

## Government Motors – The New GM

July 20, 2009

“We look forward to working with the Obama administration to ensure that the government’s majority ownership of GM will not change the industry’s competitive dynamics and that a level playing field will be maintained.”

– Ford Motor Company

---

One of the problems with propping up a failed company is that it can bring its competitors down with it. The bailout of General Motors Corporation will have far-reaching consequences that may be quite different from the original intent.

Government-sponsored bankruptcy has transformed GM into a leaner, stronger company. Its aid package includes a \$50 billion cash infusion from the U.S. government and an additional \$9.5 billion from the governments of Canada and Ontario. Bankruptcy also allowed the company to rid itself of benefit costs associated with hundreds of thousands of retirees and \$27 billion in debt. Contracts with its union were renegotiated, and relationships with over a thousand dealerships were severed.

With the U.S. government now a 61% shareholder in GM, Ford’s concerns clearly are justified. Besides its newly acquired economic interest, the bailout has given the government a huge political stake in seeing the new GM succeed. Ford obviously will suffer to the extent that GM’s enhanced competitive position allows it to offer better incentives to buyers. In addition, Ford is now left with a much riskier capital structure than its cross-town rival. Moreover, were it not for the government, GM would not even exist as a Ford competitor. If not directly picking winners and losers within in the auto industry, government bailouts of GM and Chrysler at least have kept the losers in the game.

Equally intrusive was the government’s heavy-handed circumvention of longstanding bankruptcy law to pick winners and losers within the bankruptcy process itself. As part of the GM settlement, the United Auto Workers received a 17.5% ownership stake through its retiree health-care trust. Apparently to avoid leaving taxpayers on the hook for the benefit costs, the government saw to it that the UAW received more-favorable treatment than did the company’s debt holders, especially in relation to the union’s unsecured status. We believe this decision may come back to haunt union-dependent companies during the next wave of the credit crisis as investors become increasingly wary of the bonds of such issuers.

Despite these shortcomings, things could have been much worse. The government simply could have written GM a blank check, thus setting up yet another bottomless money pit alongside those represented by AIG, Fannie Mae, Freddie Mac and the banks. Even so, by continuing to intervene on behalf of individual companies, the government has created a system in which a company’s ability to compete for government assistance ultimately can prove more important for its survival than its ability to compete for customers. That does not bode well for U.S. business efficiency or the economy as a whole.

## Realignment of Incentives

Majority ownership of GM places the government in the difficult position of having to pursue a number of conflicting objectives. It will be interesting to see how long it takes for Congress to begin using GM as a tool for advancing its own agenda under the guise of asserting “ownership rights” on behalf of the U.S. taxpayer. While the best course of action from the taxpayer’s perspective arguably would entail a quick return to profitability and sale of the company, Congress may decide that preserving “American jobs” and achieving environmental goals are more important. The terminology here is somewhat amusing because, according to the prevailing logic, jobs held by Americans at foreign-owned auto plants in the South apparently do not qualify as “American jobs.”

The UAW, meanwhile, faces its own incongruities. Although the threat to strike has long been a mainstay for union existence, the auto-rescue package includes a pledge from the union not to go on strike against GM or Chrysler before 2015. Also, despite its ownership interest, the union may decide to sacrifice company profitability in pursuit of more-traditional aspirations. It may, for example, continue to resist layoffs, plant closings and assembly-line speedups without actually having to go out on strike. Or it could flex its newly found political muscle by seeking to force unionization of suppliers or foreign-owned U.S. plants. The point here is that behavior patterns corresponding to deeply ingrained beliefs are not easily altered simply because a few incentives have been tweaked here and there.

## The Picture

The stock market moved higher last week from somewhat oversold levels. The chart on the next page shows the S&P 500 Index rallying sharply off support at 875-880 and beginning to test resistance above 940.

In recent weeks there has been a subtle improvement in price-volume behavior. The Accumulation/Distribution line depicted in the bottom panel of the chart was particularly strong last week and climbed to new highs. The green line highlights the positive divergence of this indicator from the price chart, as it failed to confirm the S&P 500’s momentum lows of early July. Other such indicators also have shown improvement, with Chaiken Money Flow (not shown) rising to levels not seen since early May.

Momentum also turned positive last week. RSI pushed above the key level of 50, while MACD moved into positive territory. MACD also generated a bullish moving-average crossover, which caused its histogram bars to reverse from inverted to upright.

While such bullish evidence cannot be ignored, last week’s rally also displayed characteristics of a buying panic that could prove to be at least a temporary exhaustion. Gap support at 910 and gap-fill support near 906 are important levels in that regard. If those levels can hold, it could set up a move to new highs for the year. Failure to breach the June highs, on the other hand, likely would result in continued sideways movement, though a sharp selloff could not be ruled out in that circumstance.

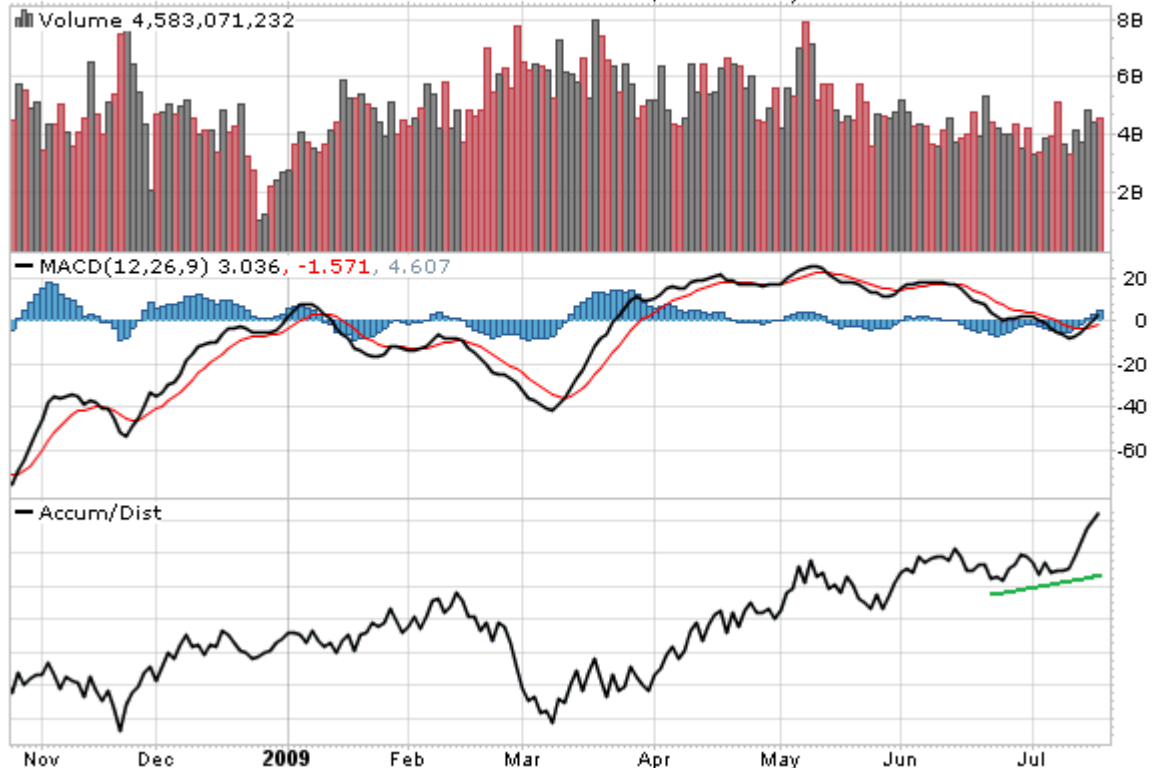
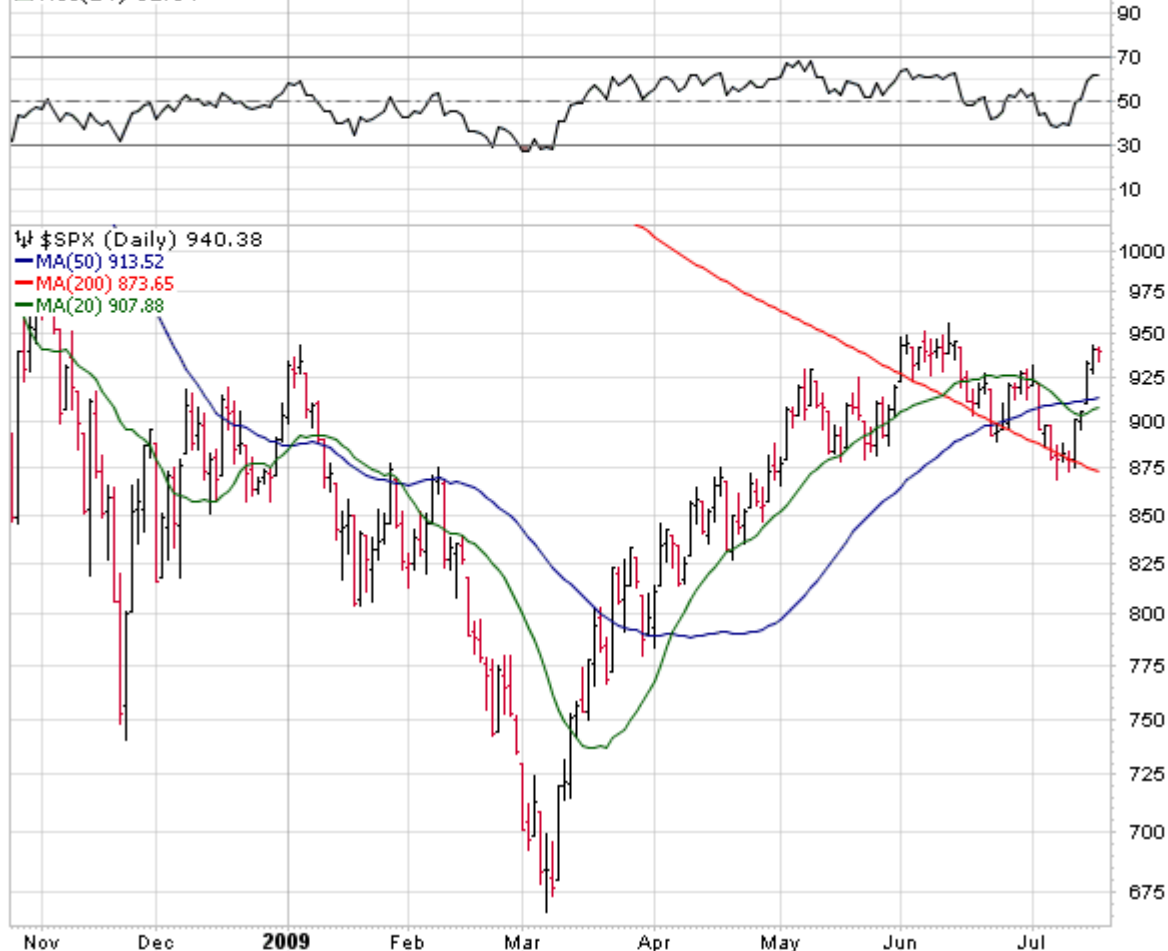
**\$SPX (S&P 500 Large Cap Index) INDX**

© StockCharts.com

17-Jul-2009

**Open 940.56 High 941.89 Low 934.65 Close 940.38 Volume 4.6B Chg -0.36 (-0.04%)**

▲ RSI(14) 61.54



In short, the market is at a crossroads. There is a resistance zone from here all the way up to 956. Evidence is mixed as to whether that resistance can be overcome. Both bullish and bearish resolutions are possible, and the outcome will hinge upon the relative conviction of buyers versus sellers.

**Disclaimer:** All ideas, opinions, and/or forecasts expressed or implied herein are for informational purposes only and do not constitute investment advice or an invitation to buy or sell securities. The views expressed may be short-term in nature and subject to change. This material does not take into account your particular investment objectives, financial situation or needs and is not intended as recommendations appropriate for you. You should strongly consider seeking advice from a qualified investment professional before deciding to invest, trade, and/or speculate in the markets.