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First Trust

Jun 28, 2010

Monday Morning Outlook

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Feds Spin Wheels on Financial Regulation

Later this week, President Obama will sign an overhaul of the financial industry, the biggest change required by law since the Great Depression. For all the legal change it brings, it won't prevent the next crisis but also won't do much harm.

This bill will force existing firms to restructure their operations in order to comply, which may hit profits. For example, the new law will limit banks' proprietary trading, and investment in private equity or hedge funds.

But this does not stop the process of financial innovation or prevent useful financial operations. Even if banks cannot do these things, they will still get done. It's just a matter of some other firms – including independent spin-offs from today's banks – hanging out a shingle and getting down to business.

Indeed, the new law opens the door for higher capital standards (meaning less leverage), which will result in a larger share of financial risk being absorbed by equity rather than debt. That will add to financial stability and reduce the risk of large taxpayer bailouts for particular firms.

Another part of the bill will push more over-the-counter derivative and swaps trades onto clearinghouses and regulated exchanges, at least when those trades involve speculation rather than the hedging of underlying business risks.

Clearinghouses may improve transparency and provide regulators with more information, but, ultimately, the risk of this activity is not eliminated and will only be shifted toward the clearinghouses. We suspect the financial markets will decide that "too big to fail" applies to these entities as well.

A new consumer financial protection agency, housed at the Federal Reserve, will also be created. Like any bureaucracy this means more paperwork for consumers. But all the paperwork we already fill out for mortgages didn't stop the last crisis. The question is how this agency will be used and whether or not it brings even more political pressure on the Fed. The Community Reinvestment Act, also overseen by the Fed, helped create the subprime mortgage mess in the first place.

The new bill also raises a tax of $19 billion on banks and hedge funds. Any tax increase will distort markets, raise the price of financial services to consumers and hurt the economy. And banks have already been hit with higher deposit insurance rates by the FDIC.

In the end, little in this bill, which gives the government broad power over the financial system, will stop another financial crisis. Everything the government wants the power to do during a crisis it did during 2008. It forced an investment bank, Bear Stearns, to be sold, it closed down banks, Wachovia and Washington Mutual, and it bailed out an insurance company, AIG.

Moreover, the bill does not address the role of monetary policy (and 1% interest rates), or the role of mark-to-market accounting, or Fannie Mae or Freddie Mac. Nor does the bill really address "too big to fail." The government is taking no blame for the subprime crisis and is demanding more power over the US financial system. In other words, the more things change, the more they stay the same.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
6-28 / 7:30 am	Personal Income - May	+0.5%	**+0.3%**	+0.4%	+0.4%
7:30 am	Personal Spending - May	+0.1%	**+0.1%**	+0.2%	+0.0%
6-29 / 9:00 am	Consumer Confidence - Jun	62.9	**64.1**		63.3
6-30 / 9:00 am	Chicago PMI - Jun	59.0	**62.9**		59.7
7-1 / 7:30 am	Initial Claims - Jun 26	455K	**450K**		457K
9:00 am	ISM Index - Jun	59.0	**58.7**		59.7
9:00 am	Construction Spending - May	-0.7%	**0.0%**		+2.7%
sometime	Domestic Auto Sales - Jun	3.9 Mil	**3.9 Mil**		3.9 Mil
during the day	Domestic Truck Sales - Jun	5.0 Mil	**5.1 Mil**		5.1 Mil
7-2 / 7:30 am	Non-Farm Payrolls - Jun	-110K	**0K**		+431K
7:30 am	Manufacturing Payrolls - Jun	+25K	**+50K**		+29K
7:30 am	Unemployment Rate - Jun	9.8%	**9.7%**		9.7%
7:30 am	Average Hourly Earnings - Jun	+0.1%	**+0.2%**		+0.3%
7:30 am	Average Weekly Hours - Jun	34.2	**34.2**		34.2
9:00 am	Factory Orders - May	-0.5%	**-1.3%**		+1.2%

Consensus forecasts come from Bloomberg. This report was prepared by First Trust Advisors L. P., and reflects the current opinion of the authors. It is based upon sources and data believed to be accurate and reliable. Opinions and forward looking statements expressed are subject to change without notice. This information does not constitute a solicitation or an offer to buy or sell any security.