



STILL ON TRACK.

In the past year, equity values have soared and a wide array of economic data has turned upward while pessimism is still rampant. If one looks hard enough, one can find many excuses to believe the worst is not over. The two largest issues that keep our focus are jobs and government policy.

There is nothing good about a 10% unemployment rate. While the profit of companies improve through slashing employees eventually an increase in revenues are needed to grow. As the company grows, hiring employees will follow. Once you see improvement in unemployment rates, the companies have already begun their growth and their stock prices have already moved higher.

In our view, the health care bills being discussed in Congress would undermine the dynamism of the U.S. economy and hurt health care. Our economy is based on capitalism and the notion that success is rewarded with an increase in the quality of one's life. If this ceases to be true, then our economy will suffer. If success is met with huge tax burdens or healthy people are unfairly penalized, where is the incentive to be healthy, wealthy, and wise? In their desire to "change" America, many politicians want the U.S. to look more like France, a non dynamic economy that has not given the world innovation since champagne was created.

But none of this will derail the V-shaped recovery. Nor are they a good reason to run for the hills, with your gold, guns and canned goods. It is times like these when it's important for politically conservative investors not to let their view of the way things ought to be cloud their view of what investment returns are going to be. The equity markets have no political or social conscious, thank goodness!

In a certain way, the U.S. is about to find out what the 1980s economy would have been like without the tax cuts enacted by President Reagan. The last time the jobless rate spiked to 10%+ was in the brutal recessions of 1981-82. If high unemployment is a reason not to invest today, it was an even bigger reason not to invest back then. But doing so - remaining pessimistic because of high unemployment - meant you missed out on at least a part of the bull market.

Back in the early 1980s, President Reagan cut marginal tax rates across the board and, at least for a few years, restrained the growth of government social spending. Now we have similar 10% unemployment and public policy is moving in the exact opposite direction, with higher taxes and bigger government.

^[1] But the recovery in 1983-84 was enormously powerful, with real GDP growing at a 6.6% annual rate. We are not going to experience such rapid growth. Instead, we're more likely to get about 4.5% over the next couple of years. So the shift in policy will have an impact, but it doesn't mean a recovery won't take hold at all. It also doesn't mean stocks that are undervalued relative to profits won't keep heading toward fair value.

If you're looking for the effect on the economy of the shift in policy, look in the long term. During every recovery in the 1970s, the unemployment rate fell, but its low point was higher than in the previous recovery. This is happening again now. The unemployment rate fell to 3.9% in 1999, but just to 4.4% in 2007. Given the growth in government we have already seen, we'll be lucky to see 6% during the current recovery.

That's the price we will pay: not continued unemployment at 10% for as far as the eye can see, but good times ahead that never get quite as good as they ought to be. We don't expect clear sailing forever, but the seas look calm enough to enjoy for the time being.

As always, thanks for your trust.