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• One Man's Opinions – 4/01/11 – Spring 2011

ONE MAN'S OPINIONS – Spring 2011

The most obvious topic for this issue is the return of investor confidence in the first quarter. Three months ago I wrote that professional investors were highly optimistic. They led the way and brought public investors to the party as well. The stock market gained 5.42% as measured by the Standard and Poor's Index so far this year. This is a healthy gain indeed, as we expected a market gain on the order of 12% for 2011. We have half of it already.

The rally continued right through March 31, which concerns me. It began last November and has had no substantial corrections since then, which is not normal. While still optimistic about both the markets and the U.S. and world economies this year, I am on the sidelines just now with any new funds.

March unemployment dropped again, to 8.8%. While welcome, the rate is not dropping nearly as fast as economists and the Obama administration would like. The economy is growing at a relatively slow rate of 2.9-3.5%. In a strong recovery the rate would be more than double this number. For example, after hitting bottom in the Great Depression the economy came back 7-14% a year for three years. While I, nor anyone else I can find, expects that type of roaring comeback, the current rate, on an historic basis, can best be described as anemic.

Of the 216,000 jobs added in the U.S. last month, private payrolls accounted for 201,000. Historically privately owned businesses are the chief source of new jobs in this country. Offsetting this, state and local governments, coping with heavy deficits, continue massive layoffs. Private sector layoffs fell to 41,528 last month against 50,702 in January.

For many months I have been warning my readers about the potential inflation I expect as a result of the U.S. government's many stimulus programs these past three years. It appears inflation has started, and not just with gasoline prices at the pump. Raw material prices have literally shot up in recent months. Food prices are also up sharply in the same time frame. And just last week Bill Simon, the CEO of Wal-Mart, warned us that inflation is "going to get serious! We're seeing cost increases starting to come through at a pretty rapid rate!" I can't think of anyone who has his finger on the pulse of retail prices any better than Mr. Simon. I suggest we all pay attention to his alerts.

Along with steep increases in raw material costs I learned while in China last month that labor costs there and increased fuel costs are now weighing heavily on retailers, and their effects will be seen in this quarter. Nearly all retailers are paying more for their goods and they are passing them along, as Mr. Simon indicates in the previous paragraph.

Except for fuel costs U.S. consumers have not seen much in the way of inflation for about ten years, so broad based increases in prices are unprecedented in the last decade. But they are coming. The Consumer Price Index was up .5% in February, reaching for my predicted level of 6-8% on an annual basis. One month does not a trend make, but I believe it may well be an indicator of similar inflation just ahead.

I spent twenty enjoyable days last month on the Sun Princess, delivering my well attended ten lectures to a largely Australian audience. We traveled from Sydney to Shanghai, some 8000 miles from summer to early spring. There were no new countries for me this trip, but I did travel 20,000 miles on Delta in addition to the 8000 mile cruise.

Invitations to do these cruises has dropped off sharply since the economic meltdown of 2008, but they have not ceased altogether. Hopefully they will pick up with the world economy.

While on the trip I heard that an Asian economist was predicting that the mainland China economy will continue to grow at a rate 8% FOR THE NEXT THIRTY YEARS! It went on to also say that their economy will pass the U.S. in size in the next ten years. I consider this outlook ludicrous of course. I don't believe anyone can predict the economy of any country more than three years in advance, and that is a stretch! The prediction reminded me of similar predictions twenty five years ago that Japan would soon outpace the U.S. economy and become the largest in the world. This did not happen, of course; instead their economy languished for twenty years and has only recently began to recover a healthy growth rate.

China is very impressive of course, along with Hong Kong where I spent two days after an absence of seven or eight years. They have done a phenomenal job, growing their economy fourfold since 1994 when I first visited mainland China. But they have their troubles as well. Chinese banks are overextended in their loans to major businesses, especially those where the Chinese Army or the government itself has a major ownership stake. Corruption is widespread, and their reputation for quality products is slipping, and never was very good. They may be able to paper over their problems, but I cannot foresee any scenario where they overtake the United States in my lifetime.

My advice for investors remains the same. Avoid bonds (except U.S. government TIPS with inflation protection) with maturities of more than three years, two years would be better. Stay invested high quality and blue chip multi-national common stocks. Increase your equity exposure as opportunities present themselves. I plan to use any pull backs in the market to add to my equity positions.

My weekly blogs will resume the week of April 11. Have a great Spring!

Tom McAllister – 317-571-1112 Please note: My 800 number has been discontinued.

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