THE PARLIMENT PAGES

July 1, 2010

THE DATE – JULY 1, 2008

Let's go back two years. At that time, under the leadership of President George W. Bush, the United States was accumulating the largest budget deficit in history. It was estimated to be somewhere north of $300 billion for that fiscal year. Many economists were stating that this was sure to cause dollar devaluation, inflation and increasing interest rates.

Now let's pretend that a psychic appeared and told you that Barack Obama would be elected President and would immediately crank the budget deficit up to $1.5 TRILLION for the next 3 years, and would publicly admit that there was no chance for the annual deficit to fall below $1 TRILLION for at least the next 10 years. Suppose you would learn of the sorry state of the virtual bankruptcy of Social Security, Medicare and the new Health Care reform costs. You, along with every economist in the country would have all lined up on the same side of the ledger. There would be absolutely no doubt that the dollar would crash, interest rates would sky rocket and we would be facing unprecedented levels of inflation.

And yet, here we are in that exact scenario. The dollar is stronger today than it was 2 years ago, interest rates are still just above zero, and there is no imminent sight of any inflation. It defies all reason. That is precisely why it has become so difficult to predict and anticipate the future. All of the history we have studied, all of the economics classes we have sat through, and the formulas learned, all of the common sense that we have accumulated over the years, just doesn't seem to work anymore.

Why is this? I am reminded of a conversation many years ago with a frustrated sales manager lamenting on the sorry state of his sales force. He could not believe the low level of competence amongst his group. Surprised, I said to him that they couldn't be that bad because they were leading the industry, gaining market share, and firmly establishing themselves as the key players in their market segment. He replied, "It's not that they are any good, it's that they are better than the sorry lot of competitors." That, my friends, describes the United States of America right now.

Most of us distinctly remember the tragic days following the 9/11 attacks. The country was emotionally distraught, angry and very frightened. And yet despite this cataclysmic event, retail sales in this country hardly blipped at all. If you look at a 5 year chart of retail sales covering that period, you would be hard pressed to identify the date of the attack. I heard an economist describe it simply as, "Our economy is so big that there are very few events that can bring it down. It has a life of its own that operates, to a great extent, independent of the political leadership of this country. We are like a battleship being rammed by an inflatable boat."

We still are that battleship. I believe we are pretty rusty, the engines are getting old, and the captain at the helm is lost. However, we are still the biggest ship afloat, and until something else comes along, we will continue to rule the seas. Right now, over 60% of all nations' foreign reserves are held in US Dollars. China, alone, has over $3 trillion. It is in no one's interest to see the dollar lose value and the economy of the United States fail. In order for the dollar to crash there has to be an alternative. As the Euro is still thrashing its way downward, there just is not another alternative to the dollar.

As leaky and decrepit as our ship may be, it will probably continue to stay afloat. And until another ship is seen on the horizon, the world will want seats on our ship.

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THE KEY INDICATOR OF OUR STRENGTH –

In order to fund our huge national budgetary deficits, we, as a country, must sell bonds to cover those deficits. Periodically, those bonds are put onto the international auction block. Some are bought by individuals and institutions, preferring the "security" of US Bonds over the stock market. The rest are bought by foreign investors and foreign central banks that have currency available and are looking for a safe place to put it. Both of these are presently working in our favor. With money market interest rates low and a questionable stock market, US bonds are a safe alternative to the many money managers around this country. Outside our borders, money managers really don't see an alternative. There is no stronger currency than the US Dollar. It truly is the best of a sorry lot.

I think these periodic auctions will be one of the best indicators of the future of our economy. When the foreign investors decide to slow down or even stop buying the US Bonds, it will be the beginning of a tough and long road for this country. What to look for - first we will see the interest rate on the 10 year bond creep up. That is a great indicator of what the investment world thinks of the long-term security of the dollar as a currency.

But, for now, our battleship continues to sail. Even though it is smoking belching and listing, there is not another ship on the horizon. Let's hope we can somehow keep this thing afloat.

INTEREST RATES, INFLATION, GAS PRICES –

Simply put, they will all probably stay low. There is no visible sign of much in the way of interest increases, and there won't be until either the foreign investors disappear from the bond market or sure signs of inflation appear and the Federal Reserve has to intervene. So, let's count on mortgage rates continuing along about where they are for at least the rest of the year. Forget inflation for the time being. There is no talk of that and, in fact, there is considerable talk of deflation.

Gas prices are so dependent on economic activity that there will be no material change in prices at the pump until some change in the overall economy takes place. A double-dip recession will probably lead to lower prices and a higher than projected economic growth will quickly drive gas prices up.

THE LATEST ON HOUSING –

Straight off the press is the depressing, but expected news that housing starts have fallen to the lowest level in recorded history. Housing starts have been manipulated by the government. On again, off again incentives and on again, off again mortgage approvals have put the housing market on a government designed roller coaster and out of the realm of free enterprise and capitalism. This has caused a herky-jerky fix to the industry. I think the evidence is that the incentives really didn't do much other than move sales around from one period to another, while costing the taxpayers yet more billions of dollars. Maybe, if Washington will quit messing around, we will get back to a normal growth rate that will be predictable and consistent.

So, absent more DC intervention, we believe we will see a steady rise in starts. The latest inventory statistic shows that there are only 211,000 new homes on the market. This is one of the lowest new home inventory levels ever recorded. We believe the sustainable rate of housing starts in this country is somewhere between 800,000 and 900,000 per year. Compared to the recently released number of 300,000, those numbers would be a breath of fresh air. Hang on and be patient. Barring the unexpected, we will see those numbers over the next couple of years.

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BARRING THE UNEXPECTED?

Despite our cautious optimism, we recognize that there are still some hidden land mines that could upset everything. Unemployment remains stubborn and chronic. Systemic unemployment rates will continue to put headwinds into the economy for years to come. This 3 year downturn has cost this country over 8,000,000 jobs. If we recover at a modest growth rate of 3.8%, it will take over 8 years to gain back just the jobs lost. In fact today, there are 5.5 jobless people for every job opening.

Even though consumer confidence has risen for 3 straight months, retail spending has not followed suit. With 75% of our economy driven by retail spending, it will be impossible to see economic recovery until the consumer starts buying. That rising confidence needs to manifest itself in cash register rings.

The US Government deficit is presently larger than the combined governmental deficits of the entire world. While other nations are preaching spending cutbacks, our government is urging more governmental stimulus. I don't think anyone knows for sure what is right or wrong, but the big question is whether or not the other large economies will support our contrarian view.

A year ago, there was a lot of talk about a double-dip recession. Six months ago that talk had pretty much disappeared. Now, that dreaded term is passing across more lips every day. Our economic recovery can be, under the best circumstances, called fragile. Caution is the word of the day. We could still tip either way, and whichever way it tips would not surprise a lot of people.

CAPACITY REDUCTION –

In the past couple of issues, we have addressed the need for capacity reduction at all levels of the sales chain. True to our predictions, we are seeing everyday signs of that very thing. Manufacturers continue to sell and merge, closing down old operations and consolidating into fewer and more efficient facilities. Distributors continue to cut their offerings and inventory levels, instead, concentrating on fewer and more profitable products. Dealers are likewise joining forces either through friendly mergers, hostile takeovers, or bank directed sales or closures. This is not a bad thing. Until excess capacity is flushed from the chain, profits are difficult to achieve. Keep your eyes open. There will be a substantial and visible increase in this type of activity in the near future.

UNSCRUPULOUS ACTIVITIES –

Our industry has always had its share of unsavory characters. Credit losses, quality issues, misrepresentations, and a slew of others have followed our industry around for years. As times have gotten tougher, some of these characters are in full bloom. Approach your purchasing transactions with a cynical eye. We are faced every day with competitors misrepresenting the quantities, prices and quality or brand of the products being sold. We have had customers weigh and count product and have found incredible discrepancies between what was represented, invoiced and actually delivered. Too often we hear stories of a difference between quoted price and what was actually invoiced. Suppliers will quote products that they don't even have in inventory. Be careful. If the deal is too good to be true, it is too good to be true. Watch your returns and credits and restock fees. Many products are returned and the "credit" never seems to get done. Eventually, it is forgotten. As everyone struggles for every order, ensure that your supplier is not selling back door directly to your customer. Make sure your supplier is a real business partner to you.

INVENTORY MANAGEMENT –

As we travel around the SE United States we are always amazed at the wide spectrum we see between successful dealers and those on the brink of failure. Sometimes it is caused by localized market conditions, but more often it is the difference of good management and leadership.

One of the big differences we see between the good and the bad is the sophistication in inventory management. Consistently, the good managers are aware of their proper inventory level requirements and strictly adhere to those measures. They avoid sales people who will willingly overload their customer's inventory just to make some their quota. In today's market place, just-in-time delivery, proper product selection, and inventory levels are often far more important than the lowest pricing. The most effective leadership we see, recognizes that the greatest profits come from effective selling, not shortsighted purchasing.

PRODUCT PRICING AND AVAILABLITY –

For now, it appears that most product pricing will remain fairly level. The Chinese economy is still purring along and this has caused their internal consumption levels to pretty well match their production capabilities. That has effectively kept a lot of the import products off the market, which has helped the domestic suppliers keep their prices steady. We do not see much of a change in that situation in either direction, assuming the Chinese are able to maintain close to their present growth rate.

On the other hand, there are some factors at work that will make product availability less of a sure thing. As mentioned before, capacity is being reduced. Part of this reduction is a cutback in inventory levels at all points within the sales and distribution chain. This lack of availability is becoming critical in some cases. While we don't see this problem as widespread, keep your eyes open because it will occur, as always, at the worst time.

EMPLOYEE THEFT AND EMBEZILMENT –

We recently heard of a company that discovered a long-term, trusted employee had taken close to $3 million dollars out of the company over a period of several years. It is surprising how often you hear stories about this, especially when you learn that less than 2% of employee theft is reported. Very few of our readers have lived their business careers without experiencing theft by an employee at some level. Forensic experts will tell us that theft is most common when the following takes place:

- The opportunity exists
- The owners role model behaviors seem to condone it
- Employee lifestyle commitments exert pressure to find additional income

Those same experts will say that the biggest factor is the role model position taken by the owner. If the owner is seen taking cash out of the business, paying personal expenses with the company checkbook, or cheating on his taxes, it sends a subtle message to the employees condoning that type of behavior. Most major defalcations will ultimately show an ownership group that participated in much the same type of activity. Don't underestimate the importance of your role model behavior.

Today's economy has put more and more pressure on employees to maximize income. Many of our employees are overextended financially at the same time they are experiencing cutbacks in hours and reductions of base pay and commissions. Don't be oblivious to the lives of employees in your company. An overextended financial situation can lead a good employee to do things that he would have never dreamed of before.

ONE DEPARTING SHOT AT GOVERNMENT IN ACTION –

Most of us have experienced cutbacks in employee's hours and in some cases even pay rates. Those moves have been very difficult but necessary in today's economic environment. When was the last time you heard of a government agency giving pay cuts? Pay attention to this statistic – the average Miami – Dade government employee makes $76,000 per year. The average pay for the private sector is $29,000. Something is inherently wrong with that picture. And we expect this formula to work at reducing health care expenses?