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Stock prices declined by about one-eighth this summer amid fear for the economic future and the sense that the current administration's competency in the matter is seriously deficient. The S&P 500 Index was down 10% for the 9 months through September 30.

Dow Jones Industrial Average



At such times of financial volatility, it's useful to be aware of positive elements. Here's one, and it's major:

Western democracies are finding that they cannot afford the role of nurturer in addition to protector. In Europe and America welfare entitlements have run into the realities of arithmetic and demographics. The hope to keep on spending more by borrowing and raising taxes is seen as invalid by a substantial minority on the right, with another big minority in the middle presumably still thinking about it. A shrinking minority remains steadfast on the left either through a flawed grasp of economics, narrow self interest, or an antipathy for the better-off often referred to as fairness. The latter believe the bottom 40% should be supported by the more prosperous 60%. Some of them fear a reduction of the subsidies to which they have become accustomed while others, in political and labor union circles, fear a diminishment of their own power. They prefer postponement of financial crises by temporary measures.

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In the case of Greece, for example, there are unknowns as to the extent of losses to be booked by Europe's banks in the event of curtailed government spending on one hand and default on the other. Delay is easier to vote for and few are brave enough to say: no more. The single certainty is that the current course is being choked off.

The drama is intensified by the differences between two approaches:

- 1) Reduce outflows to an affordable level while encouraging competition in a low tax environment
- 2) Fund welfare programs by confiscation of assets through taxation and confiscation, until there is little to share.

The evidence is clear that prosperity is enabled by the first and impeded by the second, and the less the interference the greater the prosperity. The government's job should not be to make jobs, or define our moral values, or reduce our cholesterol intake, but to protect us from invasion and crime, encourage competition in commerce and maintain a sound currency.

Now that the limits to borrowing and taxing have become visible, we will be able to see the crisis as it evolves, weigh the alternatives and make sensible choices. The political process is now ripening nicely and, in the election one year away, the stage will be set to restore prosperity by cutting back on the intrusions that are suppressing economic vitality.

A second element of strength in the underlying foundation is the financial condition of the companies that make up the stock averages: Corporations are rigged for heavy weather in that they have become more financially liquid, expenses are lean and profit margins are healthy, so that any upturn in demand will cause earnings to pop and ignite a sharp rise in new hiring. Stocks are priced reasonably, bonds should be avoided except for short term investment grade corporate and inflation protected US bonds, and we think gold prices have gotten too high for prudent inflation hedging.

The coming year should be rewarding and highly educational.

John May