



THE DANA VIEWPOINT

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STOP THE WORLD, I WANT TO GET OFF

What a century, and it is only seven and a half years old. We started this century with the mother of all stock market bubbles, followed by a recession; then we had record low interest rates, followed by a housing bubble which led to a financial crisis, both of which are still ongoing. In between, we had (have) a strong economic recovery with the Dow Jones Industrial Average making new all time highs. Subsequently, the stock market has reversed course and is now down about 20% which by technical standards is a bear market. This has been brought about primarily by the crisis in the housing market and the financial sector. We have talked in the past about the media's role in the current malaise hanging over the country. Someone once said that a recession is when your neighbor doesn't have a job, and a depression is when you don't have a job. Part of the reason for all the negativity in the news may be due to the upheaval in the way news is presented today. The younger generation is more and more tech savvy and turns to the Internet for news. As a result, many newspapers are folding, and reporters are looking for opportunities elsewhere. If your world is crumbling, it seems like the rest of the world is also. However, that's not the case. Joseph Schumpeter, a Czech economist, popularized the term creative destruction. In Schumpeter's view, creative capitalism was the force that sustained long-term growth even as it destroyed the values of existing companies through improved designs or efficiencies. The industrial revolution is the classic example, and a more specific example would be Polaroid or Xerox. Because of our tech savvy young population, these changes are occurring more rapidly.

Yes, some areas of the economy could be considered to be in a recession (housing, finance and autos), but we are a \$14 trillion dollar economy, and most sectors are doing fine. We are not in a recession. Consider that 9.3 million net new jobs have been created since the end of the last recession (2001). Unemployment is 5.5%, and that is below the average of 6.1% since 1980. The economy in general has grown at an average rate of 2.7% from 2001 to 2007. We may have slowed down from that rate, but we are still growing. The media recently reported that Americans' net worth dropped \$2 trillion in the first quarter (what they owned less what they owed). What they didn't tell you is that total wealth was \$55.97 trillion, down from a peak of \$58.20 trillion in the third quarter of 2007. It was still \$15.3 trillion above where it was seven years ago (*Investors Business Daily*, June 30, 2008).

Further good news that you probably haven't seen or heard in the American media comes from London. Writing on the defeat of Al Qaeda in Iraq, the *London Sunday Times* called it "the culmination of one

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of the most spectacular victories of the war on terror.” A terrorist force that once numbered more than 12,000 with strongholds in the west and central regions of Iraq has over two years been reduced to a mere 1,200 fighters backed against the wall in the northern city of Mosul. This is important for obvious reason. It gives us a strong ally in a troubled part of the world. Surrounding countries should like how democracy and capitalism can improve their lives. Then of course, there is oil. Iraq probably has the second largest oil reserves after Saudi Arabia (we could actually be the largest producer of oil if Congress would wake up). The revenue from this oil could build a vibrant economy. According to T. Boone Pickens, Chairman and CEO of BP Capital, Iraq could double oil production to 5 million barrels a day in coming years. This would be a start to reducing oil prices.

As expected, the Fed left interest rates unchanged at their last meeting. Bernanke apparently wants to focus more on growing the economy at this point and trying to talk tough on inflation. It’s hard to trust economic numbers coming out of Washington, and there is usually a delay coming through the pipeline, but we suspect inflation is actually higher than the 4.3% annual rate being reported. Food and energy are of course the biggest factor in rising inflation. China is now a big factor also. For years, China has been exporting deflation to the US as their production costs were low compared to the rest of the world. Now, however, the rising cost of raw materials plus rising labor costs in China and the rising concern over the quality of their manufactured products has forced them to raise prices, and they are now exporting inflation. So we would expect prices to rise on manufactured goods thus increasing our core Consumer Price Index (CPI)—consumer prices minus food and energy. At some point, products manufactured in the US become competitive on a price and quality basis. So, we expect inflation to continue to advance, but not meaningfully, and the economy will continue to grow.

Random thought for July:

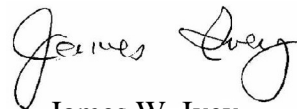
Never be afraid to try something new. Remember that a lone amateur
built the Ark. A large group of professionals built the Titanic.

Dave Barry

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