

## Recent Economic Events

The recession is showing only faint signs of loosening its grip on the US and the global economy. Employment trends have deteriorated with alarming speed, housing and auto sales are plumbing multi-decade lows, GDP is set to post a third quarterly decline in a row, and the slight bounce year-to-date retail sales ex-autos puts me in mind of *The Doors*. You know, “I’ve been down so G\*!D\*!” long that it looks like up to me.”

Close to 2 million American workers have lost their jobs in the last three months, bringing the total losses since the recession began in late 2007 to over 4 million. This drove the announced unemployment rate to 8.1%. Adding in discouraged workers and those working part-time who would like to work full-time brings the rate up to 14.8%. Other employment details are discouraging as well. New claims for unemployment insurance are holding at high levels and continuing claims are at all-time records. The diffusion index (percentage of employers hiring) was less than 25% in February, and the only strong gains were in health care and government.

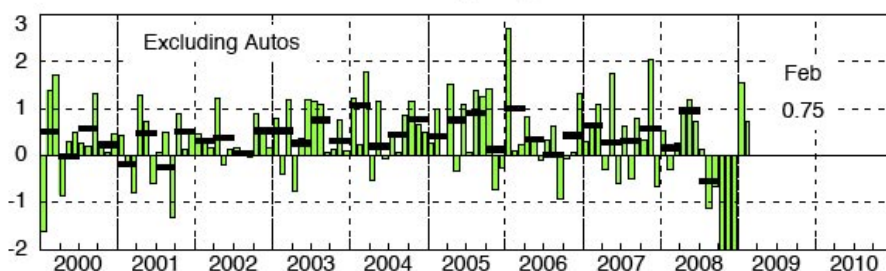
However, just as the first daffodil sprouts herald spring, there were a few hopeful signs that the worst may be behind us on the job front. First, the average

workweek held for the third month in a row, and compensation advanced for those still working. Second, there are some anecdotal indications of stability. The *Wall Street Journal* reported this week that some factories are running so lean that they really cannot lay off anyone else without simply closing.

This latter point may help cushion the blow from collapsing housing and car sales. Sales of new homes in January were off 3.1% from December, 29% from one year ago, and almost 80% from the peak. Housing starts are a measly 350,000, which is only about one-third of those needed to keep up with long-term demographic demand. February’s annualized car sales totaled only 9.1 million - below the yearly number of scrapped vehicles. The rapid adjustment in these markets suggests that they cannot fall much further.

On the other hand, GDP can, did, and will. 2008’s fourth quarter printed a 6.2% decline that may be revised even lower, and economists are now predicting that the first quarter may be just as bad. The trade deficit, evaporating even as our exports slow, reinforces the weakness of domestic demand. We imported “only” \$36 billion more than exports in January, the best performance since late 2002.

### RETAIL SALES Seasonally Adjusted



Source: Bureau of the Census.

The short list of positive economic developments is led by the two-month increase in retail sales ex-autos. We have not yet regained the levels of last summer, as the fall and early winter collapse was larger than the recovery, but it appears that consumers

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Recent Economic Events (continued)

have finally cut back to their minimum levels. Note this also led to an unexpected increase in consumer debt in January (up \$1.8 billion).

The economy is hardly out of the woods, and it is likely that both the first and second quarters of 2009 will show contraction. However, in the search for the

elusive inflection point where the bleeding slows, there are glimmers of hope. Human beings are a successful species because they adapt. Once acclimated to a lower level of activity, they treat it as the new base and revert to their normal optimistic ways. Human nature, along with the expected fillip from the stimulus package over the next six months or so, should help us identify further signs of renewal. III

Commentary

The World Series of Poker has moved from Las Vegas to Washington. President Obama and the Congressional Republicans have gone all in. The President is betting on recovery while the Republicans are betting against. Why would each make such a big bet?



Mr. Obama is famously unflappable. The day-to-day appears as mere noise to him, so his calculation is easier to understand. One of two things is going to happen between now and the Presidential election in 2012. Either we will descend into a multi-year economic contraction on the scale of the Great Depression or the economy will stabilize and resume some growth. If the former occurs, the country will lurch to the left, perhaps leaving even the President behind for having not done enough. After all, the 1930s did not usher in an age of fiscal responsibility and a return to the principles of Calvin Coolidge. However, if as is much more likely, some recovery takes place, current fiscal actions will be cited as the reason. Never mind that both the size and

the timing of the stimulus and the follow-on budget for 2010 may not have anything directly to do with it. A recent WSJ headline: “Economists Give Fiscal-Rescue Effort Low Grades.” Of course, economists are hardly the wizards of accurate economic prediction. The political view on the stimulus package is almost all upside and little if any downside. Good bet Mr. President.

What are the Republicans thinking? It is much harder to understand their wager. The last two election cycles proved close to disastrous for the party as voters all over the map rejected GOP candidates to the point where Republicans hold only about one-third of the Senate seats outside the eleven states of the Confederacy. The House is a bit more geographically balanced, but even here, there are no Republican Representatives in all of New England. To revive fortunes beyond a simple knee-jerk response to Democratic majorities, the Republicans need to establish clear differences with the Democrats. Hence, the unanimous vote against the stimulus in the House and the meager three-vote support in the Senate.

But let’s look at the political calculation from the Republican perspective. First, the key election is 2010, not 2012. This gives the economy just as much time to crater but not as much to recover. On the surface, this may allow for a rejection of the stimulus as ineffective; the timing may prove them right. (continued on page 3)

Commentary (continued)

Look at the dicey deal they have made, however. A continued weak economy may not save them. The voters could be ready to throw everyone out. Plus, they have been clearly portrayed as rooting for failure (Representative Cantor of Virginia and loudmouth-in-residence Rush Limbaugh). Factor in the hypocrisy of wanting to rein in spending after enabling President

Bush to run up huge deficits for eight years running, and you have a recipe for disaster.

My advice for personal economic recovery: find a poker game populated by Congressional Republicans and play for table stakes. III

Market View

Low risk has proven the best investment plan on the planet over the last three months. My FDIC-backed NOW account (yield: .10%) is ahead on the year. There has been practically no place else to hide. The chart below showing correlations between stocks, real estate, and commodities indicates that the markets have moved together in the last few months. Note the triple peaks in late 2007 with the bubble blow-off at hand, in late 2008 when everything was being sold at fire sale prices, and now in March 2009. Between these episodes, the relationships were much less stable suggesting that investors were distinguishing between asset classes. Here is the lesson: high correlation amongst asset classes that historically should move differently is an indication that emotion not facts are driving the bus.

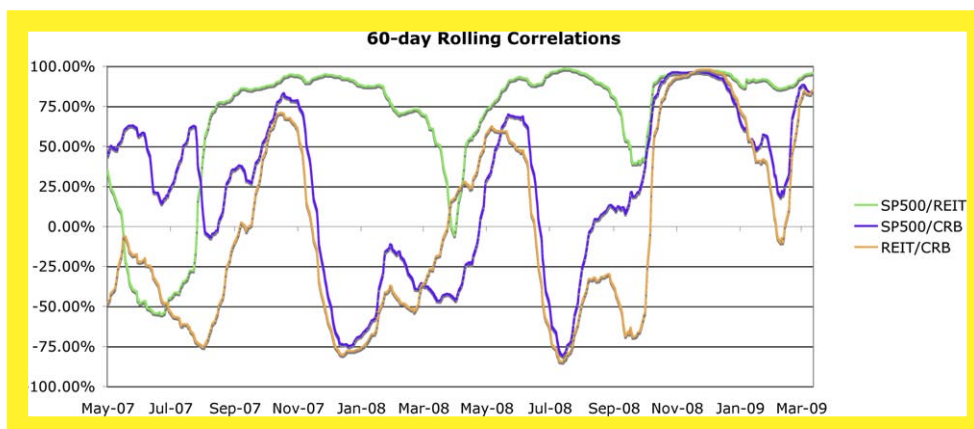
Last quarter I suggested that the markets would not be investible until volatility (another sign of emotion) settled down. It hasn't, and high, unexpected correlations are another warning sign. I believe that we remain in a casino market where dart boards and a Magic 8-ball may be

as effective as good hard analysis. With that said, there may be a play using the following idea. Buy equal dollar amounts of at least ten stocks selling below \$10 per share. Better yet, limit your purchases to those stocks of companies with immediately identifiable businesses, no ABC Global Synergy Inc. or XYZ Amalgamated Services.

Readers, however, don't pay the big bucks to subscribe to this newsletter to be advised to guess rather than invest. Let me suggest a somewhat less facetious and more reasonable strategy. Don't bet on the end of the world. If you do and are right, you really can't enjoy your sagacity.

Instead, let's assume that the economy will recover in the next year or so. That happy event would be accompanied by a much higher risk of inflation. Why? The huge monetary

and fiscal stimulus being applied to the patient will still be coursing through the system. Where will this money go? I offer two modest destinations for consideration — TIPS and precious metals. (continued on page 4)





Market View (continued)

Treasury Inflation Protection Securities offer real yields of around 2%. The total investors receive is equal to this 2% plus whatever the realized level of inflation turns out to be. For example, if inflation averages a modest 2% over the next ten years, you will net about 4% total. Compare this to the sub-3% yield on the regular ten-year Treasury.

Gold has performed well this past year while silver and platinum have lagged. The latter two metals have industrial uses which have been significantly reduced due to the recession. Going forward, however, each of these metals will benefit from heightened inflation

and/or economic activity. If I had to choose just one, I believe that silver is the best based on its current bargain relationship to gold.

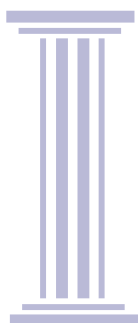
For those who need some income over and above the meager yields available on short-term investments, the one area that offers some value up to about ten years is municipals. The trick to this choice is to make sure to invest in the highest quality issues available and to try to stay with general obligations rather than revenue issues. Even in difficult economic times, municipalities (but not mere authorities) are necessary providers of basic services. ¶

Editor's Note

*A trip to the Southwest found me at the intersection of two six-lane roads a little north of Albuquerque waiting for a left-turn arrow. Kitty-corner was a sign for a new housing development in front of a half-built clutch of houses, earth-moving equipment, and desert dust. Then what should appear but a tumbleweed, blown across that six-lane intersection all by its lonesome (traffic was at a minimum). A fitting coda on the excesses of the housing market?*

*While this sight may speak most eloquently to our current state of affairs, it was not the most thought-provoking. Albuquerque houses the National Hispanic Cultural Center, itself the home to three very interesting exhibits. One included works by American Hispanic artists, and in it, there were two separate depictions of the marriage of Mary and Joseph. Not so unusual you say, but they were. Both versions showed the couple in rich garments and one even presented Mary as obviously pregnant, but what really caught my*

*eye was the presiding official. In both cases, the marriage rites were delivered by a Roman Catholic priest in full regalia, his headgear covered in crosses. Clearly an anachronism, but one so thoroughly embedded in the culture that no comment was offered in the museum notes nor the artist's comments. All cultures have unwritten foundations that can cloud judgment and change how we see "facts." How similar is a "Christian" marriage ceremony before the birth of Jesus to our belief in "free market" benefits during the illusory prosperity bubble?*



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