



# Weekly Market Commentary

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### Highlights

President Obama's State of the Union address this week will likely be more pro-business in contrast to the anti-business tone of last year's address.

During this week's State of the Union address we will be listening for three key areas of emphasis that have the potential to be market moving: job creation, social security reform, and corporate tax cuts.

## A Pro-Business State of the Union

This year's State of the Union Address, scheduled for Tuesday evening (January 25), is likely to be different in tone and substance from last year's address. At that time, the President's tone was forceful as he voiced strident attacks on the business community and the substance of his anti-business agenda included financial services reform, climate change legislation, the termination of various oil tax breaks, carried interest, and federal subsidies to banks making student loans. His address was delivered in the midst of an 8% pullback in the stock market, as measured by the S&P 500.

Since the mid-term elections, the President has taken numerous steps towards the political center and is now embracing business interests.

- The President has taken business-friendly actions in recent months such as signing into law the Bush tax cuts which included pro-business provisions such as 100% expensing for businesses to write-off equipment purchases. He also signed off on a free trade agreement with South Korea and pledged last week to sponsor an effort to cut regulatory red tape to help businesses.
- The President has also reconstituted his advisors, bringing business leaders into key positions. Last week he appointed Jeffrey Immelt, GE's chairman and chief executive officer, as chairman of his outside panel of economic advisers. He recently named William M. Daley, a former JPMorgan Chase executive, as his chief of staff.

President Obama's approval ratings have reversed course and moved above 50% (according to Gallup) since he began his shift towards the center. He is focused on winning over moderates (Independents voted Republican by 56-37 margin in the mid-term elections). We believe this year's centrist and pro-business State of the Union address is likely to be both stock and bond market friendly.

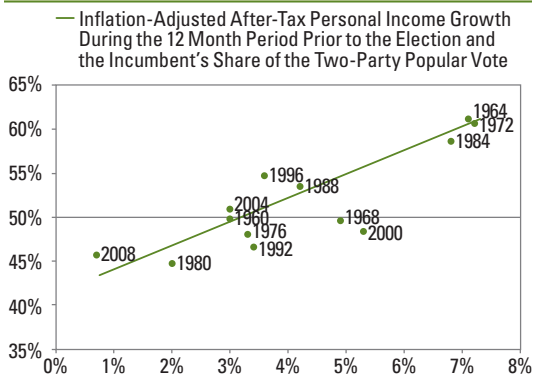
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### Job Creation

Of course, politics can drive economic outcomes, but the economy also affects political outcomes. The economy will likely be the key driver of the 2012 election and the most important measure will be job growth.



### 1 3% Income Growth is the Key to Getting Re-Elected



Source: LPL Financial, Bloomberg data 01/22/11

As you can see in [Chart 1](#), inflation-adjusted, after-tax income growth of about 3% appears to be the threshold for incumbents to get 50% of the popular vote. Currently, this measure of per capita income is only growing at 1.4%.

Clearly, factors other than jobs have a bearing on the election. However, job creation may be the key measure by which his presidency will be judged when he is up for re-election in 2012. The President is likely to address measures to stimulate job growth in his address. These may include exceptions to an overall discretionary spending freeze such as spending increases for maritime, road, and telecommunications infrastructure and for job-training programs. With General Electric's CEO heading the President's new Council on Jobs and Competitiveness, intended to come up with ideas designed to get unemployed Americans back to work faster, the programs are likely to be pro-business and, therefore, stock-market friendly.

### Corporate Tax Rates and Change in Tax Rate by Country

Country	Statutory Corp Tax Rate	Change Since 1997
1 Japan	39.5%	-10.4%
2 U.S	39.1%	-0.4%
3 France	34.4%	-7.2%
4 Brazil	34.0%	+9.0%
5 Canada	31.3%	-13.3%
6 Germany	30.2%	-26.6%
7 Australia	30.0%	-6.0%
8 India	30.0%	-5.0%
9 Spain	30.0%	-5.0%
10 Mexico	28.0%	-6.0%
11 Norway	28.0%	0.0%
12 U.K.	28.0%	-3.0%
13 Italy	27.5%	-25.7%
14 Sweden	26.3%	-1.7%
15 Finland	26.0%	-2.0%
16 Netherlands	25.5%	-9.5%
17 China	25.0%	-8.0%
18 Korea	24.2%	-6.6%
19 Switzerland	21.2%	-7.3%
20 Czech Republic	20.0%	-19.0%
21 Hungary	20.0%	+2.0%
22 Russia	20.0%	-15.0%
23 Turkey	20.0%	-24.0%
24 Poland	19.0%	-19.0%
25 Ireland	12.5%	-23.5%

Source: LPL Financial, and Various Resources 01/22/11

### Social Security Reform

While the deficit is the number one issue on the minds of voters, there is likely to be more rhetoric than actual spending cuts. The President could highlight some minor cuts to defense discretionary spending as he emphasizes that the gains in Afghanistan and Iraq will allow him to continue troop withdrawals. This may result in lower supplemental funding requests, though we do not look for any material cuts in spending.

One area where the President could hope for a centrist legislative achievement is to cut a deal with the Republicans to reduce the deficit by tackling a major entitlement program like social security. While President Obama is well aware of the political pitfalls, and of the political consequences of his predecessor's reform effort, he may indicate his openness to the reform proposals of others in his address. While any action is a long shot, if the President signals a willingness to open a discussion to address this very costly program it may be bond market friendly.

### Cutting Corp Taxes

We also expect Obama to highlight the need for corporate tax reform. Last November, President Obama's bi-partisan commission on reducing the deficit proposed to sacrifice many "sacred cows" in an attempt to balance the budget (i.e. curtailing the home mortgage interest deductions, indexing social security to age, etc.). However, one of the less contentious items was the proposal relating to corporate taxes. While some deductions would be eliminated, the proposal lowered the overall corporate tax rate by about 10 percentage points. This would help the United States catch up to the rest of the world as a home base for businesses and likely boost domestic job growth. The United States presently has the second highest corporate tax rate in the world, and unlike its peers, has not materially lowered that rate in the past 13 years. For example, in Germany they have lowered the corporate tax rate from 56.8% in 1997 to 30.2% today.

It is important to remember that corporate tax receipts are less than 10% of total federal tax receipts and corporations can relocate. Corporate tax rates



are falling around the world. The consequences of inaction can be severe for politicians—one of the reasons the Prime Minister in Australia was removed by his own party last year was for overtaxing the mining companies.

In summary, President Obama's State of the Union address this week is likely to be more pro-business in contrast to the anti-business tone of last year's address. This may provide a more favorable backdrop for the stock and bond markets as we head into February—historically, one of the weakest months of the year for the S&P 500 with an average monthly loss of -0.3% since the start of the index in 1927.

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