Sub-prime mess will get much of the blame, but debt is the real culprit and until the debt problem is resolved, the problem will only get worse.

But thanks to the Government's "Stimulus Package", we are all going to get \$800 bucks to make us feel better. This is tantamount to the bartender giving you a cup of Irish Coffee, on the house, before you head out to your car, drunk from a night of partying that lasted way too long. The bartender consoles himself in the false thought that the cup o' Joe will wake you up enough to get you home safely.

What an idiot!

Instead of keeping you from doing something really stupid, (drunk driving), the bartender gives you more booze, disguised as a cure - coffee. It won't work. You are still falling down, oblivious to the world, stinkin' drunk. And only a lot of time and pain, (the hangover, or in economic terms - a recession) will get you sober.

For years I referred to Greenspan as the bartender and debt as the drink of choice. Bernanke is just a new bartender, ready to pour a glass full whenever you ask. (See [the Fed Buys a Round](#))

The planned "Stimulus Package" is nothing more than a cup of Irish Coffee for a drunk economy. When you boil it down, it is nothing more than more debt, to solve a debt crisis. (Choose your crisis -Sub-prime, consumer debt, Mortgage debt, Muni debt, Current account deficit...) Everybody knows the fastest way to sober up is to have another drink! (The real answer is "NO!" for those of you that might not get the dripping sarcasm.)

What Are You Gonna Do With Your 800 Bucks?

This is, acknowledged even by the planners, nothing more than a short term fix. Everybody gets a check for \$800 and goes and spends it. That's the plan. This shot of new money into the economy might get it over the hump and avoid the dreaded recession.

The fear is that everybody squirrels the cash away in the bank or, Heaven forbid, pays down their credit

cards. This gives no bump. This doesn't help the economy at all, in the short run.

But from what bottle are they pouring this magical elixir that is supposed to stave off recessions. It looks like they are mixing in a well aged spirit into our coffee. More debt.

Where do the supporters of this plan think the money was coming from? Does the Government really think that we are so dumb that we believe they have accounts full of cash with our names on them that represent the taxes we've paid the government and that they are just taking this excess cash and giving it back to us?

The Federal Government is running a deficit. There is no excess cash. There is no account with your name on it. (Except at the IRS, where they seem to somehow know every penny you earn. Better declare that income from selling those Girls Scout cookies!) To get the \$800 bucks into consumers' hot little hands, the government is going to go deeper into debt. Hooray for part 1 of the plan! Don't you feel better already?

The second part of the plan, which will get less play but may be more important is the part targeted at businesses. This will come in the form of tax incentives, guaranteed loans and other inducements to get businesses to make major capital expenditures. This increased spending, it is hoped, will give the economy some lasting strength.

The details will be hashed out in the weeks to come, but here's how the parts of the plan play out. Tax incentives mean less taxable income for the Feds. At a time when we are running a deficit, this means the Federal Government is financing this part with more debt. Subsidized or guaranteed loans are more debt at the Corporate level. More debt is more debt. And that is the last thing we need.

Lower interest rates are also part of the overall plan, but since they are not a direct part of the plan, we will discuss their impact and why they won't work in a separate article here: [Risk Costs](#).

Couldn't you see this coming?

For weeks, I have told investors that I anticipated the government would do everything they could to stave off the inevitable downturn until after the election in November.

The plan has bi-partisan support because both parties realize their chances of getting their guys elected get worse if the economy is in a tailspin come November.

Key Points

- ◆ \$800 isn't going to cure anything
- ◆ Expect higher L/T Rates

Those in power are afraid of the "throw the bums out" mentality and those out of power are afraid that the electorate will be too scared to put a new guy into power at a time of crisis. (No, its not rational to hold both positions at the same time, but this is politics.)

There is also strong incentive from the White House to push this problem onto the next guy, whomever he or she might be. The last thing a President wants is to hand the keys of a failing economy over to the next guy. Ruins your legacy.

The Federal Reserve wants to push this out as far as possible if only to show that they are as creative as the previous Fed chairman at smoke and mirrors, economically speaking. The last thing this Fed Chair wants to be known as is the guy that dropped the baton Greenspan had carried for years.

Ya Gotta Have Faith

Our economy is based on the faith of people involved. They believe that America is the greatest land in the world. They believe that anybody can become a success here. They believe that the American economy will survive and thrive in the future. None of my skepticism questions these articles of our economic faith.

But it is not a blind faith. The problems facing the US economy cannot be fixed by simple tax tricks, loans and \$800 allowance checks from our Federal daddy.

Nothing they are proposing or can propose solves the Real Estate crisis. Nothing they are proposing will reduce the amount of debt in our economy. Nothing

they are proposing reduces the inflation rate, it makes it worse. Nothing they are proposing gets people out of debt and reduces the economy's dependence on debt growth.

Conclusion

Maybe it will work in the short run. Maybe the stimulus package will give the economy the bump that both political parties need and then they can go into the election claiming credit for the boost in the economy and victory for their constituents.

But when the dust of the election settles, we will be left with even more debt, a real estate market that is still struggling and all of today's economic problems staring the new administration in the face.

And if it doesn't give the economy a bump? Expect another stimulus package in the summer.

Investment Implications

More debt means higher interest rates at the long end. Investors would be wise to lighten up and shorten their bonds holdings.

They also should hedge their Dollar positions with strategies to benefit from a declining Dollar. A declining Dollar will also likely ignite more inflation. Gold and commodities are the answer there.

Fortunately for our clients, none of this is a surprise to us at Cornerstone. Our portfolios are already structured to benefit from the wonderful scenario described above.

Questions, comments, further information, to set up an appointment or request forms, call: Toll Free: 1-888-277-5968 (outside Rhode Island) **Providence Office:** (401) 453-5550 **Dallas Office:** (972) 563-8990

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