THE PARLIMENT PAGES

October 1, 2010

WILL THE ELECTION SAVE OUR ECONOMY?

As has been so typical over the past few months, the rhetoric concerning the upcoming elections has been all over the place. Many say it will change the direction of the country radically, others say it will slow things down. There are many, who think it will really not have much impact on life as we see it today. I tend to find myself in the first camp, but probably for reasons that many people wouldn't think. I try not to get all hung up on the many differing statistics and analyses that are out there prepared by PhDs, but would rather look at things more simplistically with a large dose of common sense.

As a regular reader of this newsletter, you probably have realized by now that I am a real believer in fundamentals. In fact, our issue at the beginning of the year focused primarily on that very topic. Despite everything that I read and see, I can't get the following fundamental out of my mind: between 70% and 75% of our economy is driven by consumer spending. (That number used to be firmly in the 75%+ range, but with the recent government stimulus, consumer spending is being diminished by the amount of federal spending.)

With that much of our economy resting in individual checkbooks, it only goes to reason that the direction and health of our economy will be driven by personal spending. It seems so simple to me. There are a number of indicators that track consumer spending and none of them have looked favorable for a long, long time. Actual spending has been lukewarm for months and consumer confidence just can't seem to see any kind of a sustained increase. Is this why our economy continues to perform in such a lackluster condition? I think it may be so. As hard as they are trying, the government cannot put enough money into the economy to offset the lack of consumer spending.

IT'S THE CHECKBOOK

So, if you agree so far, let's keep this thought path going. In order to move our economy in a positive direction, we really need to see a substantial increase in consumer spending. Now, I don't know about you, but I seem to spend about everything that I make right now. And, I think that goes for the vast majority of the population out there.

Let's divide our population into the following income demographic strata: low income; middle income; upper middle income; and high income. The low income strata is spending everything that they have just to survive and get their bills paid. True, credit has tightened and many in this group can no longer overspend as they once did. However, the sad truth is that group doesn't really represent a large enough stratum to incrementally make much of a difference in overall consumer spending.

I think much the same can be said for the middle income group. Look around you and you will see most of our population fits this category and again you will find that they have nothing left at the end of the month. In the past, often this group fueled their discretionary spending with overtime hours, high commissions or bonuses that have all but disappeared. As a result, their entire income now goes for non-discretionary spending. They have no ability to make an incremental difference.

The picture changes quite dramatically when we look at the next two tiers; the upper middle and the high income groups. These are the income groups who have some money but have decided not to spend it. This is evidenced by the decreases in consumer confidence, increases in the savings rate, and the amount of new money that continues to flow into investments. These two groups have effectively put their checkbooks, credit cards, and banking friends on the shelf. I know many people in these categories, and I consistently hear them say, "We just are not spending money on anything other than the bare necessities."

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Why is this affluent group not spending? I think the answers are that they are apprehensive, distrustful, uncertain and scared %$%*#& of what is going on in Washington. Whatever their political leaning, they are in no mood to do anything other than accumulating assets rather than spending assets. It also should be noted that these are entrepreneurs, executives and business owners who are daily making business decisions that affect expansion, payroll levels and development. They can't help but take that same emotion to work with them and are keeping the corporate checkbooks closed as well.

NO – IT IS THE ELECTION –

Will the election change this situation? After all, Obama was elected on a platform of change. Is more change what the consumer is looking for? No, I think the consumer, the spender, and the possible resurrector of our economy is probably, in fact, looking for no more change at all. I believe the people who have money in their checkbooks would like nothing more than absolute gridlock in Washington if not a change in the current direction. If that gridlock occurs because of a Republican takeover in the House and possibly the Senate, I think we could start to see a major uptick in consumer sentiment. I think we will hear a collective sigh of relief and find plans being made instead of plans being put on hold. Checkbooks will be opened, products and services will be bought and ultimately people will get hired back into jobs which will then produce more spending. That is the Reagan trickle-down theory.

Remember, the upper middle and upper income groups have the ability to kick start consumer spending by themselves. Also remember, many of these same people are the ones that can also begin the process of business expansion and hiring.

LET'S NOT CRUSH THIS OPPORTUNITY –

With all of this being said, there still lurks on the horizon some storm clouds that could put an end to this rosy scenario. Hopefully by the time you read this, the madness over extending the Bush tax cuts will be resolved and they will be extended in their entirety. If not, and Obama gets his way, the only people in this country who have money to spend will be faced with what will be perceived as class specific asset confiscation. I cannot in my wildest imagination see how taking money from the only people who can jump-start our economy is a wise decision. If Obama is successful in this area, I see nothing but further economic stagnation.

OUR PREDICTION –

If the Republican Party regains control of the House and / or Senate, we believe the fourth quarter will see a substantial increase in consumer confidence followed by a moderate increase in spending. This consumer spending will take at least 2 quarters to maximize the trickle down effect. So we should start to see some significant progress in the housing industry by the beginning of the second quarter of 2011. Now that growth will not be spectacular, but I think there will be a sense of calm, predictability, and confidence that the path will be upwards for some time.

Of course, there always needs to be some type of disclosure, and in this case, I believe that disclosure would come in the way of any type of international economic or political upheaval. There are a lot of fragile situations out there that could literally blow up and wreak this scenario. Keep your eyes on all geo-political and economic hotspots.

CONSOLIDATION AND CAPACITY –

One of our regular subjects for the past year has been the consolidation that is taking place at all levels within our industry. You may recall that we believe the biggest catalyst for this consolidation is the need to reduce capacity. There has been excess capacity all the way throughout the distribution channel starting with manufacturing and ending in construction and the sale of new homes.

Remember fundamentals? The fundamental of capacity is quite simple: market size and number of providers. Right now, in our industry, both of these are moving targets. The overall size of the housing market continues to slide backward. The latest reports show housing starts well below an annualized number of 300,000. Again, let's put this in perspective. At the peak of the boom, housing starts exceeded 2,200,000. I don't think my calculator has numbers that go high enough to calculate that percentage decrease.

There are plenty of signs that the market has stabilized and I have to believe it can't get any lower. (However, I will also remember the stock that I bought for $19.50 that dropped to $1.00. I held on to it because I knew it couldn't go lower. Six months later I finally sold it for a nickel.) However, people are still forming new households, babies are being born everyday and the immigration flood has not slowed. These people require housing and at some time, new construction must begin in earnest. We still believe we will see housing get to the 900,000 start level within the next couple of years. As that happens, the market side of the capacity equation will finally move in our direction. But until that does occur, we will continue to wallow in the market driven side of overcapacity.

The other part of the equation is the number of providers. Quite simply, you cannot have the same number of providers selling in a 300,000 unit market as in a 2.2 million unit market. Sadly this excess must be absorbed by consolidation or business failures.

As we monitor our accounts receivable of over 650 accounts, we have a good view of business survival. In 2007 and the first part of 2008 we saw a fairly large number of businesses fail quickly. We saw a trickle of additional failures through the rest of 08 and the first half of 09. The second half of 09 saw another flood of closures as many businesses finally got to the point where they just couldn't hold on any longer financially or psychologically.

However, in 2010, we have seen incredible stability with very few business failures.

MORE ON CONSOLIDATION –

While we think most businesses that have made it this far can make it to the end, we do believe there will be some failures and those failures will be spectacular and huge. At all levels, we think several national players are on their last legs and won't make it to the end. These failures and closings will be at all levels in our chain from manufacturing to distribution level to the retail wholesale dealer and finally to the builder.

HOW LITTLE IT TAKES TO SURVIVE –

For the past 9 months, I have been on the most successful weight loss campaign of my life. Throughout this process, I have learned something that continues to astound me. Every day as I calculate what I have eaten, I see how little food it really takes to sustain life. No fancy diet, no quirky pills or supplements, just a major reduction in food intake.

I think this same concept will help explain why so many of our customers are doing ok while so many of the big nationals have failed or are on the verge of failure. Most of us are entrepreneurs who can easily remember the days when our business was small and we did it all, from answering the phone, to loading the trucks, to cleaning the bathrooms. That is the life of an entrepreneur. When things got tight we were able to remember those early days and quickly move to adjust our businesses back to that scale. We were therefore able to reduce expenses to the point of making a little money despite the horrendous business conditions surrounding us. Like my diet, we realized how little expense was really necessary to sustain our business.

In addition, most entrepreneurs hate debt. After all, even if it is company debt, it is most often personally guaranteed and hangs over our heads every day of the week. Because of that, entrepreneurs pay cash as often as possible and do everything in their power to continually reduce debt levels.

Now let's contrast this mindset with that of the big corporate managers. The ultimate goal of most big companies is growth and not necessarily long term profits. Promotions, bonuses and opportunities come from growing. Most things in a large corporate type entity are designed around growth. In many cases it is all about driving a stock price up while in others, it might be in the expansion of one's personal power base.

Shrinking the size of a large corporate type entity goes against many of the systems and thought processes within the organization. As a result in a declining business environment, the larger the company, the less nimble they tend to be and the slower they are to react. Decisions have to be filtered through many layers of organization, and individual agendas and security will often trump the right decision. We have seen in just recent weeks the radical acts of downsizing of some national giants. This downsizing should have been done two years ago. You have to ask yourself why it took so long for that decision to make its way to the top and how much damage was done to the company by this delay.

In addition, the large corporate type entities, in contrast to the entrepreneur, love debt. They see debt as a leverage tool that allows them to grow quicker. With a willing bank relationship, it is easy for a company like this to rapidly become so leveraged that it becomes dangerously unstable. Combine this leverage with a falling performance and a nervous banking community and you will see strong clues of a future failure.

While some of our business is with the large guys, both from a manufacturing and a dealer level, we have found over and over that the entrepreneurial owner/operator typically will have the best run businesses. They may not be the most sophisticated or the prettiest, but they do have the advantage of being on the spot and ready to make the quick decisions.

That is why we believe that the strength of our industry still rests in the hands of the entrepreneurial owners.

PRODUCT PRICING –

Watching the pricing of our products is like watching a tide rise and fall - nothing spectacular and nothing really too unpredictable. We have talked all year about gently falling or rising prices and we continue to think that will be the case throughout the remainder of the year.

We do think there will be an increasing presence of imported products. This will result primarily from a slow-down in many of the overseas economies. For example, China is definitely slowing from is torrid pace in the past. Because of this slow down, they will not consume nearly the production that they did a couple of years ago. This excess production is bound to end up in their export column which means that we will see some of it starting to hit our shores. We don't believe the pricing pressures will be significant and accordingly are sticking with our predictions of very modest price fluctuations for the next few months.

REMODEL –

As dismal as the housing statistics are, there is sign of a slight pulse in the remodel sector. With so many people upside down on their home valuation or mortgage, many owners are opting to put money into their existing homes with the knowledge that they will be "stuck" in that home for several years and might as well invest in some improvements. We are continually looking at our product line to see if we need to rebalance to some products that are more in line with that segment. Have you done the same in your inventory and are you promoting your business to the contractor who is specializing in that area? Follow the little bit of money that is being spent!

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