JAMESSON ASSOCIATES

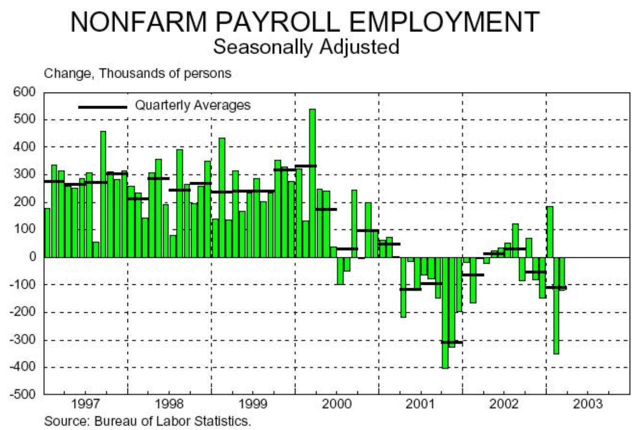
Spring Newsletter April 2003

Recent Economic Events

Mr. Greenspan's soft patch is turning into something more ominous. The job market has turned ugly, and growth threatens to become shrinkage. It appears that both businesses and consumers are frozen at the switch as they wait for the war in Iraq to end. When it does, economic fundamentals will come to the fore in determining whether a recovery takes hold or a second leg of recession unfolds.

Fourth quarter GDP registered an anemic 1.4%, representing a return to sub-par growth after a more encouraging third quarter. The most recent three-month period looks likely to produce a figure closer to zero than to potential (about 3.5%). Industrial production grew by a meager 0.1% in February, and new factory orders were down by 1.5%. Were it not for strong defense orders, the figure would have declined by twice as much. The ISM index of manufacturers fell below 50 in February (46.2) as did the services index (47.9). These statistics indicate that the economy is much closer to falling back into a recession than it is to establishing a self-sustaining recovery.

If the story from the consumer were more upbeat, we could discount the business side of the equation. Unfortunately, the recent employment and consumer confidence figures are nothing short of awful. After some positive momentum in the middle of 2002 (based on quarterly averages), there has been a progressive deterioration in the employment figures.



Some may point to the stabilization in the unemployment rate at 5.8% as a sign that things are not so bad. However, consider that in order to be counted as unemployed you must have been looking for a job in the last month and have been ready to work. It turns out that the labor force shrank by nearly 1 million people in the first quarter. If not for the fact that these individuals left the labor force, the unemployment rate would be well over 6%. More troubling than those who voluntarily left the labor force are the roughly 5 million individuals who have stopped looking for work but would still like a job. They are known as "discouraged workers." Add them to the unemployed, and we close in on idled labor capacity of 9%.

Weakness in employment has led to plunging indices of consumer confidence. We have not seen these measures in their present ranges since the recession of the early 1990's. They are easily below the levels we saw in the official recession of 2001.

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Commentary

Reasonable people can disagree on President Bush's foreign policy. Bold. Arrogant. Visionary. Naïve. Strategic. Inept. They cannot disagree on his handling of domestic policy.

The President was handed a growing economy and a historic Federal budget surplus. He has squandered the latter while essentially ignoring the former. He appears to be acting the part of wastrel scion of a wealthy family. His recklessness threatens to dissipate his trust fund in a few short years.

Independent analysts have suggested that the reversal from surplus to deficit has many causes. A slowing economy explains about half of the deterioration, but the other half can be traced to the tax cut and increased Federal spending. The last two causes can be laid directly at the President's feet. So far, Mr. Bush has not vetoed one bill coming out of Congress.

It may be that the economy would have been far worse without the implied fiscal stimulus we enjoyed over the past year or so, but I would suggest we have expended plenty of ammunition fighting the wrong battle. On top of this, instead of focusing new proposals on restoring economic health along with addressing a longer-term budget deficit, the Administration is proposing just the opposite. The $726 billion tax cut proposed by the President focuses on tax relief in the out-years and little for the short term. In addition, it contemplated using half of the tax reduction to eliminate the so-called "double taxation of dividends." Great slogan, lousy economics.

Realizing folks are not disposed to reading through a liberal rant on what is wrong with this policy, I have decided to take the initiative. It's time Democrats stopped being wimps trying to disagree with the President while voting in favor of his policies. Since no one else will take up the challenge, I will.

"No more triple taxation of spending." That's my aim. Why should I pay Social Security taxes, be taxed again on that income, and then have to pay sales tax when I buy something? This is patently unfair. Why aren't the anti-tax zealots exposing this travesty of justice?

Look at the power of this idea. First of all, triple is better than double. Second, every wage earner gets hit. The totals far exceed dividend receivers. Third, it's actually sound economic policy which can restore the economy to full potential and put Americans back to work.

There are three ways to skin this cat. One, initiate a Social Security tax holiday for both employers and employees. This would encourage businesses to substitute labor for capital and put more people to work. Second, make social security taxes deductible on the Federal tax return. Why should I have to pay taxes on the taxes? Third, rebate sales tax revenue to either the individual or to state and local governments which temporarily suspend the taxes. With lower effective costs on goods and services, more would be purchased.

Note how effectively this program increases demand in the economy rather than heap-

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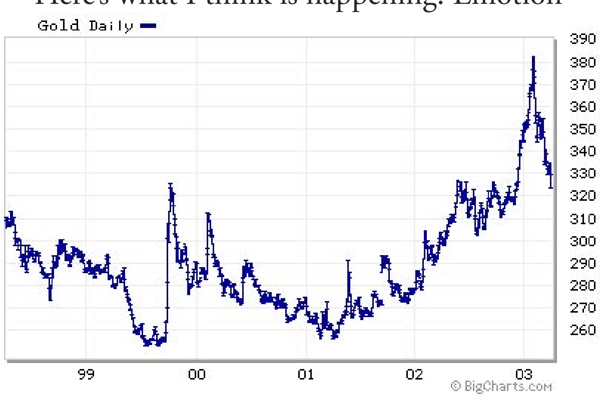
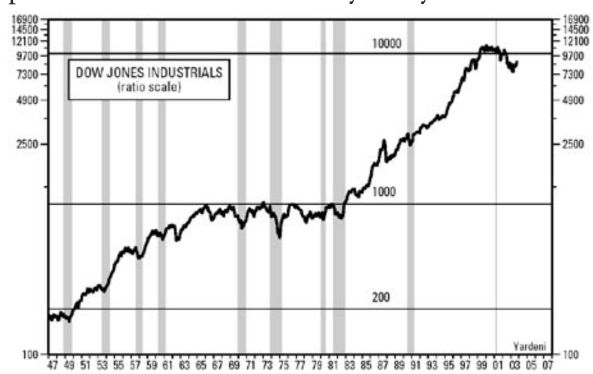
Market View

The initial success of our war in Iraq has led to an unwinding of the war premium in the stock, bond, and oil markets. In fact the collapse in commodity prices in general began well before our military forces were unleashed on Saddam Hussein. This suggests a curious contradiction.

Gold has been falling in value for a few months and now looks poised to resume residence within the longer term range below $330 an ounce. I am asking myself why. Does this suggest that the commodity market in general is set for a tumble? Is deflation a lot closer than we think?
Here's what I think is happening. Emotion



and sentiment are presently driving the markets for stocks and bonds. Most investors believe (or want to believe) Mr. Greenspan when he says that the war uncertainty is what is holding back the economy. When it ends, we will go back to normal, meaning a self-sustaining recovery. Investors looking at history from Gulf War I, conclude they better be invested for the rally. This buying itself propels the market higher in anticipation. The stock market strategists on Wall Street hop aboard the bandwagon suggesting that stocks are cheap and, in any event, can't go down four years in a row. Well they may be right, but history also shows that after a generational bull market like we experienced from 1982 to 2000, it is much more likely that we will experience a generational trading range than another leap upward.
I continue to believe that stocks are overpriced and would use any rally due to



Saddam's ouster to sell stocks and pare back to core holdings with good dividend yields.
I think gold is pointing to a reduction in demand for commodities as the global economy labors. Unfortunately, China and the rest of East Asia, which had been relative bright spots, are now under the specter of SARS. The potential impact of this mystery disease on these economies is not yet factored into projections.

But whither bonds? Sentiment in the bond market has become quite bearish. Few believe rates can go much lower and technically inclined analysts are suggesting that the assault on 3.50% yields on the ten-year Treasury have not been successful. I think it is too early to write the requiem for the long-term bond market. Federal Reserve policy has been quite ineffectual in boosting the economy.

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Recent Economic Events (continued)

Retail sales have been battered with the February level down 1.6%. No doubt some of this was due to weather, and some is due to Iraq-related worries. But deteriorating statistics are not typically associated with economic recoveries.

On a strict economic statistic basis, the current releases would suggest a new recession is either upon us or quite near. Optimists hope to see a reversal in the recessionary momentum with a sharp restoration of confidence based on a quick resolution of the war in Iraq and the transformation of such confidence into renewed spending growth. The worry is that the longer uncertainty stymies a recovery in confidence, the more likely it is that businesses throw in the towel, producing not a self-sustaining recovery, but an accelerating contraction in economic activity. We are no longer in a soft patch; we are balanced on an economic precipice with time working against us. ❖

Commentary (continued)

more incentives on expanding already excessive supply. It puts more dollars in the hands of spenders, not savers. Except for option number two, it is also temporary, addressing the long-term budget picture in a more responsible way. Since Republicans are on record as contending that deficits don't matter anymore, there should be little if any resistance on grounds of prudence.

Now I ask you. What makes my proposal different from the approach of the Bush Administration? Both proposals would likely wreck the finances of the United States over the intermediate term, but mine has the benefit of doing so while helping a lot more people than does the President's proposal. For those of you who believe, please dial 1-STOP3TAXES and make a donation. Who knows, it may even be deductible. ❖

Market View (continued)

With only a few basis points left to lower short rates and the fiscal situation chaotic at best, the Fed may resort to buying longer-term Treasurys to stimulate the economy. If they do, we will find rates much lower than they are today.

I think the odds favor bonds over stocks at present levels (near 4% on ten-year Treasurys) although the timing and duration of a drop remain uncertain. Long maturities are trading opportunities while at the short-end, I believe two or three-year investments represent the best risk/reward tradeoff. ❖

Editor's Note

The stories from Iraq have brought the brutality of war to us in real time. Never before could we see, so immediately, the truth of the adage that "war is hell." But the enduring impression that I have of this war is not death and destruction, but rather the perseverance of human values under great stress.

An American POW was rescued from a heavily guarded Iraqi hospital by a commando team that trusted information from an Iraqi — an Iraqi who risked his life to do the right thing. This incident puts a lie to the fundamentalist notion that all Muslims hate Americans, and it shows that Americans are willing to risk many lives to save one individual. On September 11th, taking risks to save one individual defined the ideal American. It continues to do so. The contrast with suicide bombers couldn't be more plain. American ideals are winning in Iraq in the face of terrible war conditions, and in comparison even our military success pales. ❖

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