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When is too much debt too much?

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In the 4th quarter of 2012 the United States officially joined the ranks of the United Kingdom, Portugal, Ireland, Iceland, France, Japan, Italy and Greece – all countries with Public Debt over 100% of GDP. With the exception of the United Kingdom and Japan, the concern for government default for these countries was very realistic. The current US debt to GDP ratio as of the 2nd quarter of 2014 stood at almost 102%, down slightly from the previous quarter reading of over 103%. Most economists would agree this is not a sustainable level of debt. The primary "economic" reason cited for not making a drastic plan to reduce the government debt is that the economy is too fragile right now, any tax increases or spending cuts would have a significant negative effect on the economy and we'd likely see ourselves back in a recession. While this is a valid concern, we can look to our neighbors to the North for a case study on reducing government debt and also compare and contrast how we've each gotten to the current level we are at.

In the first quarter of 1996 the Canadian debt to GDP ratio reached its peak of just under 80%, unemployment stood at about 9.5% and GDP growth for the previous year was 2.80% (Unemployment being above average and GDP below average). In 1995, the Canadians determined the growing Federal deficit was not sustainable and something needed to be done to fix the system. The majority of their plan called for spending cuts, to the tune of $6 - $7 of spending cuts for every $1 of tax increases. So the primary driver for their debt decrease was to decrease spending, not to be confused with decreasing spending growth. Over the next four years GDP averaged above 4% annually while unemployment continued to come down, settling just under 7% in 2000. By 2007 the Debt to GDP ratio of Canada stood at roughly 39%, a significant decrease. The global recession of 2008 brought those levels back up into the fifties but Canada plans to bring that level down even further than it was in 2007.

The United States finds themselves in a similar predicament that Canada found themselves in, only much worse off. The United State's debt to GDP in 2007 was 62%, within the range of the average of the previous 20 years. We now sit at just over 100% debt to GDP, higher than the point at which Canada determined their current trend was unsustainable. We are now at a crossroads of which direction we could head, to me three scenarios seem most likely as growing our way out of this problem is unrealistic.

One scenario is to end up like Japan. Japan has had a debt to GDP over 100% for quite some time now; unfortunately GDP growth has been pretty minimal and they remain a case study of a stagnate long-term economy. Most economists would agree having an economy like that of Japan would be a disaster for a wage growth based nation like the United States.

Another scenario is like the other countries listed at the beginning of this article, they found themselves in need of a financial bailout from the European Union or they would have likely defaulted on their public debt. Considering the size of the US debt and economy compared to some of these countries, a bailout for the United States would be much more difficult in terms of dollars and finding partners for the bailout.

Becoming Japan or Greece does not seem like a promising situation for the United States, instead we should strive to make the types of changes made in Canada. At some point with no changes, debt will become a burden on the economy and/or our creditors will cease to accept our current debt as offered. We have already seen some of the effect of the changes in debt levels since 2007, despite a significant increase in spending our GDP remains below average, not something the FED characterizes as a successfully growing economy. Many will disagree with where or how we should make those cuts, but the bottom line is current levels of debt are not sustainable for a healthy and growing economy.

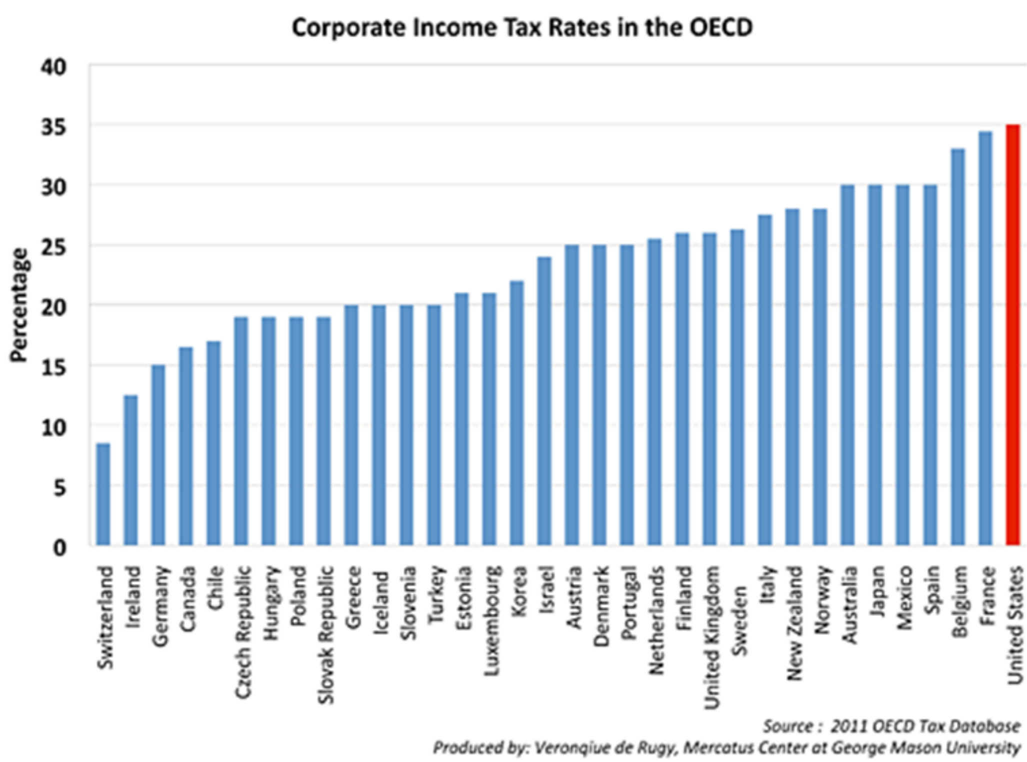
US Corporate Tax Rates

By: Bradley D Thomas—Bradley@thomasfinancialconsultants.com

Recently there have been many discussions within political and business circles about US corporate tax rates and the recent “tax inversions”. These tax inversions, which have been done for many years, are aimed at reducing corporate taxes by acquiring companies in countries that have a lower corporate tax structure than that of the United States. This tax loophole allowed companies to filter gains through their newly acquired subsidiaries thus avoiding the burdensome US corporate tax while also loading up on debt in the US to reduce their overall tax rate. Recently there has been legislation pushed to the forefront to regulate against such tax inversions, led by Michigan’s own Carl Levin.

“the United States has the highest marginalized rate at 39.1%”

The inversion loophole is likely to be closed in the near future. But the bigger problem and the catalyst for these tax strategies is the fact that the United States taxes their own corporation more than any other industrialized nation in the world. Popular inversion target countries such as Canada, the United Kingdom, and Ireland have rates that range from 12.5-26% while the United States has the highest marginalized rate at 39.1%. While most large corporation’s pay a 35% tax at the federal level that is still the highest of any industrialized nation. This rate, which was signed into effect in 1993 by then President Bill Clinton, needs to be lowered if the United States wants to be competitive in an ever growing global marketplace. Even Bill Clinton, the signor of the current bill has recently called for this rate to be lowered (CNBC interview 9/23/14). The chart below illustrates how our rates compare to other nations. If these rates were lowered and loopholes, such as the aforementioned inversions, were closed we could begin to see business and spending come back to the United States.



Financial Plans

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Putting together a Financial Plan takes into account a lot of different components. But the most important aspect of a Financial Plan is discovering what it is that we really value. Responsible people want to take care of that which they are responsible. They want to receive the rewards they deserve and are willing to pay the price for those rewards. The end result of real success is a sense of peace and satisfaction.

The first component of a Financial Plan is providing for what you cannot control. That's where life insurance and disability insurance comes in. A real easy way to look at it is you have a need for life insurance if you cannot afford to retire today.

"What we have done for ourselves alone dies within us. What we have done for others and the World remains and is immortal."

- ALBERT PIKE -

The next part of a Financial Plan is saving and investing in effective manner to enable your investments to provide future income to help support you and your family you when and if you can't work, i.e. retirement. The above is basic financial responsibility successful people don't question. Depending on others to provide for us is an appalling thought.

Even though your responsibility may end there, many want to leave a legacy. Being financially successful enough to provide for the future value of others is how civilization is built. Each of us has an obligation to leave the world a little better off than when we first got here. Leaving a Legacy for others can be the type of real success that brings about the sense of real peace and satisfaction that we long for.

As Adam Smith says our dollar (pounds) are little soldiers going off doing our bidding. With a little help from our firm you may be surprised how much you can do. The joy of making a positive input on the lives of others is one of life's great achievements.

The Markets

Volatility returned to equities markets in Q3. A strong August was followed by losses in September, when any rallies began to focus around selected winners rather than benefitting stocks across the board. Investors exhibited a decided preference for large caps; the S&P 500 closed above 2,000 for the first time ever and the Dow industrials also set new all-time highs. The NASDAQ returned to a level it hadn't seen since March 2000 and regained the lead for 2014. However, the Russell 2000, which has struggled for most of the year, fell deeper into negative territory year-to-date, while the Global Dow suffered from political conflicts abroad and concerns about global growth.

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Bond investors continued to demonstrate surprising resilience. In early September, the yield on the benchmark 10-year Treasury fell to 2.35%–a level it hadn't seen in more than a year–as prices rose. However, as the Federal Reserve continued to taper its economic support and ramped up discussion of how and when to increase rates, demand began to taper off (though geopolitical anxieties and a strengthening dollar kept the decline in check). Gold, which started the quarter at roughly $1,320, ended below $1,220. It was hurt in part by a stronger U.S. dollar, which by the end of the quarter had hit its highest level against the euro in almost two years. Dollar strength coupled with weaker global demand also meant lower oil prices; a barrel fell from $107 a barrel to roughly $93 during the quarter, a level it hasn't seen since January.

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Thomas Financial Company LLC is a Michigan based comprehensive wealth management firm with a focus on providing individuals, families, and business with advisory services to plan for a successful financial future. We take a proactive and diligent approach with our client to carefully guide them to future success.

Guest Spotlight: Medicare

By: Keith Hayward, Independent Health Insurance Agent - kwhclu@hotmail.com

This is a busy time of year for people who have Medicare or who are turning 65 in the near future. This is due to Medicare's annual open enrollment period that runs from October 15th through December 7th. During this time a person on Medicare can change their medical Medicare plan to any other plan with a new effective date of January 1, 2015

There are two types of medical coverage available beyond the basic Medicare coverage. They are supplemental insurance, which came into effect in 1996 and Medicare Advantage which came into existence January 1, 2006.

First the Medicare supplement plans run from A-N with a few exceptions. There is no supplement plan either E or I. Typically Medicare supplement plans cover the most and therefore are the most expensive. Prescription drug coverage must be obtained separately for "medigap" supplemental plans.

It is widely believed that F and G are the best supplemental plans in the marketplace. As long as your provider accepts Medicare you do not have to pay anything out of pocket other than prescriptions for Plan F. Plan G is the same as plan F except you have to pay the $147.00 part B of Medicare deductible. Also, there are the only two "medigap" plans that cover part B excess. Few people are aware of the fact that under a "medigap" plan your provider can charge 15% more than Medicare approves. This becomes more relevant under the Affordable Care Act, however plans F and G cover the cost of the 15% excess part B charges.

Medicare Advantage plans (MAPD) are new since January 1, 2006. They are quite similar to group insurance plans with deductibles and co-pays. They are typically bundled and have all parts of Medicare AB & D and are called Medicare part C. Typically, they are less expensive than Medicare supplements (medigap) plans but are subject to more out of pocket expenses.

Keith Hayward is an Independent Health Insurance Agent in the Metro Detroit area and is not affiliated with Thomas Financial or FSC Securities