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summaries

SIGMA INVESTMENT COUNSELORS

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A Viewpoint We Agree With

The February 14, 2007 edition of the Wall Street Journal carried a submission on its Opinion page from Brian Wesbury, Chief Economist of First Trust Advisors, LP. The article resonated on a number of fronts and we thought we would paraphrase the substance with our readers, and suggest a couple of interesting facets.

Wesbury commences his discussion with the following:

> *It's the best of times. It's the scariest of times. Last year, U.S. exports, industrial production, real hourly compensation, corporate profits, federal tax revenues, retail sales, GDP, productivity, the number of people with jobs, the number of students in college, airline passenger traffic and the Dow Jones Industrial Average all hit record levels. For the third consecutive year, global growth was strong, continuing to lift (and hold) millions of people out of poverty. From 30,000 feet, it sure looks like the best of times.*

We happen to agree with his assessment. Importantly, we would note that, in contrast to the pessimism which seems to have enveloped investors following the setback in global equity markets in late February and early March, most of the good news Wesbury cites about the impact of global progress continues today, unabated. We recognize that the equity markets serve as a forward looking barometer seeking to forecast expected future economic events, so the rearview mirror perspective that Wesbury brings could be challenged as the calm before the storm. However, the typical imbalances that usually precede an economic downturn (rising inventory levels, widespread and accelerating capital spending above trend, mounting inflation) are just not apparent.

Wesbury also brings to the fore a host of ills, either real or imagined, that appear to be current targets for US federal government policy remediation. While we believe that this is neither a forum for evaluating ills nor for judging policy prescriptions, we do wish to point out that serious, and often severe economic, repercussions have resulted from past policy choices that were instituted with the best of intentions.

As Wesbury states:

> *In the 1930's, the Smoot-Hawley Tariff Act caused a collapse in global trade, while the Fed allowed the money supply to shrink by one-third. Government regulation in the 1920's prevented banks from branching, which caused more than 10,000 to fail in the 1930's, deepening and prolonging the Great Depression. Hebert Hoover's tax hikes were icing on the cake, capping off a perfect storm of D.C. policy mistakes.*
>
> *It took another 35 years, and a nice run of prosperity, but Washington finally gathered the courage to try this again. Between 1965 and 1981, Great Society welfare and health-care programs, wage and price controls, inflationary Fed policy, 70% marginal tax rates, 50% capital-gains tax rates, and highly regulated energy, airline, banking and trucking industries created severe problems. The Misery Index (calculated by adding inflation and unemployment) rose to 21.9% in 1980 (today it is 7.2%).*

Again, the purpose of this discussion is not to debate the merits of past policy actions, nor to cast in an unflattering light either of the two main existing political parties. Keep in mind that these past policy blunders were not uniquely attributed to either the Democratic or Republican party – but were effected variously under both parties. One thing that perhaps can be agreed upon is that they often resulted in unforeseen, and generally negative, outcomes.

This brings us to the current state of affairs. Indeed, there are legitimate concerns about the quality of our environment, about unscrupulous practices by senior executives at publicly traded companies taking advantage of shareholders, about the number of uninsured Americans, about the absolute numbers of persons living in poverty, and a host of other non-mentioned ills. We expect these issues will continue to be debated in congress and in the

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media and this could affect short term trends in the securities market. We also expect, however, that as these issues play out, political leaders will take a reasoned approach with regard to legislation and that the solid underlying economic fundamentals/underpinnings of our economy will carry the day.

Robert M. Bilkie, Jr., CFA

The Economic and Market Environment

In Sum: Geo-political risks appeared to stabilize over the past eight weeks, as volatility (and risk) in global common stock prices increased. Economic growth on a global basis appears healthy although pockets of weakness are apparent in the United States. Monetary policy has grown less accommodating, but apparently not so much so as to cause global economic growth to contract. Fiscal policy appears generally in balance as spending is matched with tax receipts. Interest rates on investment grade debt differ little across the maturity spectrum, but lower quality debt is now carrying greater yield premiums than what was the norm at the beginning of 2007.

Geo-political: The geo-political landscape has been shifting the past several weeks. Multi-lateral talks on North Korean nuclear disarmament appear to have borne some fruit with the beginning of an agreement now in place. Prior agreements have been violated so this bears monitoring. In early March the Iraqi government hosted a meeting of its "neighbors" designed to coordinate efforts to bring peace to embattled Iraq. Attendees included representatives from Iran, Syria and the United States, amongst other countries. Meaningful progress at stabilizing Iraq seems elusive without a framework for the US, Iran and Syria to hold talks. While no plans have been made for these three to engage in further talks, their mere presence together is a potential breakthrough. Israel's prime minister Olhmert and Palestine president Abbas have been meeting, trying to hammer out some type of peace accord. Discord in South America against the United States and other developed nations continues to brew, fomented largely by Venezuela's president Chavez.

Economic: Global economic growth continued through the end of 2006 according to data compiled by Bloomberg LP, covering some 54 developed and developing nations. In the United States, growth slowed somewhat in the fourth quarter of 2006 due to the impact of decreased residential construction. Former Federal Reserve Board Chairman Alan Greenspan recently suggested that the US could go into recession towards the end of the year, and then subsequently clarified that while this was a possibility, it was not probable.

Monetary: Interest rates in the US appear set to be left unchanged for the near term, while other countries leading central banks, such as Great Britain and Japan, have recently hiked rates or indicated an expectation to do so. Clearly, global inflationary pressures do not appear likely but central banks wish to be "ahead of the curve" in facilitating continued growth without price pressures.

Fiscal Policy: The US federal budget deficit continues to shrink. Deficits in other sovereign nations around the globe do not appear to be problematic as evidenced by the statement released by the G7 Finance Ministers at the conclusion of their summit meeting on February 10, 2007 in Essen, Germany. Fiscal discipline was to have been a topic of discussion at that meeting, but no mention of the topic was made in the concluding statement.

Equity markets: The Chinese stock market dropped 9% in late February, triggering a round of selling around the globe. Subsequently, global equity markets traded in a see-saw pattern. It would appear at present that the price activity represented a technical correction given the rather sharp and sustained gains registered in the prior several months and the lack of economic imbalances.

Fixed income markets: Shorter term bonds provide about the same yield as longer dated maturities. However, following the volatility in the equity markets in late February, yield differentials have widened for lower rated debt versus their higher quality brethren as investors began to properly assess the risk in holding such securities.

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Please remember to contact Sigma Investment Counselors if there are any changes in your financial situation or investment objectives.

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