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• One Man's Opinions - Summer 2010

ONE MAN'S OPINIONS – SUMMER 2010

One Man's Gratitude:

“Dancing While Standing Still.” was a description of the great joy Sandy Sasso, Senior Rabbi at an Indianapolis Jewish congregation, felt upon the arrival of her first grandchild, according to an article she wrote for the *Indianapolis Star* a few years ago. I could relate, as I remembered feeling the same way when my first grandchild arrived. I felt the same joy at age 18, upon the birth of my first child, Deborah.

I revisited this feeling last week as I held my eleventh great-grandchild, some three weeks old, while his almost two-year-old sister entertained us by being her delightful self. Older brother Devin, who is somehow related genetically to the Energizer Bunny, was also there to warm patriarch PapaT's heart even more. Cameron brings the total of my lineal descendants to 30, an incredible number to me.

I am blessed with six children, all middle-aged now, and all doing fairly well (as things go in an economy like this). As they were taught, all of them value hard work, education, focus, family, and each other. These six have given me thirteen grandchildren, ages 8 to 31. The older of the grandkids are bringing their own children into the family, with the twelfth due in October. I look forward to more as the younger grandkids mature and marry. I/we are blessed.

Speaking of blessings, this summer marks 48 full years in the investment business for me. I accepted the proffered job with Merrill Lynch in June, 1962, and reported for duty August 1. Before this I managed an industrial chemical distributor in Columbus, IN for four years, and spent the prior two years as a disk jockey and radio announcer. I was a very busy young man, also having four children during these years.

I am very grateful for the opportunities for personal growth these 48 years have brought me. I spent seven years as a retail broker with Merrill, and then moved to Robert Baird & Co., another New York Stock Exchange member firm, as their founding Indiana manager for six years. August 15, 1975, I became self employed as I started McAllister Financial Planning, which I still operate, albeit at a reduced level.

Also, in 1975, I became a financial planner, two years later a Certified Financial Planner, one of the first 700 in the world. While I am sure I would have made more money staying in the brokerage end of the business, I believe I have served more people to a far deeper degree as a generalist pioneer financial planner. Now 72 and semi-retired, I still work part-time most week days. I also have been blessed with my lecture cruises, which are few these days, but which enabled me to satisfy my wander lust and to travel to 140 countries, and to share my experiences in the financial world with audiences totaling in the thousands. All of these career stages were accomplished while raising my large family in middle class comfort. I am blessed.

One Man's Opinions on the U.S. Economy:

I do not normally comment on politics or politicians in my weekly blogs. These newsletters though, are *one man's opinions*, not the facts and news I attempt to communicate in my blogs. I try to avoid politics in both communications, and I will try to remain apolitical here, as best I can.

For example, I supported as necessary the Obama Economic Stimulus act of February, 2009. As I stated at the time, I doubted the stimuli would work any better this time than such programs ever have either in the U.S. or abroad. Rather, as I explained, I understood it was necessary for *psychological reasons*, that

the Obama administration and Congress DO SOMETHING to interrupt the free fall in the economy at that time. Sure enough, with over \$800 billion spent or committed so far, mostly on “shovel- ready” government projects, there is little to show so far as long term economic recovery. Borrowing money to spend on infrastructure projects with no discernable way to pay off the debt incurred is counter-productive, in my opinion.

I am very concerned about the economic outlook for the United States of America as I attempt to imagine where matters are likely to stand when my great grandchildren reach their adult years. For that matter, things do not look so great for their parents, my grandchildren either. I see little likelihood that they will have as good a climate in which to achieve success as I and my children had. We Depression babies owe most of our opportunities to our parents, the World War II generation, who endured so much and gave so much to the nation. We, in our turn, have prospered, along with our Baby Boomer younger siblings, to far greater heights than our parents.

My major concerns now include the relative lack of competent leadership on the national level, specifically Congress with its many failures, and the Obama administration which appears to lack both experience (which was obvious when they took office) and leadership ability to “get things done.” Frankly, I am surprised at the latter. I thought Mr. Obama had surrounded himself with highly capable people who had the experience and leadership abilities necessary to buttress his own lack of these qualities. Alas, that has not proven to be so.

My chief concern for my descendants' future here in the U.S.A. is the rapidly exploding debt we are incurring, largely with no plans as to how its rapid expansion can be slowed, much less paid off. I was highly critical of the deficit spending of the Bush administration. By contrast, they now look like "low achievers" in the spending department! Our deficit in the current fiscal year exceeds ALL FOUR of the last Bush years! Every responsible economist believes this is unsustainable. Yet, the administration and the Democrat leaders of Congress are proposing *more* deficit spending, not less, to battle the sluggish recovery. This surely borders on insanity! Fortunately, cooler heads in the majority party have begun to question this blind devotion to more and more spending. It would appear that, for the rest of this Congressional term at least, the expanding level of deficit spending will slow down, if not reverse.

Let's look at one of the most seriously wounded sector, housing. Perhaps this story will illustrate why the recovery in housing is still not very visible. Democrats recently voted down the FIVE PERCENT RULE. Sen. Robert Corker (R-TN), in a bid to stem taxpayer losses on bad loans guaranteed by federal housing agencies Fannie Mae, and Freddy Mac, (both now 100% owned by the United States government), proposed that borrowers be required to make a down payment of at least five percent in order to qualify for a loan. Every banker I have ever known would say this is not large enough! But the proposal was rejected in the Senate 57-42 on a party line vote. Sen. Chris Dodd (D-Conn) explained the vote against the proposal as follows; “*Passage of such a requirement would restrict home ownership to only those who can afford it!*” Hello? Perhaps this explains more fully who inflated the housing bubble and caused it to burst, triggering the worst economy since the Great Depression!

Earlier this year I read a biography of Benjamin Franklin, arguably the “first” American. What I love about Franklin was that, while obviously a brilliant inventor, scientist, writer, and diplomat, he was not a dreamer. He was a doer! I have no doubt that, if alive today and running a portfolio, he would do quite well. He never stopped learning. Here are three Franklin quotes which seem appropriate for the situation in which we find ourselves:

1. "We are all born ignorant, but one must work hard to remain stupid."
2. "A penny saved is a penny earned."

3. "By failing to prepare, you are preparing to fail."

As a practical matter, it seems to me many Americans are already moving down the right path when it comes to preparing their personal balance sheets for the inevitable. While the US government literally does the opposite of these quotes, Americans seem to be doing what they've always done, adapting.

On the first point; whether it be from a mortgage application or a US equity fund flow perspective, Americans are proving that they haven't remained "stupid" enough to make the same mistake twice. They aren't buying houses or stocks. Unfortunately, many are making a very big "new" mistake, by buying bonds at record rates, at a time when bonds are at an historic high level of risk of principal.

On the second score, while the savings rate in this country has its own problems in terms of how it's calculated, there is no doubt that the direction of cash in savings accounts of fiscally conservative Americans is going one way and that is up. Last month we saw the US savings rate bump back up to 4%.

"The US government has a technology, called a printing press, which allows it to produce as many US dollars as it wishes at essentially no cost." -Ben Bernanke. One of the sayings spreading around Wall Street this spring was *"austerity equals civil unrest"* and it has become increasingly clear that the Obama administration wants nothing to do with austerity. It's also clear, judging by developments at the G-20 weekend in late June, that the US is going to try to go it alone with big fiscal imbalances. I do not believe that the USA balance sheet can sustain the current trend of larger and larger deficits. In fact, if these deficits continue, one of the biggest losers will be the American consumer. As the Bernanke & Co printing press continues to roll on and on, piling debt upon debt upon debt, this can only end badly. In my opinion, VERY badly!

At mid-year, consumer discretionary spending was one of only three market sectors up year-to-date (up 2.7%). The other two are Industrials (up 3.3%) and Financials (up 0.7%). But in recent weeks I have noted both personally and in my business reading, a surprisingly broad and deep drop in consumer confidence. Everyone has a different view on the consumer, but there are some changes on the margin that should be considered as we look toward the rest of 2010. Mortgage rates are still going down. The employment picture is turning around, but growth is quite slow by historic standards. Gasoline prices are down year-over-year, but asset prices are rising. Looking at the data at the end of the second quarter 2010, it is clear that the American consumer is now being squeezed and is not going to be happy. In fact he is not happy NOW!

I don't subscribe to the theory of a double dip forming now in the economy. However the housing market seems to be in or on the precipice of one. Housing prices have continued to decline and the economy slowed significantly quarter-to-quarter from the 4th quarter of 2009 through the first quarter of this year. The housing market is still in trouble. If a double-dip depression in housing is indeed underway, it will have a serious impact on consumer behavior. Following a decade of out-of-control spending by both Republican and Democratic administrations, the state of the USA's balance sheet inhibits our ability to navigate the still serious structural issues present in the economy. Points to keep in mind include:

- (1) The benefits from the Obama stimuli peaked in the first quarter, and we see slowing GDP growth.
- (2) In 2011, taxes are going up and that will hamper the economy - Slowing GDP growth.
- (3) Real estate prices may decline 10- 20% in the next twelve months - Slowing consumer spending.

The public focus on high unemployment numbers continues. Jobless claims have not shown any material improvement over the past six months, despite huge government stimuli. Private sector job creation remains a concern. May numbers decreased sequentially from April. In June the unemployment rate dropped to 9.5% from 9.9% SOLELY because an extraordinary number of workers stopped looking for jobs altogether! Real growth was only 83,000 jobs. We need 125,000 per month just to take care of new entrants into the work force.

While private sector job creation had been growing for five straight months, it seems to be coming to an impasse as businesses have become nervous about the state of the economy. Unemployment is still at an elevated level and indicates a continuing softness in the underlying economy. As census workers finish their temporary jobs, the rate will jump higher unless other sources of employment pick up hiring drastically. Uncle Sam is running out of crutches (and/or the political will to supply them):

- (1) The Administration failed to get Congress to pony up an extra \$50B for unemployment claims. Our leveraged balance sheet inhibits the government's ability to provide more in the way of stimulus.
- (2) A strong dollar policy has proven to help job creation - Bill Clinton and Ronald Reagan were the last two presidents to oversee true job creation and both pursued strong dollar policies. The Obama administration appears to be debauching the US currency.
- (3) If a Double-dip scenario occurs, unemployment will remain elevated and may even go higher.

Reported inflation by the government looks to be under control. A closer look at the Inflation Index tells a different story. An inflation Index focuses on the part of the economy showing inflation which directly impacts the consumer, specifically the spread between the prices of things they buy and what they earn. Looking out over the next 6-12 months (and perhaps longer) consumers will be paying more to drive their cars, and to make sure they have health insurance for their family. Other energy prices also are poised to increase sharply. The prices paid by the US consumer for gasoline is far below the rest of the world and there is a possibility that the gap could close significantly under pending energy legislation. This would be a massive headwind for the consumer. The prices paid by the US consumer for gasoline are far below the rest of the world and there is a possibility that the gap could close significantly under pending energy legislation. This would be a massive headwind for the consumer.

The disaster in the Gulf is inflationary and will be a drag on growth. While certainly the greatest environmental crisis the U.S. has ever faced, I hope readers will take the constant TV oil covered pelican pictures with several grains of salt. The total amount of oil released into the Gulf of Mexico in the last 80 days is equal to less than half the amount of water coming from the mouth of the Mississippi per hour! Dilution is Mother Nature's friend. But it will take decades to recover completely.

Debasing any currency, (even the "Almighty Dollar"), ALWAYS ends badly. A lack of austerity in government policies and an aversion to facing facts among our professional politicians is not helping the long-term outlook for equities. Let us look: (1) U.S. equity markets have lost \$1.78 trillion since April 23 on concern the European debt crisis will spread; (2) China's stock market is now down 29% year-to-date; (3) The U.S. S&P 500 at June 30 was down 6.6% year-to-date.

Better news. The consumer confidence index improved in May and the consumer is now spending less than he/she earns. In both cases the market ignored the data and moved lower. We apparently don't trust the government, nor the direction in which the country is headed. The consumer is not stupid and Washington does not get it.

One Man's Recommendations:

Having said all this, the U.S. stock market remains undervalued given the solid growth of corporate earnings coming in versus 2009. *Bond yields remain very low on an historic basis. Net of inflation and taxes, bonds are producing automatic losses. Preferred stocks of non-financial U.S. companies are still paying 7-8% and they are a BUY! These are very competitive with bonds. Since taxes on these will rise next January from 15% to as high as 39%, they are best held in non-taxable retirement and charitable foundation accounts.*

I hope your summer is a restful and pleasant one. We should have a very interesting fall on the political front here in the United States.

We are required by our regulators to offer a copy of our annual income statement to our active and prospective clients. If you would like to receive one, please call or email us.