

Not a Start but the Beginning of the End

December 15, 2003

One of the first things we learned in the investment business was that you never annualize less than yearly numbers – for example how misleading would it be for Central Plains Advisors, Inc. to state that on an annualized basis a 2% increase for the 3rd quarter was reported as 8% or for that matter a 2% for the month of November was 24% annualized? Under normal circumstances 2% doesn't seem like much but 24% is likely to create some excitement. Maybe even enough that will allow some 800,000 Wall Street employees to sell common stocks to the public. We are not quite certain why the U.S. Government reports GDP numbers on an annualized basis, the rest of the world does not. The lesson is that one needs to factor this into account when making comparisons to other un-annualized percentages.

As mentioned in a previous Buzz, the 8.2% annualized 3rd quarter GDP was a blockbuster but please keep in mind three things:

1. Most all the tax stimulus came in this quarter.
2. The 3rd quarter, we believe, will represent not the start of a “normal” recovery but rather will be the peak of an on going “un normal” recovery.
3. The consumer and federal government continuing to borrow money at record levels is the only thing that has allowed such a number to be obtained.

Of course, another misleading number we have mentioned many times is the hedonic accounting for computer sales (AKA Productivity). This, along with the afore mentioned annualization, made capital spending in the 3rd quarter a very robust number. This is particularly important as capital spending must expand if we are to have sustainable growth. For the 12 months ended 9/30/03 as reported by the GDP, computer sales increased by approximately \$93B, however, the actual dollars spent increased just \$11.5B.

Another interesting aspect of this entire computer related business is that increases in productivity are supposed to make for a combination of increased profits and wages. Where are they? Wages and salaries have been flat and profits have grown some, but most of the gain has come from cost cutting and financial speculation. Cost cutting helps on a micro basis but hurts on a macro basis. Why? My cost cutting reduces your sales – it's at best a wash.

As a final thought – when will people start to be employed again? You have only to look at the previous paragraph for the answer. Computer and cost cutting replace people who have become too expensive to hire. 300,000 new hires a month is needed to absorb new entrants and add to sustainable economic growth.

Most all financial analysts are expecting the economy to grow around 4% next year. We believe that is too high a number, but even if we are wrong, 4% will represent a slower than normal recovery from the 2001 recession.

