



Friday, May 28, 2010

Are You Optimistic or Pessimistic?

Events of the past few weeks have rattled the confidence of even the most stalwart of optimists and caused more than a few to question fundamental tenets of the economy. How can millions of gallons of oil flood the Gulf and not permanently ruin that ecosystem and the livelihoods of millions of people who depend upon it? How can markets be called efficient when an aberration can cause the loss of a trillion dollars in mere minutes? How can the Euro survive a potential default by Greece and survive?

There are always two viewpoints possible in addressing difficult questions; the optimistic and the pessimistic. Unfortunately, we seem to be too eager as people and a society to take the latter position. Television news and newspapers, fighting for survival, blast sensational stories pessimistically slanted because they sell better. Opinion polls of politicians at all levels of government are reaching new lows. Casual conversation among friends finds that many are in dour moods.

Optimism is tougher to sell and tougher to maintain. People become pessimistic as life deals its tough blows. Others accept pessimism because it's safer than risking failures of the optimistic. Mark Twain said "the man who is a pessimist before forty-eight knows too much; if he is an optimist after it he knows too little." Pessimists see what we want to see. As Jack Cleary said "a pessimist is never disappointed."

There was plenty of fodder this week for the pessimists, but glimmers of hope continued for optimists too. According to the Conference Board, the US consumer is becoming less pessimistic. Their measure for confidence rose 6.6 points to 63.3 in May. Their assessment of the jobs market improved sizably for a third month. Respondents describing jobs as hard to get dropped in number from 47.3% in February to 43.6% in May. Those who see more jobs coming in the next six months increased in number by 2.7% to 20.4% in April. And fewer see jobs declining ahead; at 17.7% vs. 19.9% in April. On the question of income rising in the next six months, pessimists continue to outnumber optimists in what is unprecedented in more than 40 years of data according to the Conference Board.

The weekly report of initial claims for unemployment showed modest improvement as that number declined by 14,000. The month-to-month look is mixed with the four-week average showing marginal improvement and the latest week showing a marginal increase. Unfortunately there is not enough strength in these numbers to support significant optimism.

Along with unemployment, the housing market is another significant drag on the US recovery. But this week's housing data provided some glimmers of hope that improvement might take hold and endure. New home sales surged in April 14.8% to a 504,000 annual rate. The buying spree contributed to a 7% drop in supply, the biggest decline in nearly 42 years of record-keeping. Supply at current sales fell to 5 months vs. 6.2 months in March. April's end to second-round stimulus was supposed to have depressed new home sales which are measured by contract signings, not by actual closings which had to make the April 30 deadline to qualify for tax credits. A big negative in

the report was the large drop in prices; down 9.7% to a median \$198,400. That represents the lowest level since 2003.

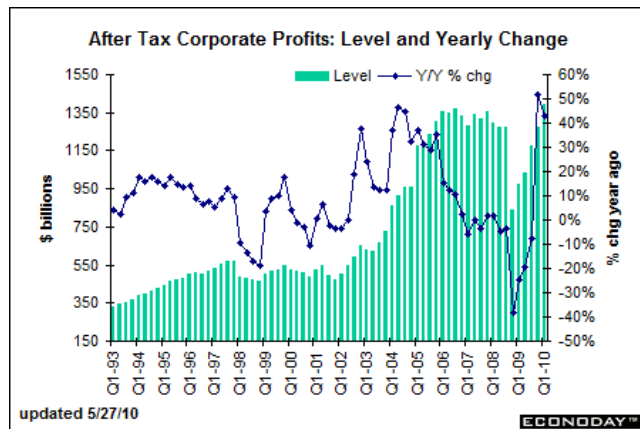
Case-Shiller takes an in depth look at prices, but results are a little dated. Their data point to flat home prices during March. The Composite-10 rose 0.2% vs. a 0.1% rise in February with the composite-20 unchanged vs. February's 0.1% decline. Year-on-year, sales are at recovery highs of plus 3.2% for the adjusted 10 index and plus 2.4% for the 20 index.

As for the sales of existing homes, government incentives did indeed drive a significant 7.6% jump in the sales. Unfortunately, supply ballooned by 11.5% as pent-up sellers rushed to the government-incented market.

This strength of the US recovery so far has been driven by business and by manufacturing. In a good sign for the health of that effort, S&P said this week that the chance of downgrade for US companies that aren't financial institutions is the lowest since July 1998 as the nation's improving economy overshadows European debt strains threatening global growth, according to ratings firm Standard & Poor's. The proportion of corporate debt issuers with a so-called negative bias in their ratings fell to 19% at the end of March. Ratings upgrades this year outpaced downgrades 105 to 70 through May 19th.

Of the 500 companies in the S&P 500 445 have reported with first quarter earnings 54.9% higher than the same period last year. A full 77% of those companies' earnings were higher than analysts' estimates.

Corporate profits as monitored by the government advanced in the first quarter to an annualized \$1.393 trillion from \$1.270 trillion the prior quarter. Profits in the fourth quarter were up an annualized 44.8%, following a 37.0% jump the prior quarter. Corporate profits are up 42.7% on a year-on-year basis, compared to up 51.8% in the fourth quarter.



According to the Institute for Supply Management-Chicago, business activity in the US expanded in May for an eighth straight month. The group said today that its business barometer fell to 59.7 this month from 63.8 in April, the highest level in five years. A number greater than 50 signal expansion.

April Durable Goods surged 2.9% in April. The jump was led by huge boost in the transportation component. Without it, new durables orders slipped 1.0% after a 4.8% spike in March. The swing was largely in civilian aircraft. But as Bloomberg points out, the relatively small decline in ex-transportation sectors leaves new orders at healthy levels. Year-on-year, overall new orders for durable goods in April were up a robust 18.9%, compared to 17.3% in March. No signs of manufacturing faltering as a result of Europe's financial woes yet.

We are all deeply concerned about what impact the oil spill will have on the Gulf. While there are plenty of pessimistic reports out there, maybe there's still room for a little optimism. LiveScience says "there is effectively an oil spill every day at Coal Oil Point, off Santa Barbara where 20 to 25 tons of oil leak from the seafloor each day, for the last several hundred thousand years. The oil from natural seeps and from man-made spills are both formed from the decay of buried fossil remains that are transformed over millions of years through exposure to heat and pressure."

Recent global estimates of crude oil seepage rates suggest that about 47% of crude oil currently entering the marine environment is from natural seeps, whereas 53% results from leaks and spills during the extraction, transportation, refining, storage, and utilization of petroleum.

Dave Valentine of the University of California, Santa Barbara asks "what happens to all of this oil? We know some of it will come ashore as tar balls, but it doesn't stick around. And then there are the massive slicks." Based on their previous research, Valentine and his co-authors surmise that the oil sinks "because this oil is heavy to begin with. It's a good bet that it ends up in the sediments because it's not ending up on land. It's not dissolving in ocean water, so it's almost certain that it is ending up in the sediments." Valentine says "nature does an amazing job acting on this oil but somehow the microbes stopped eating, leaving a small fraction of the compounds in the sediments." Their studies will continue to find out why.

In the Gulf for now, the gusher is halted and the cleanup continues. British Petroleum vows they will clean up "every drop" of the oil. To do so will require the help of thousands of people – people whose livelihoods are changed dramatically by this disaster. But at least hundreds or thousands of jobs will be created in the clean-up for those who want them.

An economy is the sum of all of its parts both created and consumed. When pessimism outweighs optimism, an economy shrinks and it shrinks as long as pessimism outweighs optimism. In typical economic cycles the growth of pessimism is eventually replaced by an ascendancy of optimism. But think for a moment. How many new inventions are created or businesses started by pessimists? Isn't this the land of invention? Albert Schweitzer said "to the question whether I am a pessimist or an optimist, I answer that my knowledge is pessimistic, but my willing and hoping are optimistic." We thank God for those who have sufficient optimism to take a chance, to create something new and to risk much for their part in propelling our economy.

The US economy is unlike any the world has ever seen and perhaps will ever see. Our diversity, rule of law, protection of intellectual property, political system, natural resources, agricultural abundance, rivers, roads, and rail, along with countless other blessings fuel an economy capable of remaining the world's greatest for generations to come. How's your will and your hoping?

We are deeply thankful for the millions of American men and women who have died in the military uniforms of this country defending her from those who would destroy the rights and freedoms we all too often take for granted. May God bless you and your families.

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