

Good News!

July 11, 2011

Really? Can we be serious? Well, yes. For one thing, after another bout of fearfulness in June, the equity markets recovered nicely for a flat quarter. Clearly the markets are discounting the disaster scenarios and recognizing good things happening in the world economy, including the United States. Companies are lean and profitable - healthy.

Despite the politicians' and spinmeisters' transparent attempts to panic everyone about the August 2 "deadline" for raising the debt ceiling, the bond markets were not impressed. They concluded that this is a phony crisis with no meaningful consequences likely, and thus yields did not budge. Heresy? Ask the bond markets-- they don't lie, and they aren't easily fooled.

The Bad News – Yes, There Is Plenty

We went back over a few of the pieces we wrote over the last year or two: Greece (and therefore Europe) in crisis, dollar falling, national debt spiraling out of control, structural unemployment at an historically high level with no improvement in sight. All true, then and now. We are, in fact, stuck in a long-term unemployment crisis; if we had a chance to address this problem effectively, we missed it.

TCW wrote an interesting article entitled "Trading Secrets: The Keynesian Bridge to Nowhere." Worth a look. One chart was certainly eye-catching, showing that, 40 months after the start of the "Great Recession," we are miles behind any of the past recoveries in putting people back to work. After making huge gains in the percentage of the population employed in the 80's and 90's, we have given it all back.¹

We are spending 25% of GDP these days, compared to the usual less than 20% we have come to consider acceptable.² Another interesting chart that catches your eye shows the Federal deficit as a % of GDP exploding past 10% for the first time since WW II. It also happened during the Civil War and WW I, never before when we were not engaged in a Big War.³ Huge spending, thus the accelerating debt, already past \$14 trillion.⁴

Depressed Yet? How About Some Light Reading for the Beach?

Reckles\$ Endangerment: How Outsized Ambition, Greed and Corruption Led to Economic Armageddon.
By Gretchen Morgenson and Joshua Rosner.

We were attracted to this angry work (by a New York Times reporter) by a review which makes it seem a compelling read for the student of finance and government trying to understand how in the world such a catastrophe could happen.⁵ Having just skimmed the book we could not wait to mention it to you; full disclosure- I have not read it yet. But it seems to rise far above what you might expect from such a source. It is not simply venting against evil Wall Street tycoons, but seems to go to the very heart of the

issue, dead center in Washington DC, where large money meets the naïve, the well-meaning, and the deeply corrupt. They name names, including many still in power. This debacle was – this had to be – a joint effort.

So Why So Sanguine?

First of all, the markets clearly foresee a deal in Washington. After all the usual fear mongering and posturing, there will be major cuts in spending. And despite the hand wringing, these cuts will not harm the recovery. No other scenario makes sense if you think about it. The markets clearly see it.

Related to this, many of the states, including two of the worst, New York and California (led by Democrats!), have already taken major steps to balance their budgets with spending cuts, and without the kind of harmful tax increases being proposed by some. These are important events.

A few of us used to live in Minnesota, but that state closed last week over the demand for tax increases and we have all been forced to move to Canada. No more jokes from here about California falling off the edge into the ocean-- we are the fools now. Perhaps we will be the new example of how not to handle things and others will benefit. One can only hope.

And the fact is, despite the two year rally in equities, valuations remain modest by historical standards as corporate profits are increasing. That provides a cushion and room for multiple expansions if the dire predictions don't pan out.

The next year and a half will be an eventful time, with a presidential election at the end. None of this will be easy or very pleasant. But we are making major and very painful adjustments; we can see it starting to happen, and that really is good news. Maybe we won't become Greece after all!

Sincerely,

A handwritten signature in cursive script that reads "Roger C. Hewins III". The signature is written in black ink and is positioned above the typed name.

Roger C. Hewins III
President

References

1. Rivelle, Tad. (29 June 2011). Trading Secrets: The Keynesian Bridge to Nowhere. *Fixed Income Commentary*. TCW Group, Inc. Figure 3: Comparative Job Creation With Other Cycles. Retrieved from https://www.tcw.com/News_and_Commentary/Market_Commentary/Insights/06-29-11_The_Keynesian_Bridge_to_Nowhere.aspx
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