

The Fork in the Road

After a strong fourteen month rally, equity markets have become more volatile and the trajectory has turned down. On April 23, 2010 the S&P 500 index peaked, up 9.8% for the year. After a brutal May, the S&P 500 had given up the gain on the year and then some, down -1.5% year-to-date through May 31, 2010.

The reversal in the equity markets and the increased volatility highlight the stark polarization of investor sentiment. There are those who believe that the United States is on a solid, albeit still somewhat fragile, path to recovery. The trend of the employment statistics on balance have a better tone; the real estate markets appear to be showing signs of life; consumer spending has rebounded; and legislation on financial regulation is finally being addressed in Washington. In short, while we have shifted to a lower economic plateau there is now a firm foundation and solid underpinnings from which the economy can grow.

Alternatively, there are investors who believe the “dark side” is upon us. The ills of our past have only been muted by recent fiscal stimulus and monetary policy. As the stimulus programs end and as the central bank (Federal Reserve) attempts to take liquidity out of the system, debt laden consumers will resurface, consumer spending will again slow dramatically from current levels and we will soon return to a severe recessionary environment. If that were not enough, while the U.S. dollar has reasserted its preeminence as a global reserve currency, the alternative currencies of

several other developed countries pale in comparison (because the liabilities of their social programs appear to be creating fissures in the system that will literally “break the bank”). Soon, all the chickens will come home to roost and developed countries will be forced to raise taxes dramatically and cut back benefits and social programs leading to a no growth or possible deflationary environment for years to come. This scenario also includes the ultimate default of sovereign debt in many countries.

This latter outlook weighs particularly heavily on U.S. investors as they observe the recent troubles in Europe, caused in large part by massive social programs which are un-funded. Either austerity programs have to be implemented and benefits curtailed or the countries will default on their debt. U.S. investors look at the European scenario and a) reflect on the recent passage of health care reform, which by almost any account will be a huge and costly social program; b) consider the massive 2008-2009 stimulus programs; c) contemplate the United States currency printing press running at full speed. All in, the conclusion is to assume dire predictions for U.S. debt to GDP ratio five to ten years into the future (the debt to GDP ratio is comparable to one’s debt level compared to annual earnings). This leads many investors to wonder how far off the day of reckoning is for the United States.

So are we looking out on to a brighter horizon or into an abyss? While not without its dangers, we believe

summaries

the recovery does have a solid foundation from which the economy can grow. There is no question that the unemployment situation will continue to weigh heavily on the economy and that higher taxes will be the way of the foreseeable future. However, we believe overall, that the data and underlying activities we observe support the underpinnings of a real and sustainable recovery. In addition to this positive bias, we expect that the stark realizations of the current turmoil in Europe will result in the U.S. addressing some of the structural issues that would otherwise take the country further down the same destructive path. There is a fork in the road and the U.S. appears to be taking a sharp turn onto the road less traveled, at least in the last 50 years.

We are not naïve enough to think that of their own volition politicians will find a way to curtail and cut spending. However, the current temperament of the electorate appears to be forcing the hand of the politicians. There is a clear message being sent not only to Washington but to the cities and states around the country. A significant part of the voter message is that spending must be curtailed and all social/benefit programs must be revisited. Evidence of this is in headlines and articles that now dot the newspapers about possible renegotiation of public pension funds; benefits for teachers, city employees, etc. This process will not be without pain and the likely outcome is that no one will be “happy.” EVERYONE will have to make some concessions. However, we think the key for the U.S. is that the liabilities in many cases are still far off, providing time to address many issues. There will be benefits and obligations that will be curtailed but not likely to be eliminated. Instead we expect to see a restructuring. For example, one might expect to see social security benefits for those now in their

early 50's and younger being deferred until age 70. While painful, the time horizon allows for enough notification for those affected to plan for the change in expectations. Nothing will be perfect but we believe the stark realities and voter activities are forcing the issues (i.e. fix it; we will vote out those who refuse to seriously address the structural problems we currently face).

The path taken will not be easy and will not be without future problems, market corrections or recessions for sure. However, at this juncture we believe there is enough movement afoot to address some of the structural issues in the U.S. While that is being done we will have the benefit of an underlying economy that has a slow but steady recovery.

Two Weeks in China: Terrific! Two Weeks in China with My Grandson: Priceless!

Recently, I was privileged to accompany my Grandson, Russell Ladd, and 43 of his classmates from Birmingham's Derby Middle School, on a two-week crash tour of China. The school's Chinese language teacher, Mrs. Whey-Jane Butchko and her husband Dan did a superb job of organizing and leading the trip, their fourteenth such adventure. The participants included 44 eighth graders, all of whom have been studying Mandarin Chinese for three years, 33 parents, another teacher and the Butchko's seven-year-old daughter.

Apart from the obvious appeal of going to China for two weeks with my Grandson, the trip had the additional attraction of comparison. In 1988, my wife and I participated in a two-week tour to China with stops at many of the same places. The changes that have taken place over this 22-year period are dramatic.

The journey began at 6:00 am Friday at Detroit's Metropolitan airport, and the next time any one saw a bed was 29 hours later in Shanghai. Eighteen hours by air from Metro to Shanghai's airport, followed by seven minutes to the outskirts of central Shanghai on the Shanghai Maglev Train, hitting peak speeds of nearly 300 miles per hour during the 19 miles. (This could well be the future of hi-speed rail travel). All this, plus some sightseeing and everyone's first introduction to dinner in China.

The itinerary was quite ambitious with very full days. Typically we were on the bus between 6 and 8 am and continued non-stop until well after dinner. As we were occasionally reminded, "this is not a vacation." Throughout, the kids were great. Everyone paid attention and was on time. Those who were not travelling with a parent looked out for each other and stayed with the group.

From Shanghai we visited Suzhou, an ancient water town and now the site of an incredibly large new industrial park. Our journey continued to Chengdu, some three hours by air, west of Shanghai and the home of the Chengdu Panda Breeding and Research Center. While in Chengdu, we also enjoyed an evening at the Sichuan Opera with a Face Changing Show, all performed in Chinese, but quite understandable and very entertaining.

Leaving Chengdu, we traveled by bus over seven hours of poorly maintained mountainous road, to Chongqing to board our boat for a three-day Yangtze River cruise. The highlight of this part of the trip was the Three Gorges ship locks and dam site. This has been, and still is, a very controversial project. The benefits, in terms of significance, eco-friendly electric power, down river flood control and improved access to much of central China, are evident. Unfortunately, it is not as easy to assess the upriver consequences of uprooting more than 1.3 million people and flooding large areas of historically valuable and scenic countryside.

Our next stop was Xian, with the famous terra cotta soldiers and then on for a final four days in Beijing. There we visited the well known, must see places, including the Great Wall, Summer Palace, Forbidden City, Tiananmen Square and the Olympic stadium. As noted above, this was a very ambitious, but thoroughly worthwhile agenda.

After one particularly strenuous day, some of the parents were wondering if we should name our trip, "Survivor-China" or "The Amazing Race." My vote was for, "Are we tougher than an eighth grader?"

The whole itinerary was great and the changes over the last 22 years, most interesting, but for me, spending two weeks with Russell and more than 40 of his peers was the best of all. The boys tended to hang out together, on the bus, at meals and at every other opportunity, with mild rough housing and sort of leaning on each other. The girls tended to be more self-possessed and interacted with the parents a bit more. All in all, it was a most congenial group and a terrific experience.

local independent personal accessible
interactive creative local independent personal
knowledgeable thoughtful ethical experienced

It quickly became evident that Russell’s peers view him as the “go to guy” for electronic problems. He was often called upon to give assistance when cameras, i Devices and other electronic products were not performing as hoped. He was generally able to quickly solve the problem. I don’t know why I’m surprised, last year he wrote an application for Apple i Devices, got a Copyright (with help from lawyer mom), submitted it to Apple and had it approved. If you have a sudden urge to simplify a polynomial, the App store is open.

All of our hotels were excellent and all included exceptionally good breakfast buffets, including, American, European, Chinese and Japanese selections.

Lunches and dinners were typically Chinese, served family style, at tables for eight or ten, with a large lazy susan in the middle. The food was really very good, although not always easy to identify, and included a wide variety of meat, fish and vegetable dishes and rice. The kids quickly got the hang of eating with chopsticks and gradually became more adventurous with the food. All of the meals were much better than those available 22 year before.

Travel is great! But always remember, it’s not where you go but whom you go with.

Walter J. Kirchberger, CFA

We at Sigma Investment Counselors would like to extend warm and heartfelt congratulations to our own Marisa Lenhard for becoming the newly elected President of the CFA Society of Detroit.

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