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## **CLIENT BULLETIN**

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### ➤ ***Congressional Dithering***

Last week Congress passed and President Obama signed into law, legislation that provides a short-term extension of the payroll tax cut; extends federal unemployment benefits; and prevents deep cuts in payments to doctors who see Medicare patients. Once again, Congress took a tortured path to pass legislation that is both modest and short-term. All three provisions last only through the end of February which sets up Congress to start debating them all over again when they reconvene on January 17<sup>th</sup>. Not much will be different 3 weeks from now that will make it any easier for them to come to an agreement.

### ➤ ***The End of Open-Ended***

The U.S. government's current financial straits bring us face-to-face with economic realities that are no longer avoidable. While government-provided health insurance, extended unemployment benefits, student loan assistance and helping homeowners with underwater mortgages seem to be desirable goals, they ignore the most fundamental fact of economics, that resources are inherently limited and have alternative uses. Benefits such as these cost money and the needs are essentially open-ended so the real economic questions are: how much do they cost and who will pay for them?

For example, the payroll taxes that Congress just cut are the only source of funding for the social security system. If Congress were going to "live within their means" as we all want them to do, then they would also have to vote to reduce social security checks to retirees to "pay for" the decreased payroll taxes going into the system. Unlike a business, governments cannot directly create money – they merely redistribute it. We need only look at Europe to see where continued well-meaning but unconstrained government spending will lead us.

### ➤ ***China Rising***

I recently read a research report titled: "Welcome to China's Universe: How to Invest in What Will Become the World's Dominant Economy". The certainty with which China's path to world economic domination is projected should set off some alarm bells – history shows that whenever everybody believes something will happen it rarely does.

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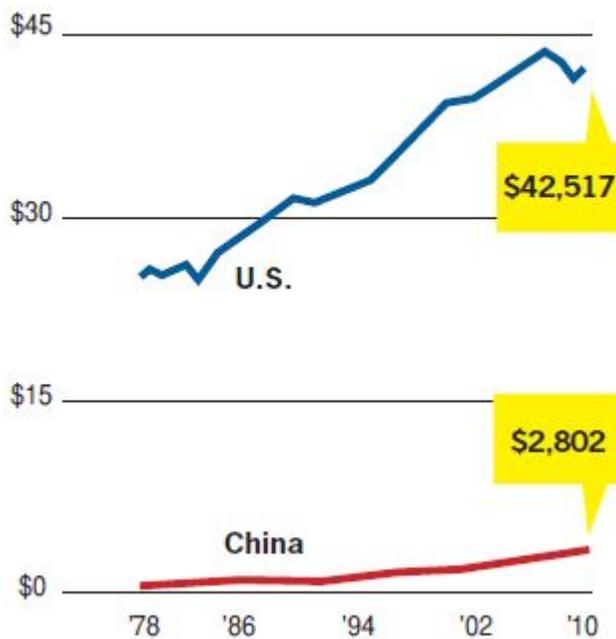
## ➤ *Export King?*

While China's economy has quickly grown to be the world's largest exporter, the reported numbers do not tell the whole story. Many companies from other countries have moved their *facilities* to China to access cheap, low-skilled labor. So while China may be where many items are made, the facilities are to a large extent owned and controlled by foreign companies. Components are shipped to China for assembly but when China ships a product back to the U.S. for example, its entire value is counted as an export rather than simply the value added while it was assembled in China. The next time you see "Made in China" on a label, consider that it should read: "Approximately 55% Made in China".

## ➤ *Chinese Economy*

### China Vs. The U.S.

Real GDP per capita (in thousands, 2005 \$)



China's economy is growing at an incredible rate. They recently passed Japan as the world's 2<sup>nd</sup> largest and may one day exceed the Gross Domestic Product (GDP) of the United States. In similar fashion to the export figures noted above, however, China's overall GDP numbers do not paint a complete enough picture for economic comparison.

GDP figures should always be evaluated in light of the population of a country in order to make a fair assessment. After factoring in China's \$1.34 billion population (over four times larger than the U.S.), the picture changes dramatically. The chart at left compares the GDP of the United States and China on a *per capita* basis – a much more accurate measure of the true wealth of a nation. As you can see, China has a long way to go to catch up.

Source: Economic Research Service, Dept. of

## ➤ *Non-Financial Issues*

Beyond economics, major problems lie beneath the surface for China. While these factors may not cause a dramatic crash in the Chinese economy, they will certainly lead to long-term decline if they cannot be dealt with. First on this list are the human rights atrocities and staggering economic inequality that exist in the country. Social unrest is a distinct possibility. Next on the list is their somewhat bizarre mix of communism and capitalism – an experiment if ever there was one. Finally, an aging population is probably China's greatest area of concern. Following a huge population boom mandated by Mao Zedong during his 33 year reign, the government began a horrific one child policy in the 1980s which "boasts" of having prevented 400 million births. Now the burden of too many elderly and too few able-bodied workers to support them threatens their economy. China may very well grow old before it grows wealthy.

*\*The information contained in this newsletter is of a general nature and should not be acted upon in your specific situation without further details and/or professional assistance.*