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Strange as it may seem, a positive case is building in each of three big arenas: economics, politics and world interaction. The events of recent history, rich as they are in instructive power, are available to all but those who lack the grasp or will. Historic political positions can be verified and falsehoods discovered. That must be worrisome for those who hold power by means other than logical persuasion. How would one feel as an aging, dictatorial oligarch in a world of pods, pads and googles? Comfortable about one's future?

More people have figured out that big socialist concepts do not work. In Europe and the US, long established welfare programs are being found to be unkeepable promises. It's easy to sell "fairness" to yokels in exchange for votes, but eventually even we learn.

Reference to history finds numerous failed attempts to control economies governmentally in Germany, Russia, Cuba, and currently Venezuela, Iran, Vietnam and North Korea. All disasters. Then there are the "free market" successes: South Korea, India, Japan, Poland, Central Europe and much of free Asia where prosperity and opportunity abound and modern times have arrived. Who could remain puzzled? The black swan is China, an enigma inside of a mystery, so far.

As the spread of information and prosperity changes the dispersal of power and wealth in the world, the potential for favorable surprises increases: Iraq governs itself and restores oil production, China disciplines North Korea, Israel bombs Iran's nuclear sites, Iran's mullahs are deposed internally, Al-Qaeda is hunted down, America restores its financial balance.

As far as the economy and the political outlook are concerned, enthusiasm is in order at the prospect that our legislative bodies will, after thorough and open discussion, create the obvious working policies. I do not remember any time past when so many winning arguments were so firmly grasped by a majority of Americans.

We should expect from the new Congress respect for the confines of federal authority, sensible reform of medical legislation enabling a spectrum of private medical insurance arrangements, and the extent to which government administrators should influence deathbed services. I must admit that if it was my responsibility to dispense national medical service, care to the elderly would be "rationalized". Sad but inevitable, and the best reason to not put that power in government hands. An alternative arbiter at the end of life is a family member, comparing family costs and benefits.

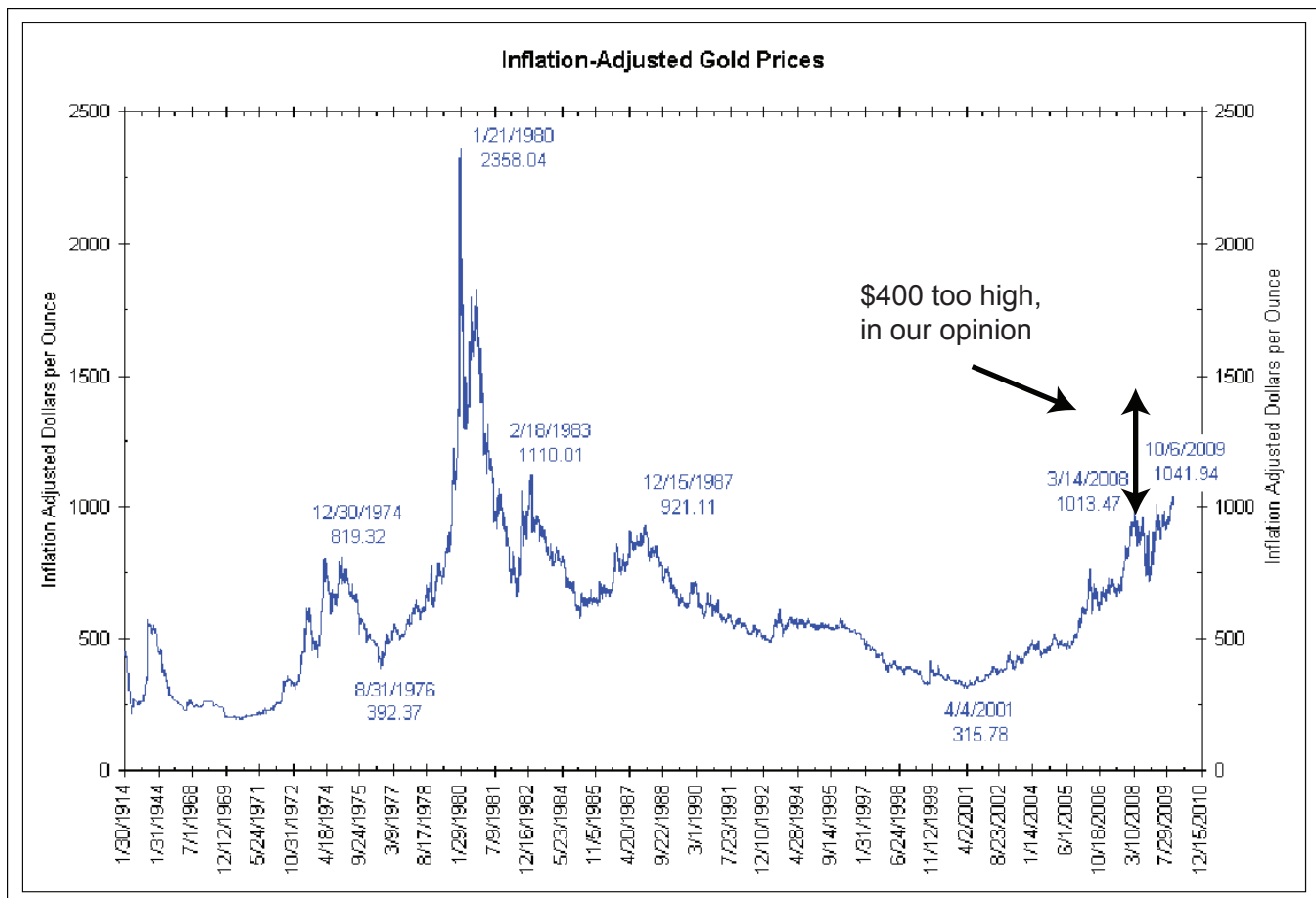
When timely, a Congressional investigation of union influence in government worker unions would be useful. They have become a cancer on society, especially with respect to decisions on salaries and pensions. State bankruptcies and reorganizations may be necessary, but one way or another, the parasitic transfer of money to entrenched favored recipients will have to be stopped. A starting point would be to expose the conflict of interest between teachers unions and public education.

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The subject is in flux already. The recent Washington D.C. case is informative, in which scholastic achievements enabled by an enlightened mayor and a talented administrator ran into union opposition, because the success reflected poorly on the union.

Real union reform will await a change in the Senate and Presidency, prospects for which look good at this writing. One interesting set of contenders would be Donald Trump and Sarah Palin against Oprah Winfrey and Barney Frank.

The display of political energy in the last election is taking hold. People are assuming that the various messes will be cleaned up in the return to power of the grownups, inspired by an array of attractive, strongly motivated new conservatives. The weight of economic uncertainty is being relieved: The President's desire to raise taxes has been thwarted and the magnitude of the coming inflation has eased with the prospect of Republicans at the reins.



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The flight from the dollar is relaxing, causing gold to pull back from recent fear-driven highs. A resurgence of inflation still lies ahead, though prospectively less damaging than if we were still increasing government spending to solve the problem of prior government spending. Recent prices of \$1400 per ounce are above an imagined, projected inflationary trend line by around \$400 per ounce (*see chart on previous page*).

Corporate liquidity is sound, operating costs are lean, and the turnaround is still in an early stage. Profit surprises on the upside will be frequent when the sales increases start to hit. Soon to come will be upbeat headlines about employment gains, export orders, rising selling prices and increases in consumer income and spending, moderate though the latter may be as consumers continue to restore their financial resources.

The best assets to own under these conditions are those which provide an income return, can prosper under inflationary conditions and are not unduly exposed to the loss of value that occurs as interest rates move back to normal. Stocks are reasonably valued based on prospective 2011 earnings (cheap on the imagined earnings of later years) and should continue as the portfolio mainstay; real estate when appropriately financed; and inflation protected bonds. Long term bonds would decline in value under those conditions and short term bonds will erode to some degree. Substitutes would be convertible bonds with a fair responsiveness to higher share prices and good dividend paying stocks.

Happy New Year.

Sincerely,

John May