



February 8, 2011

Dow: 12,233

TIPPING POINT

In physics, the tipping point is the point at which an object is displaced from a stable equilibrium into a new, different state. The term can also be applied in sociologic, economic or political terms. The current unrest in Egypt actually began in Tunisia and the tipping point there was when a young man immolated himself over government harassment over a business permit. Trouble had been fomenting in the streets, but this was the tipping point that escalated the turmoil that spread to Egypt and could ensnare Jordan, Syria and even Saudi Arabia. This almost certainly will turn into a different state that will have ramifications well beyond the Middle East. Those who watched the Super Bowl on Sunday may agree that the tipping point was the fumble by the Steelers' Mendenhall that was recovered by the Packers and changed the momentum of the game. Some tipping points are clear and have immediate results. Most are harder to identify and take years to move into a new state of equilibrium. Tipping point has become a fashionable catch phrase today. Representative Ryan, now head of the budget committee in Congress, used it recently while discussing our economic outlook. He feels, as do many others, that our debt structure in this country has reached a tipping point. This is not necessarily a bad thing. If the tipping point is recognized, steps can be taken to push us in a more stable direction. Most Americans were made aware of this problem and voted last November to let Congress, state, and municipal legislators know that they were concerned and wanted this problem addressed. Governments across the nation are taking steps to cut spending and reduce debt. This will be a real stimulus for the recovery. As one uncertainty after another is removed, the economic recovery will gradually escalate and take us to a new state of equilibrium.

The jobs report for January was a major disappointment as only 36,000 new private-sector jobs were created. According to most economists, we need at least 200,000 – 250,000 new private-sector jobs created each month to lower the unemployment rate. So why did the unemployment rate drop to 9.0% from 9.4% the previous month? Simply because approximately 500,000 people stopped looking for a job, and as people not looking for work are not counted as unemployed, the percentage drops. How then can the economy be growing at a 3% annual rate and the stock market making new recovery highs? Because corporations, due to the recession, reduced their work force and upgraded their technology. They were thus able to increase productivity and earnings. One only has to look at stocks in the technology sector to see where companies have been spending money. Eventually productivity will reach a tipping point, and companies will have to hire new workers in order to increase revenues. This may happen this year as we expect growth in GDP to be stronger at year-end than most economists project.

Inflation, what inflation? If you can live without fuel or food there is little inflation – about 1%.

(CONTINUED ON REVERSE SIDE)

However, gasoline at the pump is now over \$3 a gallon almost everywhere and headed higher especially as the summer driving season approaches. The uncertainty in the Middle East will add to oil price pressure. In addition, commodity prices from copper to cotton to grains have been escalating, and they will work their way down to the consumer level. Proctor & Gamble and Colgate recently announced price increases. These price increases are not the cause of inflation; they are the effect of inflation. The real cause of inflation is the growth in money supply and the velocity of that money. The Fed has created mountains of money out of thin air over the last two years in an effort to avoid a depression. Eventually as this money works its way into the economy and the recovery picks up speed, the effect will be a higher overall rate of inflation. Banks appear to be opening up to more loans, so the velocity of money will accelerate. We will soon see a tipping point where inflation will be recognizable by all. Interest rates have been rising in part anticipating inflation. In the past, the US exported inflation, but now with our negative balance of trade, we are importing inflation primarily from China. China is finally starting to feel some of the difficulties of capitalism in the form of wage increases and worker benefits, but their basic problem is a rapid growth in money supply. Unlike us, however, they have been experiencing rapid velocity of their money. They are currently experiencing an inflation rate of 5% - 6%. They are trying to hold this rate down by forcing banks to cut back on lending policies (they are not a true capitalistic economy). Fears that China will overtake the US are very premature at best. They are a big factor on the world stage now and do impact the global economy, but they are relatively new to capitalism and have many growing pains ahead of them.

These are exciting times and the world faces many tipping points that will change many established paradigms. Our system of capitalistic democracy and entrepreneurial spirit will keep us in a leadership position for the foreseeable future.

Random Thought for February 2011: “The most remarkable thing about my mother is that for thirty years she served the family nothing but leftovers. The original meal has never been found.”

Calvin Trillin

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