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INVESTMENT COUNSEL INC.

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Economy Update:

A recent 35 minute video of a Charlie Rose interview with a roster of very good thinkers, may be accessed at the following link: http://www.charlierose.com/view/interview/11710

Fore those who don't have time to access this recording, a summary of this video is provided below:

- *"fifteen years to get things right" is one expectation.*
- *"Debt or Deficits are too big or rather, are they BIG enough?"*
- *Deep job deficits (14 million unemployed in USA; double digit unemployment in many other developed nations)*
- *Structural imbalance of Budget Deficits*
- *"...inflation increases are temporary and will come down next year....expect more government interventions...to include changes in Taxation"*

Ongoing travails:

We find that the solutions presented are experimental, highly technical and fraught with execution risks. About thirty-five trillion dollars of *remaining* losses (global) picked up in 2007-8, have yet to work through the financial system. Basically, collateral has been expunged and then some. In part, this is the reason that so much time will be required to heal the 'painful' economic malaise that is unfolding.

"The game is over" and "the age of finance is dead" are apt observations[1] on what the world can expect, at least for an undetermined time. Unemployment rates are stubbornly high and prospects for improvement are low. Consumers have quickly found that their Home-ATM machines no longer, magically and indiscriminately, dispense money to them. The act of borrowing when collateral is nonexistent, presupposes that one mortgages future income to satisfy current consumption needs. Well, when future income is not secure or non-existent, money runs out very quickly. This may have happened for about 14 million Americans.

There has been some improvement; the USA economy is no longer losing 700,000 jobs per month. A semblance of stability exists I suppose and a point from where to build? The propensity to save in the USA is finally rising (by necessity, not choice) and is indeed a positive development for the long-term health of the economy (and the saver).

The concept of "technological unemployment"[2] from the 1930's is gaining some contemporary attention. In developed nations (especially valid for USA), corporations have basically outsourced much of their labour intensive industry to lower cost jurisdictions in the hope of thus increasing productivity and wealth, by retaining and propagating a vast and growing stable of intellectual property. This is working for many companies. For labour, it is a bleak development. Even if the currently unemployed are quickly retrained to propagate the coveted Intellectual Property stream, fewer jobs will be needed and they will be available to a different *skill-set*. [e.g. one person invents and develops the gizmo while 20 people are require to manufacture it; I really don't know the mathematical ratio but I expect that many who want to work, will not be able to find a job.] Haven't figured out yet who will have the money to buy these new creations and services.

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[1] Mark Lapolla, strategist with Sixth Man Research.
[2] John Keynes in "Economic Possibilities for our Grandchildren"

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The European Common Currency and Union experiments are still under duress. Reasons are structural and further aggravated by the economic blow-up late last decade. My understanding from various reading, is that the European economic problems are worse than what has been experienced in the USA. UK and the US seem to have been the most proactive in facing up to the capital destruction that occurred. For this reason, a resolution may perhaps be forthcoming earlier.

China, the miracle economy that so many are depending on? Another observation that I find credible is that China 'no longer controls its own destiny; the free markets do.' Food inflation in China is running at over 30%; Wage/price inflation (also in other emerging economies) will be very difficult to control through the usual arsenal of tools (monetary, legislative, fiscal). These developments are fodder for social unrest and contribute to stressing an already volatile situation.

The Fed's actions during the recent financial chaos, although necessary at the time, have been ineffective at meaningful credit creation and have rather contributed to massive speculation (i.e. exaggerated and distorted commodity markets).

What does all this mean? Living standards for most will go down further, savings rate will remain higher than experienced in recent history, high commodity prices will likely cannibalize demand and will contribute to the latent deflationary pressures that are also on our radar. Employment to remain lower than hoped. Economic growth to be muted at best. 'Three years ago we witnessed food-riots in thirty countries.'[3] Primary conduit and catalyst was the ETF-repackaged facilities, created to speculate on human essentials [basic foodstuffs]. Such riots may soon become a common occurrence. As for the abusive speculators at large, commodity and otherwise, they'll probably soon find themselves *'looking at each other across the same trading desk.'*[4]

How to best invest your savings in this environment? Government bonds and a maximum of 5-10% in corporate bonds deals adequately with your Fixed Income components. Although present yields do not satisfy your current income needs, keeping a large portion of your capital in 'riskless' investments is still advisable. As the economic healing process the world is experiencing is still fragile, disjointed Government-policy-mistakes can adversely damage your portfolios (as can a disproportionate concentration). The cost of being 100% wrong must not be irrecoverable.

Equities, the riskier component in your financial portfolio, can be effectively deployed in companies that ideally have stable earnings and can grow their dividends faster than their earnings. Where? In the USA. America may have helped create the anathema but is probably well on the way to its resolution. Much more time will be required to arrive at the desirable results.

John Evdokias

[3] (Bankers and Politicians turned food into a betting game." http://www.guardian.co.uk/commentisfree/2011/jun/07/bankers-politicians-food-betting-game?INTCMP=SRCH

[4] Mark Lapolla