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- ## One Man's Opinions - Winter 2009-2010

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Recently former Federal Reserve Board Chairman Alan Greenspan, like a growing number of economists, was surprisingly upbeat on the current recovery from the recession. "Companies fired far too many workers during the financial crisis, he declared, and so they are operating at the limits of their capacity, setting the stage for a strong potential upturn in employment growth."

Greenspan is not alone in his sunny outlook. I, for one, agree with him! The November unemployment figures of 11,000 jobs lost, versus a projection of 125,000, temporarily managed to turn around the dollar's slide and halt the advance in the price of gold. I think it is a harbinger of things to come in 2010. Accompanied by a downward revision of 160,000 in the number of jobs lost in September and October, there are new reasons for optimism. Some economists have found evidence to support the V-shaped recovery they and I have been forecasting.

But we are not yet out of the economic dumps. Only three months ago, Greenspan himself was voicing dismay about the costs of long-term structural unemployment, as workers continue to see their skills erode in an increasingly dynamic high-tech economy that leaves them behind. My local paper has been featuring stories all this year of the dropout problems in our Indianapolis public schools. These young people are condemning themselves to a lifetime of financial underperformance. The days of dropping out and getting a high paid union job in a factory are over. And the few jobs like this available are more and more requiring a high school diploma.

This lost generation of workers will negatively impact every aspect of our U.S. economy, from chronic federal budget deficits to incomes, and from slower consumption to productivity and global competitiveness. Undoing this damage will not be easy. Even if the rebound in 2010 is much better than anticipated, returning to 5.0% unemployment levels in the U. S. will require five years of 5.0% GDP growth, an unlikely scenario at best.

The 75% increase in equity prices since March 9, 2009 is not just a change in the price of paper. It is real, and this re-creation of wealth has positive implications for both consumption and investment in the economy. But the way that wealth disappeared in 2008, and suddenly reappeared in 2009, leaves many businessmen and investors wary. In addition, just as workers unemployed for an extended period lose their skills, many investors, like those who panicked and sold or who were and still are overexposed to real estate, have experienced long-term wealth declines that won't be so easy to replace.

I note the reappearance of a human phenomenon in this area. Investors are not cognizant of how much their investments have lost or gained versus the cost of them. Rather, they compare their current position with the very top of the market, the highest prices ever. This false mindset leads them to a certain behavior, similar to "deer in the headlights," they freeze! They tell me they are "going to wait until the new year," or "until the market stabilizes" or "gets back to what they paid," or "until the cows come home!" Home owners tend to look at their homes in the same light. When they decide to sell them, for whatever reason, they tend to price them too high to readily sell. Then they complain about the poor job their agent is doing. I hear about this from every real estate person I have talk to in this winter.

As we enter a new year, there are more reasons to be upbeat than there have been for a few years. But when sober people like Greenspan change their outlooks so far and so fast, count this observer a little dubious.

I anticipate a relatively strong 4th quarter U.S. economic report, on the order of 3% annualized. The originally reported strong third quarter growth has been scaled back to 2.2% from an originally estimated 3.5%. This number includes a 1.5% "kick" due to the "Cash For Clunkers" boost in auto sales last summer. If we take this amount away as borrowing from future auto sales, we are left with an anemic .7% growth for the quarter. But it was a plus, and the 4th quarter looks quite a bit stronger including strong holiday retail sales. This represents the end of the recession according to how these things are calculated.

Looking into 2010 I anticipate U.S. economic growth on the order of 3-4%. This is quite modest, as normally coming out of a recession the economy will grow at twice this rate. Inflation will stay under control due to the Federal Reserve continuing it's extremely low interest rates at least into the second half of the year. Their floodgates are still open!

Looking out to 2011 however, the chickens will come home to roost. The Fed's extraordinary pump priming and the spending from Obama's $780 billion stimulus package will finally take hold next year (after the economy has already begun to recover) and it will trigger heavy inflationary pressure. I expect inflation on the order of 6-8% in 2011!

For this reason I continue to recommend dividend paying blue chip stocks for investor portfolios. Look for U.S. multi-national stocks with strong foreign presences as part of global diversification. The giants which are part of the Standard and Poor's average showed a 9% increase in foreign revenue in 2008 versus a decline of .3% in U.S. revenue due to the economic meltdown. This overseas growth has continued in 2009 and will do so again in 2010. I expect U.S. corporate profits, especially of these stocks, to jump substantially, coming off a very lean base due to broad cost cutting. This should trigger stock price gains of 10-20%.

For income in these portfolios I recommend avoiding bonds in favor of high interest recently issued preferred stocks. Yields of 6-8% are available. Most are fully taxable, so I recommend they be held in tax free IRA and other such accounts. Look at all your investments as one whole (which is how professional money managers normally do it) and take advantage of favorable tax impacts where possible.

The sharp 75% recovery in the stock market since last March reflects a return of confidence on the

part of professional market participants, and, lately, on the part of the public as a whole. The lack of such confidence made last winters' sharp declines even worse than they otherwise would have been.

I am not at all happy about the two Health Care Reform bills passed by the Congress. They represent a belief on the part of its Democrat leaders that the U.S. government can do a better job than the private sector with one sixth of our economy. The government has never before been able to do this, and I do not believe they will do so now. It is interesting to note that advocates are pointing to both Social Security and Medicare as favorable comparisons to this new effort. There are two problems with these comparisons: Both those programs were enacted with bi-partisan support and; both those programs are on track to go broke, Medicare in 2017, and Social Security in 2040.

As presently passed the health care effort will be in a deficit position as soon as it goes into full effect in 2013, and it completely ignores the supply/demand factor for medical personnel going forward from that date when 30 million people are added to the demand side. It also ignores the possibility that large numbers of physicians will retire or stop taking patients who are in government funded programs which are inadequate to the point they will lose money on them. Congress has been reacting to the latter matter by repeatedly repealing planned lower medical reimbursements. They just did it again last month, adding $250 billion to the deficit. With these challenges, along with others, I see no way for this proposed health care program to not add heavily to the federal deficit.

Have a Happy and Prosperous New Year.

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