THE DANA VIEWPOINT

WEATHERING THE ECONOMY

February 7, 2008
Dow: 12,247

As of Monday, February 4, with 58% of the S&P 500 companies reporting, fourth quarter earnings are on track to drop 20.7% from a year earlier, according to Thompson Finance. However, if you strip out financial stocks, the remaining companies in the S&P 500 look to increase earnings by approximately 11%. High technology companies will likely show earnings growth for all of 2007 in excess of 25%. Energy and medical related companies should also report double digit returns for 2007. So why is the S&P 500 down 6% year to date and down 12% from its October 2007 high? Fear of a recession is only one answer. Others include uncertainty over the November elections and the direction this country will take in 2009 with regard to the Bush tax cuts as well as spending for the war on terror and universal health care (that would be 7% of the economy controlled by the government). Many of the issues will be resolved by year-end.

The non-stimulus stimulus. Rebates have been tried in the past to stimulate the economy. It didn't work then, and it will not work now. First of all, the rebates will not be sent out for another four to six months. Secondly, the money from rebates will most likely go into savings accounts or be spent to pay down bills, not to purchase big screen TV sets. Thirdly, the $150 million stimulus package will be added on to the federal budget deficit which the government now estimates will reach $410 billion in fiscal 2008 up from $163 billion last year. Still, this increased deficit will only amount to about 2.9% of our GDP ($14 trillion). This is in line with the average of 2.6% since 1980. The deficit will only become a problem if Congress continues to spend more than it takes in.

The latest blow to the economy has just been reported by the Institute for Supply Management (ISM). The ISM's non-manufacturing business index dived to 41.9 from 54.4 in December. Anything below fifty signals contraction in this segment of the economy. This report coupled with the January jobs report showing a negative number for the first time in over four years has many economists predicting a recession and soon.

And now for the good news. It has often been stated as a fact that consumer spending is 70% of the economy. In a recent report from Adrian Van Eck at the Financial Research Center (P.O. Box

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6170, Holliston, MA 01746) this statement has been challenged. He states that consumer spending comes to $4 trillion annually or about 30% of GDP. He further states that the federal government spending totals 20%, state and local spending 15%, exports 12% and construction currently 10%. This adds up to 87%. The balance of 13% can be accounted for by the cost of operating factories, private business rent expenses, college tuitions and health and medical expenses. Consumer spending will hurt retail stores and cause layoffs. However, our economy is so huge and diverse that other areas will pick up the slack. There are new projects developing to repair roads, and in particular bridges, plus new appropriations on military spending. Both of these areas will add new jobs, taking up the slack elsewhere. Spending on national defense peaked in 1980 at about 6% of GDP. The proposed $585 billion in defense spending for fiscal 2009 will bring defense spending up to 4.2% of GDP from last years 4%.

Recession or not? A recession according to Wall Street is two straight quarters of declining GDP. A recession was declared in 2001 although GDP declined for only one quarter. The National Bureau of Economic Research defines a recession as a "significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in real GDP, real income, employment, industrial production and wholesale-retail sales." The problem with both of these definitions, of course, is the lag time of anywhere from six to eighteen months to make the declaration of a recession. There is an old saying on Wall Street that says economists have predicted seven of the last three recessions. The stock market is probably the best indicator. It has been predicting trouble ahead for several months now and will no doubt start a new bull market before the economic indicators turn up.

Random thought for February:

"Finance is the art of passing money from hand-to-hand until it finally disappears"

Robert Sasnoff

Michael L. Dana

Michael L. Dana
Chairman of the Board

James Ivey

James W. Ivey
President

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