

POLITICS AND THE MARKETS

As we come into the final stretch of the 2004 presidential campaigns, it is exciting to see a race so close that pundits on both sides are loathe to predict the results. The question on my mind, as an investment professional, is what the effect would be of either a Bush or Kerry victory.

Specialists on Wall Street and odds makers in Las Vegas are betting on Bush. His commitment to make permanent, for at least four more years, tax cuts which favor holders of stocks that pay "qualified" dividends, as well as the lowest capital gains rates in decades, means that a Republican victory will be good for stock investors. Also, the financial markets like consistency, which is not so much an endorsement of the current administration, as it is a preference to avoid change.

Looking at the prospects for the long-term stock and bond markets, I wonder whether it really matters who wins the election. Both candidates will be faced with the reality of chronic and worsening budget and trade deficits, an aging work force, high health care liabilities for the population at large, and competition from abroad. In addition, our reliance on foreign governments to finance our debt really does give quite limited options as to the economic steps that the next administration can take. In the immortal words of Leon Russell, we are "up on a tightrope".

There are some stock groups that one can say might be winners or losers, depending on which candidate makes it into the Oval Office. The pharmaceutical industry would benefit greatly from a Bush re-election. On the other hand, there are several financial institutions that stand to lose more ground under Bush and who would fare well under a Kerry administration.

The stock market distrusts all politicians and I expect many readers feel the same way. It seems that to get into public office, on the national level, one's ability to express truly honest and straightforward thinking is severely hampered for fear of alienating one constituency or another. Republican or Democrat, both sides depend on stable markets to provide for the public's retirement security. From ultra-conservative bank depositors to aggressive entrepreneurs investing in stocks, every person with a retirement plan relies on stable markets. The main job of the victor is therefore to keep confidence high.

It is not that important whether the market turns up or down immediately following the election, though I expect it to go up with a Republican and down if the Democrats take the day. Any rally is likely to be short lived. Government that interferes least with the business of America is the key for a long-term healthy market. This is why the markets most enjoy a legislative branch controlled by one party and the executive suites occupied by another. Like elderly spouses that can neither bear to be together nor be apart, the Democrats and Republicans need each other to stay in balance.

The stock market has languished so far this year, dragging along bonds which have, at best, produced flat results year to date. What events could transpire that would revive prospects for higher returns? The goal for the post election administration should be to reinstall in the public's mind the belief that our money can work for us while we sleep, slowly but surely filling up our retirement coffers. To achieve the kind of world where we can be blessed with good health and (above average) children who go off to achieve financial independence, must we vote with our pocketbooks or can we vote with our hearts?

There is good news and bad news on the home front that both candidates must confront. Americans continue to exhibit ingenuity, resourcefulness and a strong proclivity to spend. Consider the fact that over two million new homes were begun over the last twelve months. The fact that existing home sale prices are down or that the nationwide vacancy rate is 20% in suburban malls means that politicians of all stripes will continue to keep the ball in the air, first you see it and then you don't, in order for investors to maintain confidence in the markets.

The most important issues, long term, are job creation and the fact that the purchasing power of our earned incomes is rapidly deteriorating. The government has a vested interest in keeping this fact of financial life out-of-sight and for most people, out-of-mind. The Consumer Price Index, the notable indicator of inflation, has come under attack as being politically manipulated. Alan Greenspan look a lot like Alfred E. Newman when he says, "who me?" It's not hard to figure out why the government would want to underreport inflation and overstate growth. Hiding the hard truth serves politicians both in and out of the White House. We are a nation driven by cheap financing. Debt promotes consumer demand, which in turn produces retail and service jobs. That all makes for good reasons to keep the truth hidden for as long as possible.

One bump on the presidential road, be it the left or right fork, is interest rates. Looking at the bond market, it is fascinating that long-term interest rates have actually come down as the Federal Reserve has forced short-term interest rates up. This is the kind of economic squeeze thirty years ago, that went under the label "stagflation". With a factory utilization rate of around 60%, we are not hearing much about job creation during this election season. Neither candidate will be able to stem the tide of good jobs slipping away to Asia or the fact that some white collar management jobs are evaporating due to technology. The concept that a portion of America's college graduates may never find full professional level employment is too charged for the candidates to discuss in public.

One area investors can be fairly certain will do well under any administration is the home improvement industry. Americans continue to believe that real estate, especially their own, will continue to go up in value. Invariably, I get dirty looks when challenging this common assumption. Many oversized or overbuilt homes are likely to have to compete with new construction down the road. Smaller and less affluent families will need more energy efficient spaces in order to best use their declining real income, that is, income adjusted for "stealth" inflation.

I doubt we will ever know what either of the two candidates really thinks about the economy. Both look to Alan Greenspan to lull the public's perception into believing that things are getting better or at least not too much worse! The fact is that people's experience at the supermarket, gas pump, doctor's, and college tuition office differs greatly from the statistical reports coming out of Washington, D.C. After the election, we will have a chance to revisit which set of half truths has its way.

On November 3rd, the proverbial day after, I will be speaking at the Santa Fe Country Club from 5 to 7 p.m. about what effect the election will have on specific industries and companies and how to meet the challenge of adjusting portfolios to the new world order. Join us to hear how it will all work out, in spite of our new leader's best efforts!

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