



OAKWORTH
CAPITAL BANK

COMMON CENTS

BY JOHN NORRIS

I had a lengthy conversation with my mother the other night. It had been a while since I had spoken to her at length, and we covered everything from stem to stern. We also discussed a little economics, which we occasionally do if no other family members are around to get on the phone. However, this was a weak for the sick at la casa de la familia Norris, and all of mine were well asleep by the time mom called. So, economics it was; more specifically, we discussed the job market and the price of labor in the United States.

I have touched on this a little in previous weeks, so she sort of gave herself away. Had she been reading the WHOLE newsletter, she would have known the gist of my thoughts. Apparently, she must read the last section, which often has something to do with her grandchildren, and maybe not so much when it comes to everything else. If I don't get a response from her on this, I will know my answer. In any event, touching or brushing on a subject is one thing; dwelling on it is something else altogether...or at least as much as one can dwell on anything over what amounts to be a little more than a page and a half. The formatting on this front page takes up space, you know. So, here it is, one man's opinion:

Given the current state of the domestic economy and America's overall global competitiveness and comparative advantages, I don't think paychecks are going up for some time. I am not trying to be some sort of naysayer or worrywart or Doomsday prophet or wave theorist or what have you. I am not. After all, Europe is in even worse shape than we are; however, the disparity in wages between American and emerging economy workers is pretty enormous. The productivity gap would appear to be shrinking. Why else does so much of the world's manufacturing take place in Asia these days? Because they are more cheap than we are productive. As such, the productive gap must be more narrow than the pay gap. This makes sense to me, although I don't have a ream of paperwork to support it.

However, when you think about it, pay is only one component of the output equation. After all, which would you rather have? A worker making \$10/hour who can produce 50 widgets? Or a worker making \$15/hour who can produce 75 widgets? Using this example, and all other things being equal, it wouldn't make any difference to you as a producer. So, which would you rather have? A Chinese worker who makes \$1/hour who can make 50 of whatever it is? Or an American who makes \$10/hour who can make 100? Sure, the American might be more productive, but the Chinese worker is cheaper still. In terms of unit labor costs, the Chinese and American workers in this example would be equal with the American making \$2/hour. Well, I suppose we could also say they would be equal with the Chinese make \$5/hour; but I think you get the point.

Hey, I understand the arguments about trade with China. They manipulate their currency, and we would probably do the same if we were in their shoes. There is a veritable spider's web of rules and regulations when doing business in the People's Republic. They undoubtedly don't account for their costs of inputs the same way US firms do. If so, they can probably get their hard assets at below markets rates from state firms which are incented on output as opposed to profitability. Oh, the list goes on and on. So, perhaps China isn't the best example, even if it might seem to be the best one.

So, what about those European countries in the G-7? I understand they are a tad more protectionist than we, but they follow the rules a little more closely, or so it would seem. Besides, their employee costs are probably more in line with the US than China. Right? Okay, if we can accept that, then we should be able to fare a little bit better against the Europeans than the Chinese. You know what? We do. However, it would be hard to do much worse.

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You've been telling me you're a genius since you were
 seventeen
 In all the time I've known you I still don't know what you
 mean
 Steely Dan

Something To Think About cont.

In December 2009, we ran a \$1.918 billion trade deficit with Germany for the month. It was \$684 million with France, \$1.285 billion with Italy, and only \$238 million with the United Kingdom. As gruesome as those figures read, they were improvements over December 2008, when the monthly numbers read respectively: \$3.309 billion, \$1.069 billion, \$1.480 billion, and \$334 million. Obviously, the euro's appreciation in 2009 helped matters some, but even so. If the US worker is as productive as the remainder of the world relative to the wage they receive, why is it we continue to run such massive trade deficits? How can we alleviate this?

Truthfully, US firms were always able to rely on the domestic markets for sales, and never geared up the old export machine the same way producers did in other countries. In essence, we weren't forced to learn the rest of the world's tastes the same way the rest of the world learned ours. That is one reason. Another is, as our economy matured, we found higher and better uses of capital than base manufacturing. We shifted into services, which often paid higher salaries. This means our manufacturers had to pay up to keep and/or attract workers. Further, the rest of the world has kept the dollar artificially strong relative to our fiscal imbalances, this was a key element in our shift from production to consumption. Finally, our trade representatives arguably weren't up to the task of taming other markets, and no one would listen to our whining since we were the world's industrial superpower. In so many ways, it was and is a perfect storm. So, what happens now?

While the US is still the world's largest and most dynamic economy, the vast differentials which it once enjoyed in technology and productivity have shrunk. In the past, we could get by with shifting people to the service sector because we could produce more with less than most other countries. Yes, we still have technological superiority, but it ain't like it used to be. You need to go no further than your history books to determine this. What was China like in 1960? Or India? Or South Korea? Were the Chinese putting people into space and building their own aircraft carriers? Not hardly. Was India a nuclear power? In 1960, per capita income in South Korea was over 10 times less than in the US. In 2008, South Korea's per capita income was 60% of the US, according to the IMF. Essentially, the rest of the world is catching up.

Now, I didn't go into all the facts and figures with my mother, largely because I didn't have them close at hand; however, we touched on these subjects in generalities. She couldn't find much fault with what appeared to be the obvious, at least to the two of us, so she asked me another question: "well, what do you think is going to happen?"

What I am about to write next isn't pleasing, and my language could be a little better, but it is apt: "The lower half of the middle class is going to get screwed, if it isn't already." I understand I probably shouldn't use such language with my mother, but I certainly didn't mean it in any sort of prurient or inappropriate way....at all.

Now, that is sort of an open ended statement about the middle class, so I decided to clarify it a little bit, and this is not verbatim: "Those families sort of in the 21-60% percentile of household income are going to see their wages either stagnant or outright shrink." If you think of the world in terms of quintiles, you could say the 3rd and 4th quintiles, in terms of household income, are going to take the hardest relative beating as the US economy transforms. Obviously, not every one will bear the same brunt, and not everyone stays in the same quintile their entire working life. However, in inflation adjusted dollars, I can't imagine there will be much growth in income for this segment.

Okay, this is crystal ball stuff; I freely admit it. I don't have any way of proving it with any certainty, and if I could look into the future with that type of clarity, you wouldn't be reading this sentence right now. I wouldn't be here to write it, you know. Still, if left unfettered, I don't see how we won't have an even greater increase in the disparity of wealth in the country. I don't see how it won't be more and more difficult for recent college graduates to land increasingly lucrative non-technical careers. Clearly, I am writing this during a period of enormous economic uncertainty in the United States, but it doesn't compute how the United States can get wealthier relative to the remainder of the world as the access to technology and productivity enhancements become increasingly available. After all, and ask yourself this question honestly: why should an American worker with the same level of relative education, productivity, and access to technology make significantly more than his Chinese competition? Or Mexican? Or Brazilian? Or Indian? Or even Spanish or Portuguese or Bhutanese? The non-nationalist, the free from jingoist rhetoric answer is: they really shouldn't, and won't over an extended period of time. Just because we are American? Hey, that sounds great, and is very politically popular, but it isn't terribly realistic. Economies either succeed or fail based on the development of human capital, worker productivity, access to capital, and access to technology....not flags and Lee Greenwood songs.

As a result, income levels will increase in the remainder of the world, while they are relatively stagnant for the much of the United States. Oh, this doesn't mean we have necessarily done a bad job at anything, and that we messed up horrifically on the timeline somewhere. It simply means everyone else catches up. The Romans caught up to the Greeks. The Europeans caught up to the Chinese. The British caught up to the French. The United States caught up to the British. I think you get the picture. In so many ways, you become a victim of your success. You expect too much for your labor and wares, as you value them artificially high, which gives your competitors an opportunity. If they seize upon it, they will narrow that gap to a point of relative equilibrium at some level of societal adjusted purchasing power parity.

With that said, believe it or not, money is a finite thing....even though it continues to grow. So, if the emerging world is seeing its income growing rapidly at an inflation adjusted basis, what must be happening in the developed world, including the US? That is right, and it isn't that I am trying to inflame passions. I am not. But why did I pick on the middle class? That 21-60% of the households? Because the poor and/or unproductive will arguably remain so, and the rich and productive will stay the same. As such, someone has to bear the brunt, right?

The Week In Review

This week actually felt pretty good, at least if you go by economic data and market action. Still, the data this week, in my opinion, was relatively mediocre, all things considered. I certainly wouldn't call what we had to be reflective of a rapidly growing economy. After all, total vehicle sales, which is a wonderful proxy for consumer spending and potential for future manufacturing activity, were tepid....to say the least. On the positive side, they were better than they were when all heck was breaking loose, but a number of a 10.36M isn't exactly going to get the auto industry humming...at least not to the degree which would foster significant growth and expansion. However, the ISM numbers, two of my personal favorites, were both above 50, which suggests expansion.

In so many ways, this continued string of decent, but completely unremarkable, economic data sets suggests an economy that isn't looking to expand, but also isn't looking to contract either. Put another way, it would appear America has gotten back to some sense of normalcy, but it isn't looking to do much of anything spectacular. It reminds me of my first trip to New Orleans after Katrina, which was 11 months post. At the time, I wrote activity in New Orleans seemed like the Tuesday after either Memorial Day or Labor Day. Sure, people are back in the office, but not all of them...and most people are still in sort of a vacation mode. In essence, I would say we are operating around 60%. Some businesses will be higher, and some will be lower.

Such a number doesn't bespeak rapid job creation, and this morning's Employment Situation report reflected that. In so many ways, this morning's labor announcement was a clear snapshot of the US economy: it ain't hemorrhaging no more, but it ain't ready to run no road race neither. Consider this: labor underutilization is at an extremely high 16.8%, actually ticking up 0.3% from January. This is slightly better than it was in October, but still worrisome...particularly due to the uptick in February. Apologists will point to the inclement weather we had during last month; however, most of this data is seasonally adjusted, which will account for some of the weather disruptions. Regardless, it is what it is....very high. You can liken it to saying: "Well, my team lost by 7 touchdowns, but we didn't have our best player." One, it is doubtful whether one player can make up such a differential. Two, you still got shellacked.

Even so, don't be surprised if we see a spate of merger & acquisition activity. Some will take this as a sign the economy and business confidence is improving. Even so, it might give the markets a decent little base. Were it so easy. Currently, by some estimates, corporate America is sitting on a mountain of cash....approximately \$1.2 trillion. What people like me want to see is corporations spending this money on what you might call 'organic expansion.' This would require greater expenditure of equipment, software, real estate, and, perhaps most important, employees. You can think of it as a firm looking to move into other markets. What happens when Company X buys Company Y?

The purpose behind acquisitions is largely to create wealth by what analysts call synergies. More often than not, synergies are cost cuts by shuttering redundant operations and personnel. The larger company might be more efficient on paper, but it takes a fair amount of investment and jobs offline. Then there is what will likely happen in the tech sector this year...if this week's Novell deal is any indication of what is about to happen.

Consider this: at the end of 2009, Google had \$10.2 billion in cash on hand, and an additional \$14.3 billion in marketable securities. This compares to \$8.7 billion and \$7.2 billion, respectively, at the end of 2008. While this is a dramatic example, it seems as though many larger tech companies have added a lot of cash to the balance over the last 12 months. MSFT seems to have done so, as has IBM and INTC. In a different sector, GE increased its cash from \$48.2 billion at the end of 2008 to \$72.3 billion at the end of last year. Marketable securities climbed from \$41.4 billion to \$51.9 billion. Yea, corporate America is socking it away.

Now, what does it say when a company decides to spend money on taking out the competition or simply buying a product line? While many would argue tooth & nail with me on this, I think it means 'they want to do something, and this was easier than having to do the work themselves.' As such, to me, it doesn't necessarily mean corporate America is overly bullish as much as the IRR on some of these projects was worth more than the 1% they were making in cash. Throw in some shuttered capacity and lost jobs, and perhaps the net result to the economy isn't as great as it would seem.

Perhaps that is finding some dark clouds in silver linings, but I get concerned sometimes when I see M&A activity, as internally I feel as though it is a way to grow without having to do the hard work. Sometimes it is justified, and sometimes it is simply the path of least resistance. However, in my personal career, I have yet to see a merger or an acquisition which led to greater employment....that ain't the point. Suffice it to say, I would much rather see GE with its umpteen billions say: "We are exploring a brand new industry, and are willing to invest \$10 billion cash to make it work," as opposed to, "We kind of wanted to go into this industry, so we decided to take out X."

Now, obviously, M&A activity can be quite good for the economy at times, as it promotes efficiencies. At this juncture, I am more concerned cash rich companies will be doing M&A for some of the wrong reasons. Besides, with corporate America 'on pause' when it comes to hiring, I am not sure how many companies we can 'take out' without their being a negative impact on things.

Sometimes I am guilty of thinking too much, but this week had me doing mental flips. In the end, I kept coming back to tepid economic growth and hoping corporate America does something more productive with its war chest than simply eliminating the competition. We need new players with new ideas, not fewer with the same. Does that make sense?

Tables & Data Points

<u>STOCKS</u>	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/07	13,264.82	1,468.36	2,652.28	766.03	15,307.78	4,399.75
12/31/08	8,776.39	903.25	1,577.03	499.45	8,859.56	2,447.62
12/31/09	10,428.05	1,115.10	2,269.15	625.39	10,546.44	2,964.96
2/04/10	10,002.18	1,063.11	2,125.43	589.68	10,355.98	2,707.45
2/11/10	10,144.19	1,078.47	2,177.41	605.46	9,963.99	2,680.25
2/18/10	10,392.90	1,106.75	2,241.71	629.32	10,335.69	2,778.30
2/25/10	10,321.03	1,102.94	2,234.22	630.46	10,101.96	2,684.42
3/4/10	10,444.14	1,122.97	2,292.31	652.47	10,145.72	2,816.10

<u>BONDS</u>	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/07	3.36	3.49	3.05	3.44	4.03	4.45
12/31/08	0.08	0.26	0.77	1.55	2.21	2.68
12/31/09	0.05	0.19	1.14	2.68	3.84	4.64
2/04/10	0.09	0.15	0.81	2.30	3.61	4.55
2/11/10	0.10	0.18	0.87	2.37	3.72	4.67
2/18/10	0.11	0.20	0.93	2.47	3.80	4.73
2/25/10	0.12	0.18	0.82	2.33	3.63	4.58
3/4/10	0.14	0.19	0.86	2.27	3.60	4.56

<u>OTHER</u>	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/07	7.25	4.25	4.70	838.00	95.98	1.458	111.79	1.983	0.991
12/31/08	4.00	0.25	1.43	884.30	44.60	1.396	90.72	1.460	1.222
12/31/09	3.25	0.25	0.24	1,096.20	79.36	1.433	93.14	1.615	1.046
2/04/10	3.25	0.25	0.22	1,062.40	73.14	1.376	89.110	1.579	1.073
2/11/10	3.25	0.25	0.22	1,094.20	75.28	1.368	89.790	1.568	1.051
2/18/10	3.25	0.25	0.26	1,118.00	79.06	1.359	91.290	1.560	1.044
2/25/10	3.25	0.25	0.24	1,108.50	78.17	1.352	88.930	1.524	1.065
3/4/10	3.25	0.25	0.23	1,133.10	80.21	1.358	89.110	1.504	1.031

Important Economic Releases

Release	Survey	Actual	Prior	Comments
Personal Income (Jan)	0.4%	0.1%	0.3%	Ran out of time on Friday afternoon to complete the comments section.
ISM Manufacturing (Feb)	57.9	56.5	58.4	Ran out of time on Friday afternoon to complete the comments section.
Construction Spending (Jan)	-0.6%	-0.6%	-1.2%	Ran out of time on Friday afternoon to complete the comments section.
Total Vehicle Sales (Feb)	10.40M	10.36M	10.82M	Ran out of time on Friday afternoon to complete the comments section.
ISM Non-Manufacturing (Feb)	51.0	53.0	50.5	Ran out of time on Friday afternoon to complete the comments section.
Initial Jobless Claims	470K	469K	498K	Ran out of time on Friday afternoon to complete the comments section.
Factory Orders (Jan)	1.8%	1.7%	1.5%	Ran out of time on Friday afternoon to complete the comments section.
Change in Nonfarm Payrolls (Feb)	-68K	-36K	-26K	Ran out of time on Friday afternoon to complete the comments section.
Unemployment Rate (Feb)	9.8%	9.7%	9.7%	Ran out of time on Friday afternoon to complete the comments section.

Bringing It Home

Behind an oak tree on the side of my house, there is a pile of sticks, a relatively sizable one at that. I put it there, and I am not afraid to admit it. If you drive past my house going 40+ mph, as most people do on my 25 mph street, you probably couldn't notice it. But if you were to walk past the yard or drive the speed limit, you might just be able to make it out. Throw said pile on a flowing body of water, and it would look as though an adolescent beaver was trying to cobble together some sort of groovy bachelor pad or something. I wouldn't necessarily call it a complete eyesore, but it also isn't desirable as a permanent part of the landscaping.

The reason for the pile is pretty simple. I have a fair number of trees in the front yard, some of them not quite as full of life as they once were. In truth, at least two of them need to come down. I also have something called a chiminea on my patio. According to Wikipedia, this is a: "freestanding front-loading [fireplace](#) or oven with a bulbous body and usually a vertical smoke vent or chimney."

When you add somewhat dead trees and chimineas, what do you get? That is right, a constant supply of fuel for your outside portable fireplace. As such things are fun, on temperate autumn and winter evenings, being the bright fellow I am, I figured I would simply stack up the yard detritus in a convenient place for when Beth and I wished to retire to the back patio.

Unfortunately, the fall was incredibly wet down here, and the winter, regardless of what Al Gore might say, was and has been unseasonably cold. Okay, it hasn't been Minnesota cold, but it has been too cold for Southerners to enjoy a glass of red wine outside...chiminea or no chiminea. In so many words, the weather hasn't been exactly accommodating when it comes to burning stuff in my Mexican made clay thingamajig. Pity that...so what do I have? A bunch of dead sticks in a pile behind an oak tree on the side of the house...roughly the same amount as there were in October.

Now, last night, the children got on the topic of allowances again. This is tiresome, as they typically fail to follow through on their myriad promises. No workee—no payee; that is my motto around the house. Still, I guess the time has come to relent, and allow the kids to earn some money. As John, or was it Annie, said: "I want to do chores so you all can pay me and I can be rich!" Lost in their dreams of untold wealth was a very basic question: "If they doesn't consider US rich, how can they be rich by taking money from US?" It is the old robbing Peter to pay Paul routine. But as our house is socialist, if not communist, in its actual operation (the kids don't produce but we still provide for them), Beth and I agreed it would be good for them to make a little money of their own. As I alluded, we have agreed on this on a number of occasions, and the kids don't seem to follow through. But what does this all have to do with sticks and chimineas and fire..fire..fire? *Thank you Bevis.* The answer was what went down this morning.

Apparently, said stick pile has been bothering Beth, or perhaps it bothers her now the house has a fresh coat of paint. I am not sure which, but I am certain she wants them darn sticks out of here. So, here was here deal to the kids this morning:

"I will pay you guys \$5, \$2.50 each, to carry those sticks down to the mailbox (where our yard clean up goes)."

Frankly, this is probably a pretty fair wage for said task. While not an insignificant pile of sticks, it would require several trips each back and forth across the yard. If anything, it might verge on a little pricey. Me? I would have been willing to pay \$4, but, that is just me....The Man, the Capitalist, the Imperialist Pig, the Exploiter of the Proletariat. I try to squeeze every last dime out of my kids, although I know darn well they ain't got two nickels to rub together. Hey, that is how I roll. Still, there was pause...a somewhat pregnant one in the hallway.

"I don't want to do it," said John, "it isn't enough money. Mom, that is a big pile of sticks...that would take a lot of time."

"If John doesn't want to do it, can I do the whole thing for \$5? I will only do it for \$5."

Okay, okay, I know they sound like brats, but, you know, it is what it is. They assign too much value to their labor, whether it is my fault or not. It is almost irrelevant. It seems the going rate to get them to do meaningful yard work is \$5. Hmm. Clearly, I haven't given them the old 'roof over your head and clothes on your back and food on your plate' speech I got umpteen times when I was a child. Gosh that was fun...good times and great speech, classic stuff. So, I imagine, if you are to drive past my house trying to find a pile of sticks on Saturday afternoon, you might just see a 41-year old banker type hauling them to the mailbox.... for free.

As a result, whether the kids realize it, the going price for the next chore in the yard just got cut to \$2 each. Sound familiar to anyone?

Disclosure

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