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REAL MONEY
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We are blessed as a community and nation with many wonderful gifts. At this time of symbolic renewal, I feel it is important to appreciate the many advantages we have been given as a kind of counterweight to the perception that the future is full of unmanageable risks. When current events seem overwhelmingly out of control, it may be helpful to start 2003 by looking at some positive opportunities that exist alongside some very real dangers.

Confidence in the future is a necessary ingredient for investing. Most people in the world want peace and to accomplish this goal, we need to be willing to share the benefits of our accumulated wealth. The power of technology and the good fortune that has been bestowed upon us as Americans through the rich natural resources of our land gives us good reason to be magnanimous. Our freedom to choose individualized economic paths is one principle on which our country was founded. This ability to choose should generate in us a sense of tolerance for people and systems different from our own. Our nation's ability to maintain its prosperity depends on our ability to remain open to new ideas. The unfolding geopolitical events will require us to have a willingness to experiment with alternative economic structures such as local currency and to create bioregional organizations that promote self-reliance.

Absent a war in the Middle East, the world economy would do quite well in 2003. My forecast is for 2.5% growth in the U.S., little growth in Europe, and feeble, if any, growth for Japan. Japan continues to lack the political will to address its main structural issue: a banking crisis approaching half a trillion dollars!

In response to the threat of war in Iraq and/or Korea, the U.S. dollar has fallen to its lowest level versus the Euro in 3 years. Oil prices have gone above $30 a barrel, which is considered to be the price at which the economy gets hurt. We now see OPEC members offering to increase oil production to help offset turmoil in Venezuela and possible supply disruptions in the Middle East.

Unemployment in the United States is 6%, almost 8% in Europe, and approaching 5.5% in Japan. American businesses and consumers continue to import huge amounts of goods and services from overseas and this has kept the world from falling into a very deep recession. The U.S. will continue to lead the world in business activity in 2003, but not with enough momentum to pull Asia or Europe out of their basically stagnant economic circumstances.

The European Central Bank has started to cut interest rates, though not to as great an extent as we have done here in the U.S. This is because there are countries in Europe with inflation and the variance in growth rates between different countries in the European Union doesn't allow the EU to react as quickly as we can to changing conditions.

Business capital spending is expected to rise 4.5% during the first six months of 2003 and by more than 7% in the second half of the year. This bodes well for technology and telecommunication companies that have been shunned by investors for three years. Governments everywhere are trying to stimulate their economies in whatever way they can but their options are limited. The real issue at hand is confidence, and confidence depends on good news and optimism for the future.

We are all aware of how the winds of war blow chillingly through the news these days. Part of my job as an investment advisor is to try to see what negative scenarios might unfold and to prepare for those as well. If the United States and its allies do not accomplish their military objectives in the Middle East, investors will flee towards gold and Euros. There will also be the increased costs for security and increased likelihood of intermittent incidents of terrorism, all of which will make the cost of doing business higher. This portends a falling level of productivity for large companies. More resources will be required to keep the channels of supply open between the United States and our economic partners and this does not bode well for the securities markets.

War in the Middle East is likely to be greeted initially with optimism by stock traders. It may also provide a short-term boost to the economy and with a stock market overdue for a recovery, a quick military victory by the U.S. would set off a surge in optimistic buying.

In the long run, however, the increased costs of maintaining military dominance may lead to falling price/earnings ratios for stocks, as investors will correctly anticipate slower growth in the future due to higher ongoing costs. This could lead to fairly flat stock prices over the next several years after the first wave of euphoria wears off.

Given the uncertain effect of a war on consumer psychology, especially if either side uses weapons of mass destruction, it is possible that consumer spending could fall dramatically. If people shop less, there will be declining business activity and falling tax receipts. At the same time, we could see government outlays for military spending and security rise. The end result would be inflation and deficit spending. This will be like the 1960s, when the U.S. tried to finance Great Society social programs and the Vietnam War at the same time. Interest rates would eventually rise due to government spending. Investment grade bonds would suffer, and holders of bond mutual funds would be severely hurt. The investments that would do best would be income producing real estate and high dividend paying stocks.

A U.S.-U.K. incursion into Iraq without U.N. auspices will be a financial disaster for the markets because the cost of an incursion, no matter what the outcome, would be borne primarily by U.S. taxpayers. This would negatively impact U.S. equity and bondholders. So, look for last minute posturing on the part of France and Russia. When the dust settles, their oil industries should benefit from a deal that gives them access to Iraqi oil in exchange for supporting U.N. Security Council approval.

The long-term ramifications of a U.S.-U.K. victory may turn out to be Pyrrhic if additional costs to our economy, national psyche, and to our other tenuous alliances around the world end up being high. If a quick, clear and easy victory is won, and an effective exit strategy implemented, the market might come back to its pre-September 11th levels. If the future brings unexpected twists, we will need to hold onto our collective hats. Remember that in times of crisis, cash can be a good investment!

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