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Our Newest Investments (Via the U.S. Treasury)

Now that taxpayers have written checks to the IRS, it's an ideal time to take count of our taxpayer dollars at work. Much needed public services like transportation, social security and military protection have been with us for a while, so I'll just leave them aside. What interests me now, given the current economic condition, are our newest investments, via the U.S. Treasury.

If you had to choose a financial partner in this world, you would be hard pressed to find one with deeper pockets than the U.S. government. After all, what other entity than the U.S. Treasury has the ability to actually create the dollars it invests. All that's really needed is a forest of trees, which the Treasury could easily access by walking across the street to the Department of the Interior, and some green ink. And as much as I jest here, the government's unique and seemingly unchecked ability to be its own self funding entity stands to be the dominate political and economic factor for decades to come.

To put this into perspective, it's important to look back at some recent government action. I, like many other economic professionals be they government or private, have lost tally of all the government assistance programs in operation. There are simply too many to follow and there is limited public disclosure. Whether termed bailouts, injections, capital assistance, stimulus or treasury relief, the net

purpose of government aid is all the same: to keep a company afloat until it can either rebound or be restructured.

While there have been bankruptcies since Lehman Brothers, I can't remember any company that filed after they received government aid. After all, it makes no sense for the government to let one of its investments be disintegrated when it has the ability to salvage it. But note that the government has yet to take common equity in exchange for the initial aid it grants to any corporation. Rather they have taken preferred shares, debt or some other synthetic stake that continues to have value as long as the company is paying its obligations and stays out of bankruptcy. I believe there are very real and well thought out reasons for this and they will affect all policy from this point forward.

Let's look at the facts. If you held debt in Citigroup, Bank of America, AMEX or GMAC since their government assistance, you have been paid your interest. If you were a shareholder, you've lost around 98% of your investment. This is not coincidence. The government seems to be saying with this financial assistance that those greedy shareholders should be wiped out for having the audacity to take ownership. In the meantime, bondholders and those that lent to these institutions literally deserve "credit" for

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their investment benevolence. And who better to provide it than the biggest lender, and therefore the biggest beneficiary: the U.S. government.

Let me state that I'm not totally critical of what's transpired. I was around last October and I saw the trepidation in the economic eye. I can wholeheartedly state that there were a few days last fall when the system was eerily close to collapse. The freezing of credit disrupted the entire delivery of any payment process and no one was willing to part with the dollars in their proverbial wallet. The entire world had an interest in this system working and the only solution was government intervention and boy did the aid come. Money market was insured, direct capital injections were issued and TARP money was dispersed. But the moment aid was delivered the entire world changed and capitalism was sacrificed for economic stability. And given the prices the government got in exchange for aid and its ability to self fund, it's my bet that this colossal shift is permanent.

While there are some public lists documenting the overall amount of government injections, I have not been able to find a compilation of every recipient and a description of their use of those funds. But the amount of assistance is so vast that new investment opportunities, such as the Government Relief Index (QGRI), are emerging that track the performance of those companies receiving TARP funds. While this index as a whole has performed poorly since its launch in January, several components deserve note. The most glaring example is

Citigroup as the initially issued government preferred shares are being swapped for common. Since this announced conversion in February, the stock is up 300%. There are other examples, but the point is that as the lender of last resort the government can inject funds at an unbelievable low cost basis and they also can dictate the terms of their own success while insuring against default by printing more injectable dollars if needed. It's a pretty enviable position and it has far reaching implications.

Now I know you economic naysayers will argue that this dollar-creating power has its limits as an increase in money supply will tank the dollar and spark inflation. But those tongues are in cheek right now given that the dollar is up handsomely against the euro, yen, British pound, Canadian dollar, Swedish krona and Swiss franc in the past year while the U.S. government has grown the money supply by 18%. Furthermore, Chairman Ben Bernanke and his team at the Fed would consider a bout of inflation the equivalent of economic T-ball after the restless nights they've endured since last summer. So, I don't see anything stopping this steamrolling government spending any time soon. (If you need validation, check the size of the new fiscal budget).

Late last year I wrote about how humorous it would be if the government turned a profit on these capital injections. Everyday this is looking more likely to occur and in the past six weeks big profits have been made as investors remembered that stocks can actually go up in value. It is likely that the economy will rebound during this presidential cycle

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and many of these government injections will turn huge profits. If this occurs, the political implications are grand.

With democrats clearly in control, any upcoming economic prosperity will be used as a springboard for big government advocacy. While public services like universal healthcare may be best for the country, more regulation and greater bureaucracy will accompany. Greater bureaucracy means more skewed and convoluted decisions out of Washington, like taking stakes in AIG, Citigroup, Bank of

America, GM, etc. So, if you were pleased by the executive bonus money that was paid after the government injections and the bailout of your neighborhood millionaire bankers, expect more of that in the future as the government expands its influence and doles out more of your tax dollars. But take some solace, because even though we might never personally see a return on them, they will certainly not fail given these are our newest investments, via the U.S. Treasury.

As always, I appreciate your continued trust and confidence.

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