JAMESSON ASSOCIATES
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RECENT ECONOMIC EVENTS

The US economy faces trouble.
Unemployment is up.
Housing is down.
The original dip may become a double.

The cost of necessities goes higher and higher.
Fifty dollars a tank,
Three bucks a loaf,
And Congress is playing with debt limit fire.

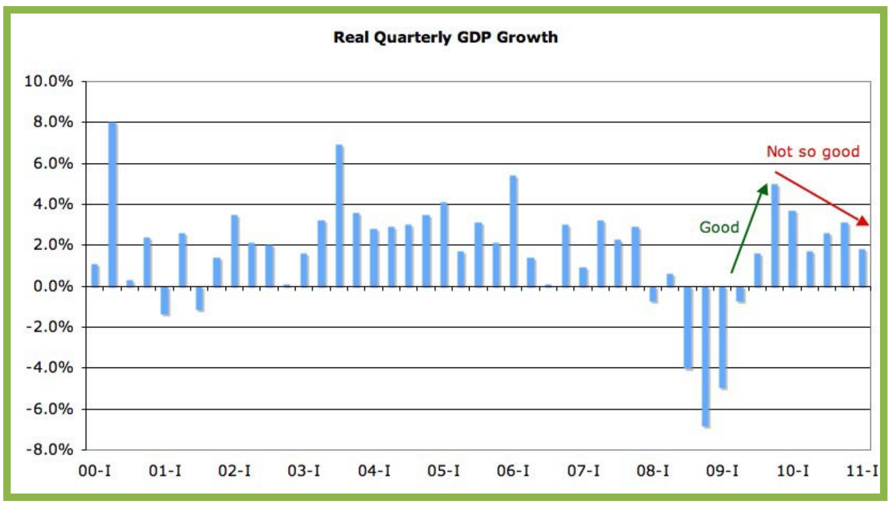
Uncertainties abound both here and there.
Greece could default.
China could slow.
And the stock market bull may become a bear.

The American economy has experienced a spate of weaker than expected economic reports. GDP slowed to a below-trend 1.8% growth pace in the first quarter, bringing the year-over-year rate down to 2.3%. Anemic as this growth is, other measures of economic health appear to be even weaker.

After a few months of quite robust employment growth — near 250,000 new jobs per month — the market was confronted with a far lower figure in May. Only 54,000 jobs were created during the month, and the unemployment rate rose to 9.1% instead of falling back below 9% as economists had expected. Furthermore, the details of the report showed layoffs for government workers of over 25,000, continuing in a range that has generally held all year. It appears that municipal decision makers are serious about cutting costs and services in order to balance budgets and maintain their credit standing. This headwind will not fade soon, suggesting that we may very well be close to a double-dip on the employment front.

Housing represents an even weaker pillar of economic support. According to the Case-Shiller index, national home prices have fallen below the early 2009 low and are now back to levels last seen in 2002. Furthermore, a recent report from Zillow indicated that over 28% of residential mortgages exceed the value of the underlying homes. The figures for those with Home Equity borrowings are even worse. It's no wonder, therefore, that housing starts continue to sag, down over 10% from March to April and almost 30% from April 2010.

Consumer confidence is taking it on the chin as the cost of gasoline and food sops up more and more of the household budget. According to economists at Gluskin Sheff, over 22% of wage and salary income is going to pay the food and energy bill. This has led to generalized weakness in the sales of more discretionary items. Car sales in May dropped from 13.2 million to 11.8 million annualized. While some of this can be explained by earthquake and tsunami-related shortages of Japanese cars, a good deal is due to lack of discretionary income.



Uncertainty may very well be the key word in the economy today. Congress can't get its act together to

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RECENT ECONOMIC EVENTS (CONT.)

raise the debt limit, potentially throwing the financial markets into chaos. The Europeans can't decide whether to let Greece default or try to paper over the problem once again, and now even China is showing signs of property price reversals and slowing growth in production. As a final validation, the stock market has strung together six losing weeks in a row. If it really is darkest before the dawn, it's time to pull out the *Annie* Broadway album, but more sober-minded theatergoers should check the shelves for *Les Miserables*.

COMMENTARY

Barack Obama
a decisive President
took out bin Laden.

Barack Obama
indecisive President
won't take on Congress.

Tea Party stalwarts
scare Republican caucus
engineer gridlock.

President Obama shed his reputation for lengthy study leading to no decision with the successful raid on Osama bin Laden. He followed that up by chugging a Guinness while on a trip to his maternal homeland. But his penchant for forceful action seems to have deserted him in dealings with Congress. We have the unseemly spectacle of the minority wing of the Republican party trying to drive the United States into default while the President is MIA.

The political drama taking place in Washington over the debt limit is further evidence of our dysfunctional public society. Clearly lunatic proposals and outright lies have replaced thoughtful discussion of and solutions to the United States' problems.

Perhaps the country is starting to wake up to the assault on the middle class being promoted by the rightwing. An Upstate New York congressional district held by the Republicans for decades fell to the Democrats in May, based largely on the successful exposure of the Republican plan to dismantle Medicare. The clearly cynical calculation by the architect of the plan, Representative Paul Ryan (R-Wisconsin), to create an age-based wedge issue by guaranteeing current law only for those over 55 was rejected by generally conservative voters of the 26th district. The upcoming recall elections in Wisconsin, where the Republican governor and legislature eliminated collective bargaining rights for public employees, may further the backlash.

But the backlash could be as ill informed as were the initial Tea Party ideas. Only a definitive, honest election can resolve the issues before this country.

By starving the Federal government of revenues over the last decade with a series of tax cuts directed primarily (but not entirely) toward the most wealthy, the Republicans created much of the crisis. Now we are supposed to be scared to death over deficits in the midst of a weak economy. Their solution: cut the benefits promised to the elderly and the poor but leave defense spending untouched.

The Democrats are no better because they refuse to recognize the plain fact that we cannot afford the benefits promised if the current tax system remains. Stealing a page from the Republican "just say no" playbook, they

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Commentary (cont.)

ask people whether they want their benefits cut without leveling with them that their taxes will have to rise. We can't cover the shortfall by just taxing the top 5%.

The fact is that the United States under-taxes its citizens for the services that we expect the government to provide. Successful countries in Western Europe (Scandinavian and other northern European lands) have much higher percentages of government spending compared to GDP, but tax their citizens sufficiently to pay for them. Successful countries with lower taxes put the responsibility on their people to pay for their own services.

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I don't know whether or not the US spends too much. I do know it taxes too little for what it spends. There are two ways that the differences can be reconciled, and I hope that the American public realizes this during the 2012 election season. If we as voters remain ignorant of the real issue and believe whichever partisan is feeding us a rosy picture of a painless future, we deserve what we get. And, in that case, what we will get is a government trying to pigeonhole reality into an ideological straightjacket. Then they will kick the can down an ever-shortening road.

Market View

The stock market has breached its support.
But fundamentals suggest it's still a short.

Previously rising commodities broke hard in May.
But underlying demand is here to stay.

QE II was successful only because it's ending.
But rates could fall further due to the lack of lending.

The Dow is below 12,000; the S & P is below 1300, and the NASDAQ is actually down year-to-date. The stock market is not acting like a harbinger of good times. As I feared when QE II was initially proposed last summer, the impact would be less on the professed goal of lowering mortgage rates and boosting business confidence to hire and much more on animal spirits in the financial markets.

The good news is that even though the S & P has been falling for six weeks, the total drop from the April high is a modest 6.75%. The bad news is the drop has been only 6.75%, and if this is a real correction, we may be less than halfway through. I believe that the market is trying to reset its expectations of a steadily improving economy, albeit at a below-trend rate. That scenario is really pretty good for the stock market as it allows companies to gain a little in sales while remaining in a buyer's market for labor. The fear at this point is that the fundamentals are weakening further when they should be gaining momentum. If modest sales gains turn to losses, or if rising commodity prices offset labor cost savings, earnings may not continue to advance.

I would not trade this market for a bounce because it has the risk of much more painful declines. If good companies that you have been waiting to acquire have hit their target prices and will pay a good dividend while you wait, go ahead.

Logically, we should be taking the same approach to commodities. However, the difference in commodities is that their prices are being driven by the emerging

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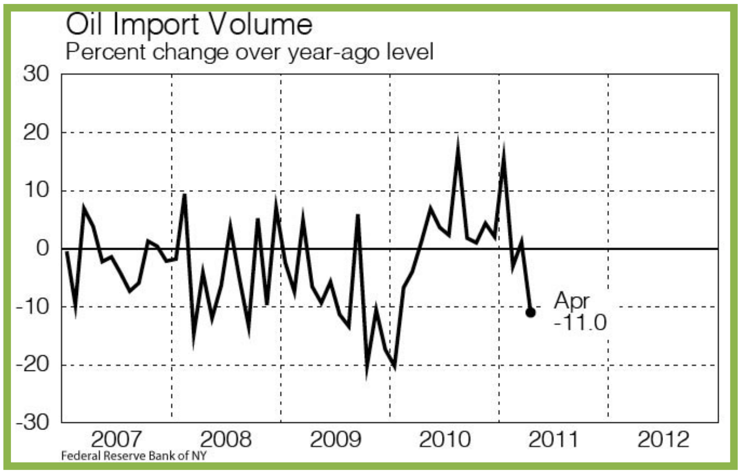
MARKET VIEW (CONT.)

economies, not the developed ones. Note how the US has reduced oil imports while prices have continued to advance. Gold, after hitting an all-time high over $1550, had a steep drop below $1500, but is now back threatening new highs. Oil has broken down as well, but even the recent Saudi announcement that they will pump all the oil that the market needs to drive the price down to $70-$80 did not have the intended impact. It appears the market doesn't believe the Saudis can control the price any longer.



Food prices are also refusing to fall. Demand for higher quality foodstuffs stoked by growing affluence in emerging nations will keep the long-term bull market intact. Buying agricultural commodities on weakness is still a good bet.

Finally, the Fed is winding down QE II at the end of this month, having raised rates from their levels last August when the plan was floated at the Jackson Hole confab and from November when they officially started buying. Now that the program is ending, rates are heading back down. Most bond holdings are at a profit as money is heading into fixed income markets due to the continued reluctance of consumers and businesses to borrow.

In fact, even had you bought a five to seven-year Treasury last August near the lows in rates (about 50 basis points lower than now), the steady march to maturity over the past 10 months would have allowed the bond to hold its value. When a market does well, especially unexpectedly, money tends to cascade in — I believe that is happening now with bonds. The best place to be is still the five to seven-year term.

EDITOR'S NOTE

Susan and Michael from Scottsville,
Sought to escape the showers of April,
Traveled to "rainy" London,
And found nothing but sun,
But now fear the travel bill's arrival.

London is one of the world's great cities, and our trip there was blessed with super weather — 60° to 70° with a pleasant breeze. My raincoat stayed packed away. Originally, I felt the costs were manageable as well. Then I realized that British Pounds converted at about $1.65 to the dollar, not one-to-one. Oh well. One important observation: pub drinkers pay little note to inside and outside. Most pubs, whether early afternoon, evening, or late at night, had crowds of drinkers spilling out into the street. A cheeky tour guide suggested a possible reason: they booted out all their Puritans to the US centuries ago, leaving behind the more relaxed natives of the British Isles.

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