JAMESSON ASSOCIATES

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QUARTERLY NEWSLETTER

## Recent Economic Events

The American economy slowed sequentially during the last three quarters of 2015. This lethargic but positive growth has helped keep inflation at bay, although there may be some stirrings on that front. Employers have added workers at a pace exceeding production needs; indications are that they may have gotten ahead of themselves. With businesses under stress, the baton has been passed to consumers to carry the economy forward. There are mixed messages whether they will do so. Car sales are strong; housing is spotty.

2015 GDP was roughly halved from the second quarter (3.9%), to the third (2.0%), and again to the fourth (1.0%). The full-year gain was a decidedly unimpressive 1.9%. In the face of this performance, the Federal Reserve raised rates in December. One might ask what they were seeing that the rest of us were not. Looking on the bright side, we did grow, and ongoing employment gains promise to maintain positive numbers. Our performance, while not stellar, appears to be envied by those in Europe and Japan, and in many of the developing nations around the globe.

Slow, but steady, progress may not be all bad. It has kept price increases at a minimum with annual gains in the Federal Reserve's preferred inflation measure, the PCE Price Index, at 1.3%. However, the core inflation rate on this metric has finally accelerated towards the 2% target. It was up .3% in January, bringing the annual gain to 1.7%.

Job gains extended their record string of positive posts in February, rising by 242,000. There hasn't been a month with private job losses since 2009. While the quality may be in question, the quantity is not. There are 14 million more jobs today than there were in the wake of the recession six years ago. The outstanding questions on employment are two: will gains continue and will pay stubs reflect a tighter job market?

Some warning signs are apparent. During last year's fourth quarter, hours worked increased by over 3% while output gained only 1%. Consequently, productivity fell by a nausea-inducing 2% plus. Businesses are not inclined to keep adding people and hours if there is no demand for what they are selling. So, in February, the average workweek fell by 12 minutes to the lowest level since the bone-chilling Polar Vortex in February 2014.

Nor can annual hourly earnings growth seem to break away from the 2% anchor. They were up only 2.2% in February versus a year ago and actually fell from January. Fewer hours and lower wages are hardly a recipe for strong consumer spending. However, lower gasoline and other energy prices are offsetting some of this drag. Which will win out?

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On the car lots, the verdict is in. The American love affair with driving is alive and well. And lower gasoline prices are directing the amore to trucks and SUVs. February figures annualized to 17.5 million vehicles sold.

Housing has shown less consistency. Home prices continue to advance at a moderate annual pace of around 5-6%. This has whittled down the number of folks upside down on their mortgages. On the other hand, both existing and new home sales seem to be exhibiting a saw-tooth pattern rather than steady growth. This is quite disappointing given the combination of low mortgage rates and solid employment trends.

## Recent Economic Events (continued)

The American economy continues to muddle along at a slow but positive pace. To stay on the plus side of the ledger, the consumer must now take the reins from businesses. Otherwise, the Federal Reserve's move to raise rates may meet the fate of every other recent attempt by a developed country central bank — reversing course.

## Commentary

Economics, as a field of study, is based on the premise of scarcity. What happens to the project if instead of scarcity, we are faced with plenty? The symptoms of the transition are abundant. HOW many fonts CAN YOU count in THIS sentence? Most Americans have too much food (obesity), access to too much information (internet), and more than enough entertainment options (Republican primary debates) to last a number of lifetimes. I would argue that the oil surplus and savings glut (negative interest rates) are further evidence.

A recent study from the Obama administration suggested that as many as 80% of jobs in America with current hourly wages $20 and below could be replaced by robots or artificial intelligence. They estimate close to a third of those jobs from $20 to $40 per hour are also at risk. The median wage in the US is a little over $25, implying that we may have work for only half the folks now employed as the game plays out.

> HOW many fonts CAN YOU count in THIS sentence?

These forecasts and the trends towards plenty are the logical endgame of capitalism. The creative destruction that drives technological and, hence economic, progress aims to produce goods and services at lower and lower cost. This process has decimated the newspaper business and has fundamentally transformed any pursuit that trades in information. The next step is physical production.

Drones are now a critical component of our military strategy. Robots, 3-D printers, and self-driving vehicles are real, although only in their initial stages. If the advances in these areas follow the normal arc of digital technology, the future, like an object in the side-view mirror, is a lot closer than you think.

Increased dollops of technology along with reduced labor input is a recipe for social upheaval unless we confront it head-on.

Here's an idea that might appeal across the political spectrum. Eliminate entitlements such as food stamps, aid to families with dependent children, unemployment insurance, Medicaid, and so on in favor of a guaranteed income for all adult Americans. Two stipends are available. One is simply a monthly payment to every adult citizen while the second (at a higher level) is a guaranteed job, working for the government in infrastructure, teaching, etc. Universal heath care would replace Obamacare, and we could phase out Social Security over time as well.

While the time may not be right today to institute such a program, I expect it will be by the time I leave this mortal coil. The ingenuity of human beings coupled with the drive for profit will ultimately eliminate all purchased labor; only equity players will desire to work. We might as well begin the discussion of what a post-job society will offer.

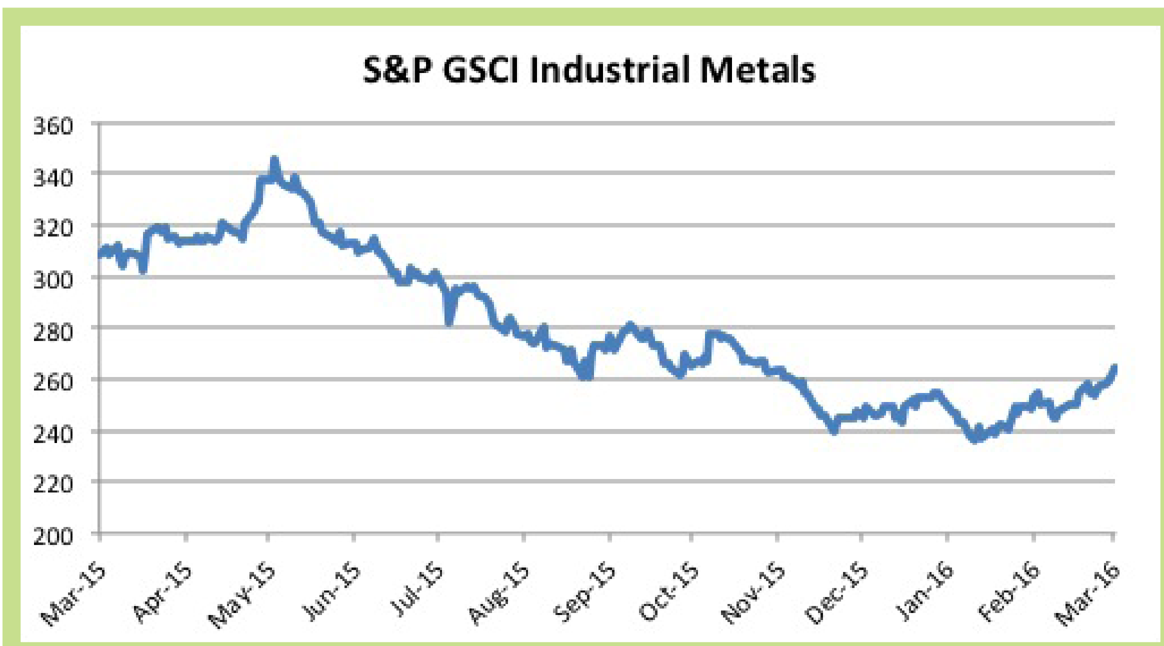
As a closing thought, if dignity and self-esteem are no longer tied to work and production, do we lose our drive and become layabouts, or does the freedom to pursue creative paths open up a new chapter in human history?

## Market View

Ever since the Federal Reserve raised the overnight rate in mid-December, we have been on a roller-coaster ride in the financial markets. Stocks are down 5% or more; longer-term interest rates, rather than increasing to validate the Fed's action, have fallen by almost 40 basis points; and commodities have continued their decline, although recent action suggests hints of a bottom. Sustained price movements have been scarce while volatility has been common.

I wish I could say I am surprised. I'm not. Anyone suggesting that they can predict the near-term direction of markets in this decidedly uncertain world is either lying or delusional. The best we can hope for is to look to fundamentals and try to discern the overall direction of least resistance.

Commodity prices have a well-established tendency to revert to the marginal cost of production over time. The late 20th Century and the early part of this one seemed to have broken the trend, convincing some that the world was entering an era of scarcity with a risk of running out of key commodities. In retrospect, there was a much more prosaic reason: China, India, and other emerging nations were entering the global economy, inserting billions of new workers into the system. By simply playing catch-up with existing technologies and leveraging cheap labor, the emerging nations prospered. But you can't add that many new workers to the system without consequences.




The consequences are now obvious. The world rushed to increase its capacity, providing raw materials for emerging nations to fashion into exports and to develop their infrastructure to support increasing standards of living. But a funny thing happens when you do catch up: the voracious need for raw materials stalls and the extra capacity goes wanting. This is what has happened in most commodity markets.

The oil market has been somewhat different. Here, not only was traditional capacity ramped up, but clever oilmen also figured out a brand new technology — fracking. This accelerated the increase in capacity well beyond the scope of other commodities and has led to dramatic price declines in its wake.

This detour down the commodity road is intended to disabuse you of the notion that a normal recovery is on the way in those markets. We may be nearing the low point in commodity prices, especially in industrial metals. Oil has become very volatile, signaling it may also have put in a bottom. However, I suspect we will

## Market View (continued)

visit the mid-$20s at least once more. In short, the worst may be over, but it could take years before a sustained upturn begins.

What about bonds? While the Federal Reserve was able to push up rates at the very shortest end of the curve, longer rates did not cooperate. In fact, compared to the day the Fed raised rates in mid-December, Treasuries with terms longer than one year now trade at lower rates. Even six-month to one-year rates are basically unchanged. This is pretty strong evidence that the market believes rates aren't going much higher. And if they aren't going higher, it makes sense to buy and take advantage of some roll down the curve. I suggest around five-year terms for taxable investments and a year or two longer for tax-exempts. Stay with high quality.

Stocks initially followed the Super Bowl indicator (down if original AFL team wins) in swooning in the wake of the Denver Bronco victory. It has recovered nicely since then, and appears to be reasonably priced versus alternatives. However, as I always argue, pick stocks with safe dividends so you get paid while you wait.

## Editor's Note

*I like to cook and judging by the stress on my belt, I enjoy eating what I make. While north in Scottsville, my opportunities come regularly. Virtually every weekday evening finds me at the stove or grill, and weekends offer two breakfast chances. New Orleans is different. The variety of ingredients is great, but the lure of restaurants is greater. I can walk to at least a dozen places that would place on a "best of" list in Rochester, and a drive of less than half an hour adds hundreds more. So when I finally stepped on a scale, I was distraught, but not surprised, that I weighed 7 pounds more than I did up north. (Susan gained a similar amount.) There are a couple of possibilities. One, the scale is mis-calibrated. Two, we are closer to sea level which increases gravity (note that the recent proof of gravitational waves depended on a Louisiana detector not far from New Orleans). Finally, restaurant food (especially weekend brunch) has more calories than home-cooked meals. In absence of contrary data, I am sticking with #1 or #2.*

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