

## Fight club

### *Obama sucker punches market for a TKO*

*January 22, 2010* – Stock markets last week registered their second consecutive weekly loss this month. It's not great news for those who believe the old adage that "as goes January, so goes the year." Indeed, great news was rather hard to come by last week, as politicians from Beijing to Washington put the boots to the banks, albeit for widely different reasons. The banks may have gotten a beating, but it was the markets that took it on the chin.

China led off the bank bashing last week, cracking down on overheated bank lending following a sharp, stimulus-driven increase in fourth-quarter gross domestic product. China's fourth-quarter output rose 10.7% from a year earlier, up from 9.1% in the third quarter. Growth for all of 2009 came in at 8.7%, putting China on track to surpass Japan as the world's second-largest economy.

A return to red-hot growth has stirred fears of resurgent inflation and asset bubbles, as consumer prices rose an annualized 1.9% in December. Producer prices also jumped sharply, by 1.7% from a year earlier. Rapid asset price increases, driven by a red-hot real estate market, in turn fired up by a doubling of new bank lending in 2009, have pushed prices sharply higher across the board.

China's monetary authorities, keen to stimulate shrinking economic activity last year through a massive program of bank lending, are now attempting to stanch the flow of liquidity by raising bank reserve requirements, increasing rates on money market instruments, and removing tax breaks on real estate. A hike in the policy rate is expected later this year.

Chinese banks are, of course, organs of state financial and monetary policy and are tightly controlled and regulated by the central government. To assert, therefore, that China's banks have been "punished" by the central bank, as many observers have done, is to misunderstand the extent to which China is still a command economy, rigorously controlled from Beijing. China doesn't "punish" its banks; it simply gives them new orders.

Meanwhile, over on Pennsylvania Avenue in Washington D.C., the lights were on deep into the night last week, as President Obama and his political advisers attempted to deal

with the stinging rebuke delivered to his administration – and, incidentally, to Congressional Democrats everywhere – by the voters of Massachusetts. The burghers of the stoutly Democrat Commonwealth elected, by a wide margin, a Republican to the Senate for the first time since 1972. The special election to replace the late ultra-liberal Senator Ted Kennedy was widely regarded as a referendum on Mr. Obama’s plans to socialize healthcare and vastly deepen government intrusion into the lives of private citizens. The election has given the Republicans the much-needed 41<sup>st</sup> vote in the Senate and taken away the Democrats’ visions of untrammelled glory in a filibuster-proof Senate chamber.

The administration quickly back-pedalled on some of its thornier healthcare proposals, which also happen to be central to the entire package. Now absent a filibuster-proof majority in the Senate, many observers believe that the much-reviled Obamacare platform is essentially dead-on-arrival, with vital signs absent and no chance of resuscitation.

The Dems’ panic was palpable as it erupted in a laughably predictable attempt to divert attention from their declining political fortunes through redoubled efforts to kick assorted “fat cats” up and down Wall Street. Obama’s trademark index finger got a real workout last week, as it wagged furiously at banks that dared both to take deposits and to trade on their own accounts. Obama’s financial sector proposals included limits on the size of banks and measures that would prohibit deposit-taking institutions from proprietary trading (i.e., from owning or investing in hedge funds or private equity firms).

“It’s all about risk,” declared the lead Obamaphytes, including their venerable monetary *éminence grise* Paul Volcker, with deeply furrowed brows. Yes, but the risk they mean is that the Massachusetts election upset will cascade into a thorough drubbing nationwide come November’s mid-term elections. That went unstated as bank “fat cats” everywhere got a taste of the Obama brass knuckle treatment. Of course, at the moment, these are still “proposals” and have a long road to travel before becoming law.

And with the fat-cat bankers timidly showing their tepid fourth-quarter results, the additional threat of revenue loss from divested proprietary trading divisions was just too much for traders, who headed *en masse* for the exits before the bell for final round. Surging unemployment claims for the latest week, together with the threat of an economic slowdown in China and moves by the US government to bring mortgage-finance giants Fannie Mae and Freddie Mac directly onto the government’s books (thereby adding another few hundred billion to the federal deficit) were enough to bring out the smelling salts on Wall Street.

The Dow Jones Industrial Average closed Friday with a week-over-week loss of 4.1%, as three straight days of triple-digit losses cap the Industrials’ worst week since February 2009. Proving that the exits were open to everyone, not just owners of global industrials, the S&P 500 Composite fared no better, dropping 3.9% on the week.

Though the sound of boots firmly planted on well-padded financial backsides didn't echo in the empty halls of Parliament Hill (said Parliament being "prorogued" till March), there was still plenty of consternation to go around at King and Bay Streets in Toronto, where Toronto's benchmark S&P/TSX Composite Index took a dive. The index lost 2.9% week-over-week, as financial sector issues staggered right along with resources, which followed weakness in gold and renewed strength in the US dollar (boosted by China's bank tightening and the eurozone's problems with the Greeks). A 0.3% drop in Canada's December headline inflation rate, for an unchanged annual 1.5% rate, combined with weak retail sales data and smaller-than-expected manufacturing sales in November spooked the Canadian dollar down to US\$0.9451 on Friday, its lowest level so far this year. The redoubtable Bank of Canada, meanwhile, kept its target overnight lending rate unchanged at 0.25%, reiterating its intention to do so until the middle of the year.

As goes January, so goes the year? Let's hope not. Because unless markets get up off the mat next week, they may well be down for the count. ■

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