THE DANA VIEWPOINT

IT'S AN UPSIDE DOWN WORLD

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When we are born, we see things upside down for the first few days. A major task of our brain is to turn these images right side up. This is accomplished through the optic part of the brain. Psychological studies have shown that the brain can be retrained to see things upside down. By wearing glasses with inverting lenses, everything appears upside down, but after a few days even with the glasses on, the brain is retrained to see things right side up. After taking the glasses off, vision becomes upside down again, but a few days later without the glasses, vision returns to right side up again.

So, one has to wonder, do some people at times see the world upside down and at other times right side up? And which is which? Some see raising interest rates as a means to stop inflation. Others see rising interest rates as contributing to inflation. Some see lowering tax rates leads to higher deficits. Others say lowering tax rates increases investing and spending thus higher revenues. Do we all at times wear inverting glasses to see what we want to see? Maybe reality is an illusion. However, if it is or it isn't, it's what we have to deal with in present time.

This wordy discourse brings us to the economy and investing. We are constantly bombarded with economic data on a day-to-day basis, and of course, there are always differing visions, of what that data means or will mean in the future. Case in point, the Congressional Budget Office (CBO) recently released statistics on capital gains tax collections. When this administration reduced the tax on capital gains from 20% to 15%, opponents predicted that this would reduce tax revenue. This 25% reduction in the tax rates prompted investors to sell existing asset holdings and reinvest in other assets with a potential for newer and more rewarding assets. The Treasury also benefited. In 2002, at the 20% tax rate, tax liabilities were $49 billion. They rose to $51 billion in 2003 at the 15% rate, then $71 billion in 2004. The CBO projects 2005 to yield $80 billion. This is one of many examples of some wearing the wrong glasses. It is also why it is important to look beyond the day-to-day noise and smooth out this data over time to get a clearer vision of what is really happening.

The stock and bond markets tend to fluctuate on day-to-day data. This presents opportunities to buy or sell depending on the longer term outlook for stocks and bonds. A trend in motion tends to stay in motion, so it is best to keep your vision on the long- term trend. In the early 1980s, when the prime rate

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reached 22%, it was obvious that corporations could not continue to borrow money at those rates, and the long-term upward trend in interest rates was broken. The downward spiral continued until rates reached 1%, and the Fed commenced raising rates. That upward trend is still in effect, and investment decisions should be made with that new trend in mind. The stock market began a long-term upward trend in 1982 that did not terminate until 2000 when savvy investors noted the extreme valuation in the high technology sector. A longer-term view of the stock market precludes the market in general moving on to new heights soon and the beginning of a new upward trend.

Now, having said all that, we will look at some near-term economic data while keeping our vision focused on the longer-trend. The markets reacted Friday (February 3) to news of unemployment dropping to 4.7%, hourly earnings rising 3.3% year-over-year, labor costs rising 2.4% (biggest gain since 2000) and productivity gains slowing to 2.7%. All of this data was considered inflationary, and the markets reacted accordingly. We look for the longer-term trend of inflation to be up and will continue so but at a measured pace. New non-farm employment was reported at 193,000 for January below economists' expectations. However, these numbers are very erratic and are readjusted every month. The longer-term pattern shows we are creating over two million new jobs every year.

Corporate America also sees the world in a vision opposite the federal government. The corporate world has seen the error of deficit spending and has been cutting and downsizing the last five years to become lean and mean. The federal government on the other hand has a hard time keeping their hands out of the cookie jar (tax receipts). The government needs to rein in spending and become lean and mean also. We have mentioned in the past how corporations have seen the negative impact on their income statements brought on by defined benefit plans and are moving to contribution plans. Social Security will have to remove the inverting glasses lest we bankrupt the country.

Random thought for February 2006: Turtles can breathe through their butts. They must be wearing inverted glasses.

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