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First Trust

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Monday Morning Outlook

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Health Care Fallout

This morning, some dour faces around the office can be understood. NCAA basketball brackets and many people's view of the US as a safe place for free markets and free people lay in tatters. NCAA March Madness brackets have been blown up and health care passed.

Cornell is the first Ivy League team to reach the Sweet 16 since 1979. Kansas, the number one seed in the tournament is out. And, lower-seeded teams won 16 games during the first two rounds (33%).

On the political front, despite an overwhelming majority of Americans being against it, the Democrats passed a sweeping overhaul of the health care system. This occurred despite the clear message of the election of Scott Brown to the US Senate in Massachusetts, the equivalent of a 16-seed beating a 1-seed.

But just because your bracket is destroyed, the NCAA tournament is still awfully fun to watch. And just because health care passed, there are still profits to be made in the stock market. Bottom-line: the health care bill by itself is no reason to run for the hills. In the short term, there are no policy changes that will derail or noticeably slow the V-shaped economic recovery currently underway.

To be sure, there are harmful policy shifts, including extra fees on health insurers and the makers of medical devices. These will raise the cost of health care and stifle innovation in that arena. But this is a sector issue, not a macroeconomic one – at least in the short-term.

In addition, new insurance regulations that kick-in later this year will boost premiums, as insurance companies are forced to transfer resources from the healthy to the sick. This is a costly policy, but not one that will affect the overall drivers of the economy, which are the incentives to work or invest.

The biggest macroeconomic impact will be from tax hikes, but these do not take effect until 2013, at the earliest. First, the law enacted yesterday raises the Medicare payroll tax on high-income workers by 0.5%. This will reduce growth, but the impact is small when compared to the 1993 tax hike (which added 11.5% to the top marginal tax rate) or the scheduled lapse of the Bush tax cuts (which will add 4.6% starting in January).

Second, the new law imposes a tax on so-called "Cadillac" health plans. The key point to remember about this tax is that it will not affect *marginal tax rates*. Workers who already have high-cost health insurance will pay more in taxes, but not on marginal income gains. Workers who do not have Cadillac plans can receive higher *cash* pay, not more insurance, and avoid the tax.

The third change, the one with the biggest negative impact on the economy, occurs because of a new subsidy. A middle-class family of four making $30,000 will pay no more than $900 for health insurance. The same family, at $88,000 of income, will pay no more than $8,360. So if the family earns $58,000 in extra income, its subsidy is reduced by $7,460, which translates into a new implicit tax rate of 13%.

A much bigger worry is the other bill passed late Sunday night by the House (but not yet the Senate) which would raise tax rates on dividends, capital gains, and interest by 4%. However, like the other tax hikes, this one would not hit until 2013. Remember, anything that happens that far out is still questionable.

By 2013, the American people will have had two major opportunities, in November 2010 and November 2012, to either ratify or substantially rework the law. Massive adjustments in the bill are still possible. If those adjustments do not occur, if the bill remains law and tax hikes go through, the economy will pay a price in higher unemployment, slower growth, and higher inflation. But until these next two election cycles occur, we do not truly know the impact of yesterday's vote.

In the short-term we have not changed our bullish stance, we still expect the Dow to reach 13,000 by year end. The economy is in recovery mode and this bill does little in the short-term to have an impact. Get ready for a great finish to the NCAA basketball tournament and continued gains in economic activity.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
3-23 / 9:00 am	Existing Home Sales – Feb	4.980 Mil	**4.990 Mil**		5.050 Mil
3-24 / 7:30 am	Durable Goods – Feb	+0.5%	**+1.0%**		+2.6%
7:30 am	Durable Goods (Ex-Trans) - Feb	+0.6%	**+0.5%**		-1.0%
9:00 am	New Home Sales – Feb	0.315 Mil	**0.315 Mil**		0.309 Mil
3-25 / 7:30 am	Initial Claims - Mar 20	450K	**458K**		457K
3-26 / 7:30 am	Q4 GDP Third Report	+5.9%	**+5.7%**		+5.9%
7:30 am	Q4 GDP Chain Price Index	+0.4%	**+0.4%**		+0.4%
8:45 am	U. Mich. Consumer Sentiment	73.0	**73.0**		72.5