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Investment Banking and Corporate Advisory Services
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December 2008

BUSINESS OUTLOOK – THE BIG PICTURE

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Where Have You Been?

We have had inquiries as to why we have not written anything in more than a year and a half, particularly about the current financial crisis. The simple answer is that there have been too many analyses and commentaries already, including revisionist apologiae by a number of involved parties of interest as to why they are not responsible for what has occurred.

The Big Issues

As noted, our interest is in the major systemic issues that confront the global economy beyond the immediate crisis in the financial sector. Such include, but are not limited to, the following.

1. Chronic Unemployment.

   For quite some time now, it has been clear that "new-age" industries are replacing old-line industries as the growth engines of the future. This economic inflection is accompanied by increasing applications of technology, both mechanical and electronic communications-oriented, which are designed to reduce operating costs by minimizing the direct human component in various production processes. Increasingly, these technological efficiencies will reduce both white collar and production line jobs, not only in the mature, developed nations, but also in the currently lower wage developing countries as they seek to upscale their industrial bases.

   While we appreciate that new job opportunities will occur with the development of new-age industries, the natures of these positions are unlikely to provide mass employment to many mid-level workers displaced by technological innovation in old-line mass-production industries.

   If this long-term unemployment issue is not adequately addressed in a timely manner, it will be an increasing source of friction, if not instability, between societal haves and have-nots.

2. The Realistic Role of Education

   In the absence of industries which can adequately meet the employment needs of displaced workers, politicians have developed a new mantra, which is that education and training is the panacea to solve the unemployment problem. The academic establishment should be wary of such a sweeping expectation, and remember that "capitalism" was the previously designated savior, and the populace has been notably unforgiving that it has not performed as advertised.

   Certainly, while education and training is necessary for those positions that will be available in the near-term future in the new-age industries, the recent painful experience of university graduates is that there is a finite number of employment positions in many disciplines, e.g., an increase in the supply of brain surgeons does not necessarily mean that there is a greater demand for brain surgery by the population.

3. Hybrid Economic Systems.

   Only the most ardent free-market ideologues would not recognize that the near-term direction of both developed and developing economies will be a combination of public sector industrialization policy and private sector capitalism. Such is already fairly well advanced in a number of countries, with the notable exception of the Anglo Saxon capitalist countries.

   As we have noted in the past, there seems to be a closer affiliation of major foreign companies, particularly foreign multinationals, to their countries of origin, than has been the recent case with U.S. multinational corporations. It has been our strong belief that the resolution of the long-term economic development issues in the U.S., including the aforesaid unemployment problem, requires the same kind of governmental / business / labor coalitions that are present in other nations. Unfortunately, many U.S. multinationals have chosen to lower their leadership profiles domestically, as they have vigorously expanded their production facilities in lower-cost foreign locales.

   We have opined that the notable absence of major U.S. multinationals' active presence at the table could mean that future economic policies might be adopted without their input, and to their detriment. Unfortunately, such now seems to be the case with major U.S. companies being designated as straw men for the current economic crisis, and simultaneously coming as supplicants for government financial assistance and labor cooperation in resolving their problems.

   We hope that the new Administration will give business the necessary political cover to get back into the game, and that business will seize the opportunity. Otherwise, a new economic societal model could evolve without adequate recognition of the necessary entrepreneurial incentives for optimal future growth. We need the best thinking and balanced input of all parties of interest; with the example of the politically managed economy of post World War II Italy as the model to be avoided.

4. A New International Reserve Currency. If the recent financial crisis has demonstrated anything, it is that the U.S. is not best served by having the U.S. dollar as both its domestic currency and the reserve currency of the world. If we are, indeed, intending to work more closely with both developed and major developing nations, the concept of a single national currency acting simultaneously as the international reserve currency is seemingly archaic. The exposures to a

single national currency, serving as both the international reserve currency for commodities (the real economy) and the vastly expanded international financial trading markets, are too great a burden for any country that must also be free to conduct its domestic monetary policy for the optimal benefit of its own nation.

It is clear that the U.S. will need future closer coordination between its own domestic fiscal and monetary policies, and being responsible for the resultant effects of such upon other weaker, or developing, nations is an inhibition in administering such. As the world's reserve currency, we note that the U.S. dollar is also the overwhelming currency of choice in regard to innovative, and speculative, new capital markets instruments, such as derivatives, etc., which are traded by international as well as domestic investors. Also, unfortunately, international financial crises ultimately fall hardest upon the banking systems of the countries, the currencies of which are most actively involved in speculative financial transactions.

We don't have any particular preference as to the structuring of a new international trade currency, whether based upon a basket of currencies, a modified gold standard, et al. We simply feel that the time has come for establishment of an international reserve currency to meet the new, and expanding, globalized world economy.

5. <u>The Decline of Monetary Policy</u>

Years ago, we were taught, and still believe, that Federal Reserve monetary policy is intended to be a fine-tuning device, and not a substitute for a lack of prudent fiscal policy. Unfortunately, the politicization of monetary policy, to support hyper-consumerism in the absence of concurrent enlightened fiscal management, has essentially compromised the moral suasion authority of the Fed. A zero-interest-rate policy essentially means that there are no traditional monetary options left in the trick bag. We have pushed monetary policy too far – a fine-tuning device cannot be expected to offset the financial excesses of a fiscal policy that pays out increasingly huge sums, financed by borrowings and monetary expansion, and decreasing tax collections.

The most recent suggestions that the Fed should expand its balance sheet and become a direct lender to the most distressed sectors of the economy, indicates that its original charter is, essentially, no longer effective or operable.

6. <u>The Decline of Fiscal Policy</u>

Fiscal policy is, of course, essentially political in nature, and the province of politically elected executive administrations and legislatures. Political campaigns are increasingly expensive, and candidates know that a platform of higher taxes rarely attracts donor contributions. Accordingly, we have had guns and butter fiscal policies for a number of years, which have fueled the rolling bubble economy that timely and prudent tax policies could have moderated.

Now, the cupboard is bare, and who will pay taxes? Corporate American has tax loss carryforwards that will take years to exhaust, as do individual investors. In addition, economic malaise will result in reduced ordinary income tax receipts from the populace, in general.

With reduced income tax collections, we can all expect new substitute governmental revenue-raising measures such as unfunded corporate mandates, "user" fees, sin and luxury taxes, etc.

Such will not be sufficient, however, to prevent our further reliance on borrowed money and expansion of the monetary base.

Which Means…

When, and whenever, the immediate global financial crisis abates, foreign flight capital will abandon the dollar and seek faster growth, higher return investment opportunities, wherever such may exist. This can only exacerbate the continuing downward trend of the dollar, with commensurate inflationary effects upon the U.S. economy.

The great tightrope act will be how U.S. monetary policy management can successfully sop up the excess monetary liquidity being injected into the economy, in a timely manner, which will prevent future hyperinflation without, at the same time, knocking over a tentatively recovering domestic economy. Such will require considerably greater future statesman-like actions from the same political establishment responsible for our current situation. We leave you to make your own judgments as to the probabilities of success.

Finally, we have often mused that a seeming consequence of enhanced general affluence, in those countries fortunate enough to experience such, is a seeming consequential diminution of one's natural sense of survival. Perhaps good living blunts our sensitivities to threat, or perhaps the required specialization of living in modern society makes us rely too much upon the opinion of other "experts". In any case, we are dismayed at the abnegation of common sense thinking and critical decision making by legislators, regulators, and the general populace, in general.

The financial crisis which we are currently experiencing could have been avoided, or largely mitigated, if the citizenry had been on top of its game. If such had been the case, and we had avoided the excess of substituting a rolling bubble economy to offset a declining real economy, we would be in much better shape now to be undertaking what must be done from this point forward.

Of continuing concern to us is that a large portion of the populace seems to have lost touch with the fact that economics is simply common sense critical decision-making, not some mumbo jumbo science controlled by mechanistic econometric models. This is particularly so in the case of the new globalized economy, wherein no model has yet been produced that can take into effect all of the competing factors at play in determining financial events.

Hopefully, recent occurrences will cause people to become more reliant upon their own basic judgments and instincts as to what is economically viable. You don't need to be a physicist to know that, if you jump out of a third story window, you are more likely to hit the ground, rather than float away unharmed.