



OAKWORTH
CAPITAL BANK

COMMON CENTS

For Father's Day, the family gave me a book I wanted entitled Dark Star Safari by Paul Theroux. It is a narrative of the author's trek from Cairo to Cape Town via truck, train, bus, minivan, car, ferry, and even dugout canoe. In his twenties, he had been a member of the Peace Corps in Malawi soon after that country's independence; he spent another four years in Uganda as a professor at a university. Now, fast approaching his 60th birthday, Theroux observes his old stomping grounds with a fresh set of eyes, mature eyes.

What had changed? Was life better? Had any of the hope of the years after the colonial masters left survived? He knew things were going to be different, but how much different? Was it really as bad as he feared, as he had read and heard? If so, what was the cause? What went wrong?

Theroux is an interesting cat. He can be acerbic, very, and you could best describe him as an extroverted misanthrope; however, that would be an oxymoron. Regardless, he is incredibly observant, and very forthright. This engenders amazingly entertaining and vivid reading, and I have put down the book on numerous occasions to Google some place or person in Mozambique or Tanzania or elsewhere. This helps to make the colors in my head more vibrant, and the din a little more cacophonous. It makes it real; I can see it and hear it all.

As for Africa today compared to his idealistic youth? Well, in so many words, Theroux thinks it is a dump. It might be a lovable dump, but he despairs at the ruin and disrepair. His former home in Malawi is now a shell. The books at the village school in Malawi? Stolen. The smart Indian-run shops throughout east Africa? Empty, with the original signs still out front. The railway stations and rolling stock? Haven't been touched since he left 35 years ago, held together by rust. It goes on and on and on. Everywhere, things seem worse than they were in the 1960s, in so many ways.

His reasons for the demise? It is pretty simply really; well-intentioned international aid and charities/NGOs, and the corrupt politicians who prey on it and them. Government to government aid never gets to the people, as bureaucrats at all levels take their cut and siphon it out of the country, or spend it lavishly on foreign made goods. The charitable organizations? Well, they have basically institutionalized the Africans' need for them.

When there is famine or a poor harvest, the NGOs are there with food. This prevents the African farmer from making the necessary decisions: should I move to where the climate is more conducive for growing crops? How can I be more productive? Further, if foreign charities swoop in to build new hospitals, schools and roads when the old ones fall into disrepair, what is the incentive to maintain to old ones?

In so many ways, Theroux makes the argument international aid has been giving Africa fish, as opposed to teaching Africans to fish. It has been this way for decades, and now the various aid organizations and programs have become entrenched into African society. Why should government officials change what they are doing when foreign donors keep them personally in clover, and charities feed, clothe, and educate the population? As a result, the basic structure of many of these countries the author visits are based on hand outs, as opposed to what might be called a hand up. SO, Africans are behaving quite rationally to the situation. Do nothing, or work like crazy to get only a few pen-

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If we take the route of the permanent handout, the American character will itself be impoverished.

Richard M. Nixon

Something to Think About, *cont.*

nies more? You be the judge.

Now, Africa is a large continent, and difficult to stereotype. After all, South Africa is a modern country, with a modern economy and infrastructure. Northern Africa is mostly Arab, and bears absolutely no resemblance to sub-Saharan Africa. The folks in Zanzibar and Cape Verde have completely different cultures than those in, say, Botswana. Basically, trying to paint Africa with a broad brush is akin to doing the same thing with Asia. Are Asians Turks, Russians, Chinese, Indians, Arabs, Israelis, Persians, or Polynesians?

Still, everywhere he goes in Africa, Theroux observes people behaving rationally to their situation, even if their arguments for behaving in such a manner are irrational...if that makes sense. Why work when you can beg? Why beg if the aid organizations are passing out alms? Why do anything at all when the rules and the rulers are capricious? Underscoring all of this are two common threads: a sense of entitlement to some degree coupled with fatalism, and an extremely short time horizon. Hmm.

Here in the United States, I would argue we face these same issues, these common threads, though in different degrees. We have developed a certain dependence on handouts, of some fashion, and we have an incredibly short time horizon. In the past, Americans would scoff at Communist countries' "Five Year Plans," as incredibly short-sighted. How can you transform your economy in five short years? However, I wonder if anyone in contemporary America thinks out that far. While the old interview question is "where do you see yourself in five years," can anyone really answer that?

However, the real issue is the prevailing notion the government has to do something about our problems. We expect to fill the holes in our personal lives; to pay the bills we when can't do so ourselves; to help us maintain a standard of living higher than our level of productivity would suggest possible; to provide medical care, and to basically address any fundamental issue, or insignificant one, in our lives and our economy.

GM and Chrysler in trouble? Well, lets scrap existing bankruptcy law, give the shaft to creditors, and turn the company over to the unions and the government. Lets bail out insignificant banks who don't factor in the money supply. Lets extend unemployment benefits out to a couple of years. Lets stimulate the economy by ballooning our deficit; never mind no one really knows where the money is going, as long as it is going somewhere. Lets expand entitlements programs to cover a variety of issues never intended by the original drafters of the legislation, let alone the founding fathers. Lets subsidize sugar producers. I think you get the picture; the list goes on and on and on.

Our government has become so invasive in our economy and society, we expect it to do the work of the private sector. We expect it to do all the things we should be doing. We sit back and wait because the government will eventually have to do something about it. How many times have you heard something along the lines of: there ought to be a law; or, what is the government going to do about it?

Budgetary issues? Well, we can't really address those because that means we would have to start cutting Social Security, Medicare, Medicaid, the military, and other social welfare programs. But what about the \$600 billion in cuts and the fiscal cliff at the end of this year? The way the budgetary process in Washington works is the Congress will try to cut \$600 billion from the estimated accumulated deficit over the next decade, and can do that in a variety of ways: 1) increase tax receipt expectations, or; 2) imply a higher rate of GDP growth, or; 3) monkey with the Consumer Price Index to keep a lid on inflation-adjusted COLAs, or; 4) simply back-end load the decrease in the accumulated deficit, and hope the economy gains some momentum between now and then.

However, no one is seriously talking about getting our fiscal house in order, or trying to live within our means. Further, no one really wants to pay additional taxes in order to increase government receipts. After all, everyone already pays more than they should for what they receive, right? Hey, if the government were a really good value, NO ONE would mind paying additional taxes. If it were a good generator of wealth, we would gladly fork over our money, and view it as a good return on our investment. The fact no one wants to raise their own taxes NOR cut the largesse from the government means a couple of things: 1) folks feel entitled to it, and; 2) they are thinking in the short-term. We accept the dysfunction in Washington because it really doesn't cost all that much for the average American. In fact, a huge segment of the population doesn't pay a single dime towards the day to day functioning of our national government, as some 40-45% of tax filers don't pay any INCOME tax.

Something to Think About, *cont.*

This is not a recipe for success, as it creates the potential for a vicious cycle, if it hasn't already. After all, IF close to half of the country doesn't pay any income tax, what is their incentive to elect people who want to trim the fat from the Federal budget? There isn't any, as the Federal government is a great deal for too many people. Since each person over 18 gets to vote, well, I think you can see the problem.

In 2007, the Tax Foundation, and admittedly conservative group, released a study on who pays taxes and who receives government spending. Let me give you the following paragraphs from page 32:

In the aggregate, households in the top two income quintiles pay roughly \$1.031 trillion more in total taxes than they receive in government spending. In contrast, households in the bottom three quintiles receive roughly \$1.527 trillion more in government spending than they pay in total taxes. The difference between the two figures of approximately \$496 billion represents the amount that federal, state and local government spending exceeded tax revenues in Calendar Year 2004. Depending on what assumption is made about which households receive the most non-tax-revenue-financed government spending, between roughly \$1.031 trillion and \$1.527 trillion of fiscal resources were redistributed downward from the two highest-income quintiles to the three lowest-income quintiles through federal, state and local tax and spending policy in 2004.

For every dollar of tax burden, households in the bottom three quintiles receive more than one dollar of government spending, while households in the two top quintiles receive less than one dollar. Overall, households in the bottom quintile receive \$8.21 in government spending for every dollar of tax, while households in the third quintile receive \$1.30, and households in the top quintile receive \$0.41.

Lets think about this for a second, and assume the data is accurate. I don't have any reason to believe it isn't, but, you know, people have agendas and all that. But isn't that amazing? The top two income quintiles in the United States, the top 40%, ran a \$1.031 trillion surplus for the government once all the taxes were collected and costs allocated. On the flipside, the bottom 3 quintiles, the bottom 60%, ran a \$1.527 trillion deficit that year. Perhaps not so coincidentally, the \$496 billion differential between the surplus the top 40% ran and the deficit the bottom 60% ran was approximate to the overall level of deficit public spending that year.

What's more, according to the study, folks in the bottom 20% receive an astonishing \$8.31 for every \$1 they pay in tax once everything is allocated; the folks in the next quintile receive \$2.51, and the income earners in the middle 20% get \$1.30...for every dollar they spend. Conversely, people in the second income quintile receive \$0.77 for each dollar in tax, and the top 20% get back only \$0.41.

As a result, you could very easily argue it is NOT in the majority's best interest to do anything about the burgeoning Federal budget deficit. Since Social Security, Medicaid, Medicare, "income security," and debt service alone, and combined, make up 65% of the entire budget AND the military makes up another 20%, hmm, where is the fat to be trimmed? Fat? There is no fat in this scenario; there are no spending problems, only revenue issues, and the only viable solution is to tax the top 40% more....at least to the majority of the voting public. After all, the only other option would be to tax the bottom 60% more AND cut the amount of money it gets from the government.

Who would vote for that? So, almost by definition, the US economy and society, in aggregate, as reflected by the majority, is dependent on government for its well being. After all, where else can you get that type of return on your money? Certainly not in the stock market. Nope; so government is the best investment for too many people in this country; they are too reliant on it, which means they will do what they can to keep things the way they are....even if maintain the status quo is potentially ruinous for everyone.

This is a combination of self-preservation and short-sightedness based on what amounts to be a handout.

The obvious comeback is: "Norris, that is kind of old data." Hey, I can't disagree with that; however, I would counter the numbers are certainly even more skewed now due to the increase in entitlements, and the reduction in the payroll tax we have seen in recent years. As a result of these, you could argue the bottom 60% is undoubtedly receiving even more from the government while contributing less. There is no need for change!

However, the economic data suggests we aren't hitting on all cylinders, and haven't for some time. It seems, despite the

Something to Think About, *cont.*

Keynesians' best arguments, our economy does more poorly the greater our deficit as a percentage of GDP. Oh, wait a second, what is the cause and what is the effect? Well, that is valid; however, what I can tell you is as the deficit was shrinking the 1990s, the US economy was more vibrant and strong than it has been since 2000, as the deficit has been exploding. IF deficit spending were truly the panacea for poor economic growth, we would never have had a recession because the government had been goosing the economy for years leading up to it.

Consider this: in 1970, US Gross Domestic Product (GDP) as a % of Global GDP was 36.1%. The US Treasury's public debt was \$389.2 billion, which was 37.5% of US GDP. 20 years later, in 1990, US GDP as a % of Global GDP was 26.6%; the public debt was \$3,233.3 billion, which was 55.7% of US GDP. Finally, in 2010, US GDP as a % of Global GDP was only 23.0%; the public debt had mushroomed to \$14,025.2 billion, which was a whopping 96.5% of US GDP.

As such, you can make a coherent argument our relative economic output has dropped considerably as our indebtedness has increased over the last 40 years. Yes, we still have an enviable standard of living; however, the numbers suggest we grow at a slower relative rate the more we borrow. You borrow money when you are in a deficit, and you are in deficit when you spend more than you make. The more the government spends, the more we rely on it, being creatures of habit and rational individuals.

Therefore, you can come to the conclusion our relative economic output decreases the more the government spends, and, again, the more the government spends, the more we rely on it. Taking this argument to the obvious final conclusion: the more we rely on the government, the weaker our economic output relative to the remainder of the world.

Sure, a lot has happened over the last 40 years, and the US was starting from a large economic base. Communism fell, which unleashed a huge number of people onto the global economy; meaning US GDP as a % of Global GDP was bound to fall anyhow. However, were the rubber meets the road, and I have done the math, there is a negative .55 correlation between US GDP as a % of Global GDP and the growth in the public debt.

Put another way, the more our accumulated deficit increases, the weaker our relative economic performance becomes. As such, it defies long-term logic to allow this to continue. Had our % of global output only to 30% from 36.1%, our GDP would have be \$4,450.6 billion higher than it was at the end of 2010. If you assume a population of 300 million, that works out to be an additional \$14,835.33 per person.

Why have we allowed this to happen? Well, clearly we have a very short time horizon, no more than the next election cycle. Further, human beings are rational, particularly when it comes to their self-interest. As such, NO ONE wants to see the spigot cut off for THEM, even if they care about the deficit. The average American is far, far more concerned with maintaining their status quo than they are the living standards of their descendents.

That isn't any different from many of the countries in Africa which Theroux visited. It was far easier for Africans to wait for a charitable handout than it was for them to maintain their infrastructure and make hard choices about their future. Why? They didn't have a vested interest in making things work. If a handout is all you know, it is all you expect. If it is all you expect, it is all you will ever hope for. As a result, Theroux would argue the more we give many of these African countries in terms of aid, the more we reduce their reliance on themselves, and that stifles economic activity and wealth generation.

Across the ocean, in the United States, therefore, I would argue the more we rely on the government, the less we expect of ourselves. The less we expect of ourselves, the more we shackle our economic growth. If this is indeed true, the presence of a massive, constantly growing long-term deficit is proof of an economy which has become increasingly reliant on handouts, which is anathema to vibrancy.

Basically, in Africa, as in the United States, handouts are the fiscal equivalent of giving the workforce fish, as opposed to teaching them to fish. Does that make sense?

So, in the end, allowing our deficit to continue to spiral out of control will continue to dampen our relative economic output. The only way to stop this is to develop a long-term time horizon, and expect more out of OURSELVES and less out of our politicians. Basically, we need to say a collective ENOUGH, even if it is seemingly against our immediate best interests, and start focusing on the future. Let's get after it.

Important Economic Releases

Release	Survey	Actual	Prior	Comments
Housing Starts (May)	722K	708k	744k	<p>A little railroad engine was employed about a station yard for such work as it was built for, pulling a few cars on and off the switches. One morning it was waiting for the next call when a long train of freight-cars asked a large engine in the roundhouse to take it over the hill. "I can't; that is too much a pull for me," said the great engine built for hard work. Then the train asked another engine, and another, only to hear excuses and be refused. In desperation, the train asked the little switch engine to draw it up the grade and down on the other side. "I think I can," puffed the little locomotive, and put itself in front of the great heavy train. As it went on the little engine kept bravely puffing faster and faster, "I think I can, I think I can, I think I can."</p> <p>As it neared the top of the grade, which had so discouraged the larger engines, it went more slowly. However, it still kept saying, "I—think—I—can, I—think—I—can." It reached the top by drawing on bravery and then went on down the grade, congratulating itself by saying, "I thought I could, I thought I could."</p>
FOMC Rate Decision	0.25%	0.25%	0.25%	
Initial Jobless Claims	383k	387k	389k	
Philadelphia Fed (June)	0.0	-16.6	-5.8	
Existing Homes Sales (May)	4.57M	4.55M	4.62M	
Leading Indicators (May)	0.1%	0.3%	-0.1%	

Tables & Data Points

STOCKS	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/10	11,577.51	1,257.64	2,652.87	783.65	10,228.92	2,792.82
12/31/11	12,217.56	1,257.60	2,605.15	740.92	8,455.35	2,216.55
5/31/12	12,393.45	1,310.33	2,827.34	761.82	8,542.73	2,118.94
6/7/12	12,460.96	1,314.99	2,831.02	760.34	8,639.72	2,143.08
6/14/12	12,651.91	1,329.10	2,836.33	762.34	8,568.89	2,148.21
6/21/12	12,573.57	1,325.51	2,859.09	764.83	8,824.07	2,199.42

BONDS	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/10	0.13	0.19	0.60	2.01	3.30	4.34
12/31/11	0.01	0.06	0.24	0.83	1.88	2.90
5/31/12	0.07	0.12	0.26	0.66	1.56	2.64
6/7/12	0.08	0.13	0.27	0.71	1.64	2.74
6/14/12	0.10	0.15	0.30	0.74	1.64	2.74
6/14/12	0.08	0.15	0.30	0.72	1.62	2.69

OTHER	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/10	3.25	0.25	0.30	1,421.40	91.38	1.337	81.19	1.559	0.994
12/31/11	3.25	0.25	0.58	1,566.80	98.83	1.296	76.99	1.551	1.017
5/31/12	3.25	0.25	0.47	1,562.60	86.53	1.237	78.31	1.541	1.033
6/7/12	3.25	0.25	0.47	1,586.60	84.82	1.256	79.63	1.553	1.028
6/14/12	3.25	0.25	0.47	1,618.40	83.91	1.263	79.35	1.556	1.023
6/14/12	3.25	0.25	0.47	1,564.50	78.20	1.254	80.28	1.559	1.030

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