First Trust
Monday Morning OUTLOOK
December 29th, 2014
630-517-7756 • www.ftportfolios.com

Chicken Little Economics

Brian S. Wesbury – *Chief Economist*
Robert Stein, CFA – Dep. Chief *Economist*
Strider Elass – *Economist*

It's now been more than six years since the failure of Lehman Brothers – when the sky fell in and economic panic seized the land. Since then, Chicken Little Economics has inflicted fear and loathing on many investors.

Much of that fear has been caused by a misunderstanding of what actually happened. Conventional Wisdom has a bumper sticker mentality about the crisis – "Greedy Financiers Push World to Brink," "Thank God the Government Saved Us" and "It Could Happen Again –Remember 1937."

But this has it exactly backward. It was government mistakes that caused the crisis. It was government over-reaction that caused the recovery to be slower than it should have been. Most importantly, it was free market capitalism that saved us, not government.

While our readers understand our point of view, there are many who dismiss it because we were late in understanding how bad the crisis would become in 2008. We believed that government would figure out the role of mark-to-market accounting in making the crisis worse and we wrongly assumed this rule would be changed before things got worse.

But the Treasury and Federal Reserve refused to deal with the accounting problem, and instead invented Quantitative Easing (which started in September 2008) and the $700 billion TARP program, which passed Congress October 8, 2008.

What many don't realize is that *after* TARP was passed, and after QE started, the stock market fell an additional 40%. In other words, there is absolutely no evidence that TARP or QE saved the economy.

Others say that it was "Stress Tests" that turned the market around. But the results of the first large bank stress tests were not released until May 7, 2009, which could not have caused the market to bottom on March 9, 2009, nearly two months earlier.

The only thing that happened on that exact day was that Congressman Barney Frank's Financial Services Committee announced it was holding a hearing with FASB to force a change in mark-to-market accounting rules.

This is no coincidence. Forcing FASB to change overly strict accounting rules officially ended the crisis. No longer did illiquid markets and a really dumb accounting rule force banks to take losses that were not real.

Since then, the economy has consistently grown and the S&P 500, without dividends reinvested, has climbed by more than 210%.

Conventional wisdom just can't deal with this. And politics has made things massively worse. Republicans who supported TARP still argue that it worked even though they supposedly believe in free markets. They also argue that as long as President Obama is in office, the economy cannot possibly grow. As a result, they join with the Fed in believing that QE has boosted stocks and the economy.

Democrats have treated the Financial Crisis of 2008 exactly as they did the Great Depression – as a reason to spend more, regulate more and redistribute more. The Democratic ideology is that government is always needed to keep markets in check and make things "fair." This argument works best after a crisis. So, the political argument from the left is that the economy is growing because of government action as well.

In other words, investors have few friends that believe in free markets. "Arm chair economists" are everywhere, arguing that it's simple to manage an economy. Just dial up some QE, redistribution and infrastructure spending, stress test the banks, too, and all will be well.

But these simple-minded remedies have run into an anecdotal and intellectual brick wall. The Fed has tapered its QE and is no longer buying bonds, yet GDP grew 5% last quarter and stock prices are at all-time highs. In Japan, massive new QE is not lifting economic activity or inflation. In Europe, with no QE, interest rates are lower than in the US. In addition, so many "end of the world" forecasters have been wrong that they are making "chicken little" look like an optimist.

Investors need to understand that the same things that boosted growth 150 years ago and 25 years ago are still the same things that boost growth today. What are those things? The answer: Entrepreneurship, innovation and creativity.

In spite of government mistakes, the U.S. entrepreneur has refused to be held back. Profits are at an all-time high and so are stocks. Chicken Little will be wrong again in 2015.

Date/Time (CST)	U.S. Economic Data	Consensus	First Trust	Actual	Previous
12-30 / 9:00 am	Consumer Confidence – Dec	94.0	**95.3**		88.7
12-31 / 7:30 am	Initial Claims – Dec 27	289K	**287K**		280K
8:45 am	Chicago PMI – Dec	60.0	**61.9**		60.8
1-2 / 9:00 am	ISM Index – Dec	57.5	**57.7**		58.7
9:00 am	Construction Spending – Nov	+0.4%	**+0.5%**		+1.1%