



OUTLOOK

“It’s Always Darkest Just Before Dawn”

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The past ten weeks have been difficult for all Americans, especially those who have investments in the stock markets. The incredible volatility of the equity markets since early August has revealed a serious wound to market psyche that has created panic bred from uncertainty. The disgust felt by Americans (and the rest of the world) over our recent debt ceiling debate has created a “doomsday” fear in many of us. In truth, the politicians are only partly to blame; the media keeps pouring fuel on the panic fire by constant reporting and interviewing all the “doomsday” pundits. What we face today in the U.S. and the world is a crisis of confidence that magnifies the element of fear and gives the “traders” opportunity to make money both as they sell to drive markets down and as they buy to drive the markets up again.

The only real question today is will the U.S. and consequently the world fall back into recession. I think we will not! Actually, we are a much stronger economy than we were in the fall of 2008. While it cannot be doubted that many developed countries, including the U.S. and Europe, need to do serious work to repair their balance sheets, we need to remember that currently non-financial U.S. companies are holding around 11% cash on their balance sheets, the highest level in 60 years, and as Bob Doll of Black Rock Investments says, “Since 1950, the United States has never entered a recession with corporate balance sheets as flush with cash as they currently are.” He further states, “Corporate earnings are all but certain to surpass their mid-2007 highs before the end of this year, and yet stocks remain about 35% below where they were at that time.”

Our new “flat world” tends to be poorly understood in terms of the interaction of emotion on such issues as sovereign debt, political intransience and even credit ratings, but one thing each economic leader clearly understands: as the U.S. economy goes so goes the developed world’s economies. The recent U.S. credit downgrade by S&P has again magnified our world importance. Part of the confidence problem lies at the feet of President Obama. As the August 14th Investment News stated: “Still, the nation’s spirit is faltering on Mr. Obama’s watch. As President, he must find a way to reinvigorate the hope and imagination of all Americans. Democrats and Republicans alike. Ultimately, Mr. Obama’s failings last week had more to do with what he didn’t say than what he did.” The U.S. and the world are waiting for him to give us renewed confidence in the

future by giving us his plan to fix the budget problem, get Americans back to work and restore economic growth – the only true way to solve the first two issues.

But here's the rub! The U.S. Congressional Budget Office says the U.S. G.D.P. is around \$14.8 trillion, which is almost exactly the same as the recently increased debt ceiling. This happened only one other time in our history, near the end of World War II. Government spending accounts for about 20% of GDP so reducing spending will almost certainly be a hit to an already weak economy. The only realistic solution then is a compromise that combines a reduction in government spending with a tax increase. The fear, however, is that as soon as the economy strengthens again the government will once again begin overspending.

Hays Advisory's 8/17/11 Comment quotes Ed Yardini's recent reports (Yardini is one of my top 3 analysts) as suggesting two things we can do right away to help with the "housing depression – not recession" with 2.2 million in trouble in the housing industry it really is a depression there. Yardini suggests the federal government provide a \$20,000 matching subsidy for down payments on new homes. At 2 million families, that would come to \$40 billion. We could pay for the program, Yardini suggests, by reducing the repatriated tax rate on foreign earnings of U.S. corporations from 35% to 10%. Moody's research indicates that about one half of the \$1240 billion cash held overseas would immediately come back to the U.S.A. Makes sense to me!

So, where do we go from here? I expect volatility will continue to be with us over the next few weeks, but that this greatly oversold market will claw its way back to even and eventually we will be positive once again for the year. Program Trading (also known as High Frequency Trading) will eventually subside as volatility lessens and good dividend paying stocks will lead the way upward. Rates will remain low and money recently moved to Treasuries and gold will come streaming back into these stocks that offer good income yield as well as significant growth potential.

Dawn is soon to arrive and it promises to be a beautiful day!

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