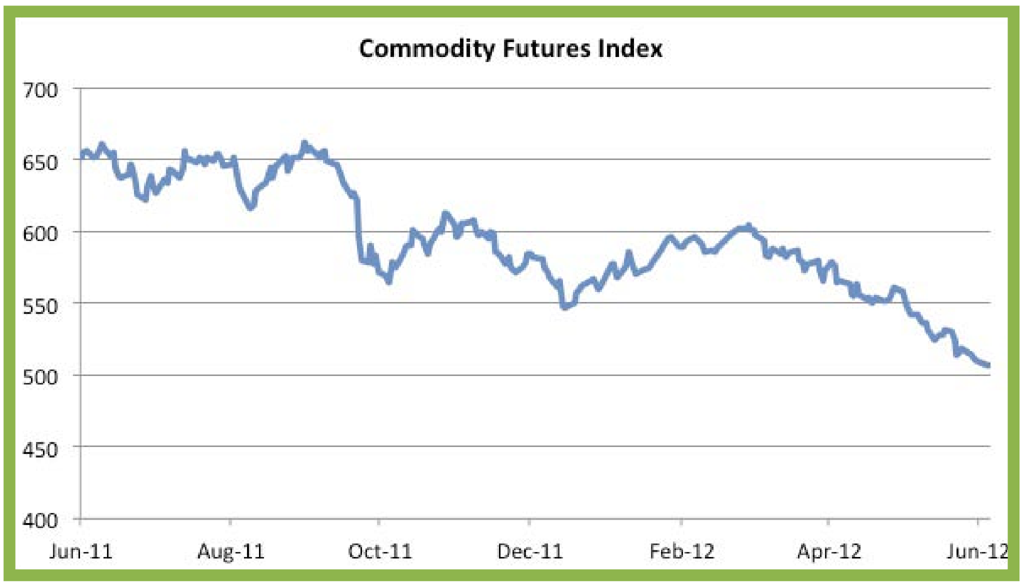
JAMESSON ASSOCIATES
06.2012 NEWSLETTER

RECENT ECONOMIC EVENTS

Unlike June, the American economy is not busting out all over. Nope, it is barely treading water. Virtually all economic statistics are less robust than they were earlier in the year. But the Untied States is still growing, and compared to others around the world, we are still the cleanest dirty shirt in the laundry.

Revised first quarter real GDP growth printed an anemic 1.9%. Consumer expenditures and investment purchases helped the economy; foreign trade and reduced government spending were major drags. Our interactions with the rest of the world had been positive coming out of the recession, but pervasive weakness overseas has sapped our ability to grow through exports. While potentially positive for the long-term, the ongoing cutback in government expenditures at all levels — local, state, and federal — is a big impediment to establishing economic momentum in the short-term.



That leaves things up to the stimulus of last resort, the American consumer, and there is a real question whether she can continue to power the economy forward. Solid job growth in the first quarter has given way to a far weaker trend so far in the second. Consider that new jobs were growing at a pace of about 225,000 per month year-to-date through March, but have advanced less than 100,000 per month since then. This is simply not enough to get the job done.

One wonders how much longer spending can grow in the face of weak employment prospects. Retail sales are slowing. April showed a miniscule .1% gain. Furthermore, we have seen car sales weaken from an annualized rate of over 15 million vehicles in February to fewer than 14 million in May. So much for getting ready for the driving season. Not even the retreat in gasoline prices has turned a young man's fancy to new cars.

On that point, the collapse in oil futures has started to drag down gasoline prices throughout much of the nation. It has already impacted the monthly CPI figures for April, which showed no change in prices during the month and the lowest year-on-year increase (2.3%) since early 2011. If gasoline simply holds at present levels, we could easily see annual inflation rates below 2% by the end of the summer.

The threat of a global slowdown has clearly taken a bite out of commodity prices. Whether we look at energy, metals, or agricultural goods, the trend over the past few months has been down. The good news is that prices for basic needs like food and energy *(continued on page 2)*

Recent Economic Events (cont.)

will leave a few more dollars in consumer pockets. The bad news is that lessened global demand suggests fewer American exports and raises the specter of deflation.

This latter worry is the underlying reason for the rush from risk assets to safety that has driven the ten-year government bond rate to record lows in many countries around the world. The US ten-year rate of about 1.50% places us only eleventh in the low-rate sweepstakes led by Switzerland (.48%). Two-year rates in Germany are now negative, as are most US TIPS rates.

The economy is clearly laboring. A hoped-for self-sustaining economy is still just that: hoped-for rather than real. However, lower prices for household necessities and ongoing rock-bottom interest rates for borrowers have a good chance of keeping US growth above zero. This may not be much, but it appears to put us ahead of most of the rest of the world.

Commentary

Economic austerity as pursued by governments in Europe and in the United States has been a colossal failure. It is hard to decide the most appropriate quote for the situation. I could choose Santayana's famous, "Those who cannot remember the past are condemned to repeat it." or the less known, but perhaps pithier Mencken observation defining Puritanism: "the haunting fear that someone, somewhere is happy."

Ideology has taken over from common-sense analysis, and could lead us into an economic contraction that may make the last few years seem like the good old days.

> And why is a failed policy of austerity being imposed when it is so obviously not working?

Let's look at a few examples. The Greek economy has been in recession for five years — five years! The overall unemployment rate is 20% and youth unemployment is even higher. Consider that the Greeks are almost running a structural balance at the government level and still the Austerians are asking for more. It's no wonder the "communists" are neck and neck in the polls.

And Spain. Before the financial meltdown in the mid to late 2000s, Spain was running a government surplus and had debt below 50% of GDP. Add austerity, and the economic statistics rival Greece's. There are now worries that they may exit the Euro before my ethnic ancestors do.

The Depression in the 1920-30s was also a time of disequilibrium in capitalism brought about by a flowering of technology which made obsolete many of the occupations then common, throwing millions out of work and sapping their ability to buy the new goods and services provided by that technology. Economists analyzed the situation as one of insufficient demand and recommended government spending to make up the shortfall. Timid politicians and bureaucrats did not take the advice, instead waiting until World War II mobilization created the needed demand. After the war, reasonable people concluded that domestic spending was a better choice to keep demand humming. We now appear to have forgotten the lesson in a sea of half-baked economic theories suggesting that the private market would make up for the weakness if only the government would get out of the way. Well, the government, especially in the United States, has been getting out of the way most of my adult life, and things are not so hot. *(continued on page 3)*

Commentary (cont.)

And why is a failed policy of austerity being imposed when it is so obviously not working? Check out Mencken above. False analogies of running a government like a business or a family budget have the sound-bite appeal that apparently seduces American voters. They want spending cut, as it has been over the past few years, but because those dependent on government for employment, contracts, or pensions end up with less to spend, economic headwinds grow.

The politics of the situation is ready to reverse. Austerity will be a dead letter in a year or so, as the stink of failure becomes overwhelming. The question then will be how the switch plays out. If it follows a Democratic path of more transfer payments and entitlements, it will fail because nothing of value is being created to improve the real economy. If it follows the Republican path of more tax cuts for the affluent, it will fail both because it already has and because the tax savings will be saved not spent (see all-time lows for Treasury rates).

We need a Marshall Plan for the US economy. The magnitude is huge (I would suggest $2 trillion). The country needs infrastructure of all types: roads, bridges, airports, high-speed internet, a modern electric grid, gas and oil pipelines, etc. We need better human capital through intensive education in the hard sciences. Let's borrow some money from those who will not risk it (the investors flooding into Treasuries and other high-quality bonds), and invest the funds to make American what it always sees itself being — the last best hope of mankind.

Market View

Not many places to hide any longer. A global slowdown threatens to drag all risk assets down with it. At the same time, government bond rates in those countries expected to pay back the debt are at all-time lows. Fear is in the ascendant.

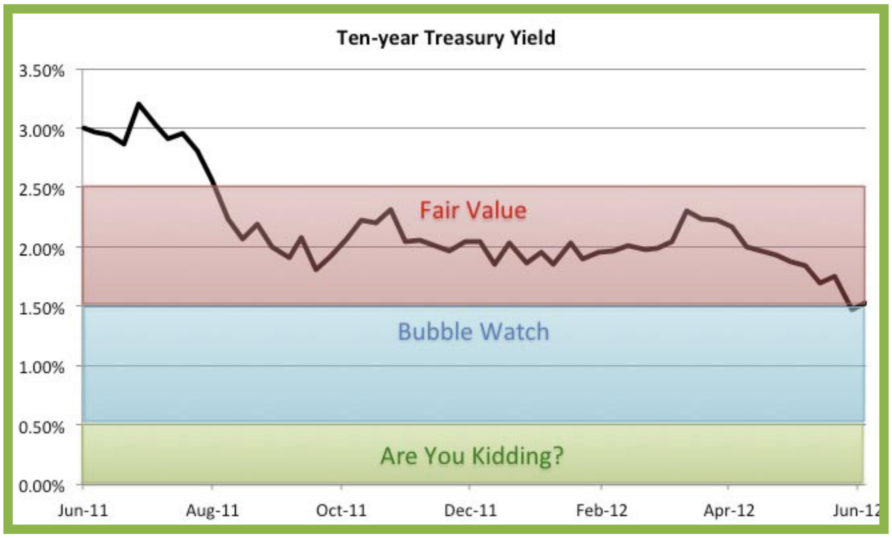
It is almost always a mistake to make investment decisions in a state of high emotion whether that emotion be greed or fear. While easier said than done, I want to review each of the main investment options to see where there may be value for the long-term investor. My guiding principle is simple, there is no reason to invest in the end of the world as being right is a Pyrrhic victory.

Commodities are in retreat based on slowing global growth. Don't try to catch a falling knife here. Stand back and wait for some type of stability before re-entering the market. While gold may have some appeal as a safe haven, the deflationary forces of debt destruction will ultimately overwhelm even that.

Last fall I opined that bonds were not in a bubble and could not be considered to be until they fell below 1.50% (basis the ten-year). Well, here we are. This prompts me to reconsider my anti-bubble argument. While I continue to see little psychological support for a bubble conclusion, the metrics are becoming more alarming. The key to the fixed-income market at present is quality. US Treasury debt is clearly the recipient of the flight to safety money. In the mad dash to leave risky assets, some other high-quality debt has been left behind. Value in today's market has shifted to non-financial corporate instruments and to municipal issues. Both have been somewhat overlooked in the bond-buying mania. I believe that the maturity range to *(continued on page 4)*

MARKET VIEW (CONT.)

focus on is the five to ten-year area. This gives enough term to benefit if rates complete their long-term march lower, while offering an exit if a turn occurs in the next few years.



Real estate may not be done falling, but if a property with a positive cash flow is available, that can help to diversify holdings. With rates as low as they are, this could be a great time to enter the market. Keep leverage reasonable and make sure it cash flows.

I am surprisingly quite sanguine on the stock market. Corporations have repaired balance sheets and may actually be better bets than most governments. The trick is the entry point. If you buy quality with well-covered dividends and limited debt loads, you should be fine. I would begin scaling in if the market takes another 5% to 10% swoon. There should be enough bad news and surprises over the next few months to create the opportunity.

EDITOR"S NOTE

I am often told by readers of this newsletter that they skip most of the articles and read only the editor's note. I am not sure whether I should be upset that many years of schooling and independent study along with over 35 years of work experience counts for so little, or whether I should be flattered that my musings and foibles give many pleasure. I will assume the latter, but I reserve the right to quiz anyone on the content of this issue. With the retro craze in full swing, I am doing my part to bring back the fifties. I cook with charcoal not gas, have never owned a car with automatic transmission, and now will be cutting my law with a push reel mower. While charcoal and a stick-shift were my choices, the human-powered mower was a bit different. After getting sick of extra fumes in the garage and the mess of oil mixed with grass, I ditched my gasoline mower for an electric rechargeable. Not a bad idea if your lawn is smaller than your kitchen. Problem is, mine isn't, and over the years, the charge duration and horsepower of the battery eroded to the point that mowing time was measured in minutes. Keeping a green theme, Susan concluded I could use the exercise of a manual mower. Voilà, I am saving the environment and combatting global warming while I mow which, I guess, offsets my charcoal cooking carbon footprint.

Michael Jamesson
Jamesson Associates
Scottsville, NY
(585) 889-8090

Mjamesson@aol.com
Michael@JamessonAssociates.com