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Spring Commentary 2006

The Markets and The Economy

The first three months of 2006 were fairly decent. The major U.S. stock market indexes rose during the first quarter to their highest level since 2001. The Dow Jones Industrial Average rose 3.66% while the broader S&P 500 Index rose 3.73%. The Rikoon Carret U.S. Large Cap stock portfolios gained 4.95% during the same period.

This healthy beginning to the New Year came despite the Federal Reserve raising interest rates for the fifteenth straight time to a level of 4.75%. The stock markets have essentially shrugged off the Fed's benchmark rate, and it is expected that there will be at least one, if not two more increases by the middle of this summer to a 5.25% level. This is important only because it gives the country's economic policy makers room to cut rates during the next crisis.

In Europe, the European currency rose approximately 2.3% during the first quarter vs. the U.S. dollar, which is very little compared to the 34% increase the Euro achieved from 2002 through 2004. The reason for Euro's strength is that German and Italian consumers and businesses are confident that their futures are good. The European Bank has been raising its own interest rates, and overall economic conditions in Europe are positive. The Dow Jones Europe Stock Index of the 50 largest stocks increased 7.24% for U.S. investors but for European investors, they increased 4.72%, somewhat in line with the S&P 500's increase in the U.S. The Rikoon Carret international large company stock portfolios increased 8.47% during the same period.

The emerging markets outside of Europe and Japan increased 12.18% during the first quarter of 2006. For three years now, smaller economies such as Thailand, Eastern Europe, Mexico, and other fledgling stock markets have bounded ahead of the larger and more established developed world. Can it last? Our feeling is that the non-traditional emerging markets have attracted so much attention that money is pouring into these markets at an unsustainable pace. We have discontinued investing heavily into those areas pending a pull back. Investors should always remember that emerging markets have been quite volatile and so sharp downturns ought to be expected. The Rikoon Carret emerging markets portfolio gained 19.71% during the first quarter of 2006. We don't expect those gains to be held onto in any great measure during the upcoming months.

In the bond area, rising interest rates continued to curtail total returns on all bond portfolios. For taxable bonds, the U.S. markets had a slight .34% decline which is to be expected in periods of rising interest rates. We have seen the Fed raise rates consistently over the past four years, and it has been a difficult environment for bonds over that entire

period. During the first quarter, the Rikoon Carret taxable portfolios gained .47%. Likewise, municipal bonds have had a strong headwind, but given renewed interest in tax-free income on the part of high net worth investors, the U.S. Index for short term municipal bonds gained .3% during the first three months of 2006 while the Rikoon Carret portfolios gained .54%.

The U.S. economy is healthy in that employers are adding jobs, manufacturing utilization reports expanded continuously during the first quarter, and consumer spending has been maintained at a 4.7% annual growth rate. Businesses are investing in new equipment and the official labor market data indicates strong job growth. While statistics are good, the news from the industrial Midwest is not. U.S. car manufacturers continue to struggle even as foreign owned auto makers make gains. On a net basis, manufacturing jobs continue to be lost in the U.S. and, with the price of retail homes declining and the inventory of homes for sale increasing, the consumer confidence levels may turn around during 2006.

For this reason, the Rikoon Carret prognosis for the markets for the remainder of the year is muted. We feel that equities will outperform fixed income but that the overriding issues of continued increases in the price of energy, we expect oil to hit \$70 a barrel. as well as the continued costs of our overseas military involvements will keep a lid on U.S. equity performance. As noted above, the Federal Reserve has no choice but to continue to slowly ratchet interest rates up, and this will keep a lid on the bond market. The overseas markets have more optimistic forecasts for growth, notable in the Far East, but higher U.S. and European interest rates will affect those economies so that the substantial returns achieved in emerging markets bonds and stocks over the last several years will likely not be repeated.

On the positive side, despite exogenous threats from the unknown, we see no reason not to believe that the basic continued integration of the world's economies will continue to slowly and steadily gain ground in many areas. We feel this is healthy for the markets in the long run, not so much because those countries themselves represent opportunities for U.S. investors, but that the continued supply of high quality, moderate goods and services on which our economy now depends seems more likely to continue given increased political stability and economic integration in the Far East.

Editorial perspectives: America's Financial Future

It is challenging to build a secure livelihood considering the underlying economic and political forces that we face today. Recent studies show that even though the nation's overall production and activity indicators are robust, the number of decent-paying jobs is shrinking and benefits associated with such jobs are disappearing due mostly to the enormous costs of health care and other issues. General Motors' recent cuts to workers' pay packages is a sign of the continuing winnowing down of the slice of pie shared by American wage earners.

Traditionally, retirees and scions of wealthy families could count on savings and investments to maintain their standards of living. With stock and bond market returns projected to remain in the single digits for years to come, even upper income families lack security. Government programs once provided a safety net for the working poor, disabled and indigent, but if you examined the recently submitted budget proposal, it reflects the bitter reality: When people in power get nervous about their standings, public interests come last. This is evidenced by reduced funding for healthcare, education and the arts.

Some feel that these are truly good times, in terms of their personal fortunes, ideology or prospects, but they too are worried about the future. Even the wealthiest Americans are finding it harder to maintain a higher quality of life, as even they are not immune to the struggle to find good medical care or safe places to live. Wealthy Americans are worried, rightly so, that their favored positions may not last.

I perceive a general anxiety that the rug is being pulled out from under the United States in terms of economic dominance, and no one is quite sure why. Perhaps you can relate to the experience of being charged more while getting less. We are, by and large, resigned to being manipulated and, at the same time, we resent the way things are going.

Economics of contemporary life requires many people to work two jobs or painfully long hours, to dip into family savings, or to incur debt early in their lives just to keep up a “normal” lifestyle. This is where the rubber meets the road in terms of frustration and discontent. What can be done about it? Our unhappiness with what our money can buy, and the fact that cash permeates most of our relationships, leads me to believe that the antidote to the downward slope of our collective fortunes is to remove dollars from as many interactions as one can manage.

Please do not interpret this as a call to give up either working or shopping. One of the most noble, but misguided, efforts to change people’s perceptions of themselves as consumers is the one-day boycott of retail stores. However, the use of money as a fluid medium, through which strangers can establish a relationship, is a great thing. Trade has always served real needs, and money will continue to be the measuring stick by which most decisions are made. Certainly, in a global economy which depends on complex technology, the allocations of items in short supply (i.e. oil), and the determination of the cost of such items, will be made through pricing in dollars (or in yen).

What I do believe, is that the shortest route to the highest quality of life is through the direct exchange of local goods and services without use of money. Trade outside of the monetary system allows for an exchange of value on a human basis. This is as true for medical services as for mulch, as applicable to education as to entertainment. If most of what we consume and transact is based on things produced and consumed locally, the benefits are easy to see. Community connections would be strengthened.

While trade between individuals can inform the local economy, it remains true that the overriding economic power is vested with those in control of our political process. If you can bear with some musings by me about this subject, please continue. My thoughts are that until and unless we clean up politics, we have little chance of addressing the pressing economic issues that threaten to engulf our country. Let's begin with the commercialization of the election process, followed by money's influence on legislation, then talk about how special interests play into the executive implementation of policy and finally, there is the huge payoffs reaped through ex-officials acting as consultants and directors of future government contract work. Shame on us for letting this continue unabated!

Unfortunately, not even the judicial branch serves to protect the public from money's influence on government. Vermont's current limit on campaign finance has drawn skepticism from the current U.S. Supreme Court. As on most issues, clever people can point to the U.S. Constitution and easily argue that the Founding Fathers never contemplated restrictions on the rights of individuals and companies to influence public affairs. There is not a sane person of any political persuasion who doesn't know that rich people and organizations buy influence, influence buys power, and political power begets more money.

I believe, along with many others, that total public financing of elections and equality of access to a plethora of media outlets is a necessity. Democratic action can only take place within an equitable allocation of print, radio, TV, and live debate coverage for all candidates, regardless of their "war chests." There is no need for 30 second sound bites every five minutes as elections near. Campaign contributions and spending need to be brought under control. This is the way to remove the influence of money from the electoral process. It is a reality every citizen recognizes, yet public outrage has yet to find a strong, collective voice.

The second area of politics that requires complete scouring is to undo the influence of lobbyists and special interest groups on legislative and executive processes. Current pressure to respond to the scandals surrounding Jack Abramoff has led the U.S. Senate to consider a one year ban on privately funded travel and fuller disclosure of politicians' travel on corporate jets. Senator Bennett of Utah expressed outrage at the possibility of such disclosure, citing the First Amendment of the U.S. Constitution. It is a travesty of our republic that the right to petition the government is used to protect moneyed interests' ability to unduly influence legislators.

One solution out of our current political morass is to require absolute disclosure of all elected representatives' meeting schedules and to have tapes/videos of every meeting available to the public via the Web. There should be no room in public service for private deals. Public officials who spend time with representatives of partisan viewpoints ought to be required to give equal time to at least one representative from a group of opposing views. No gifts of any kind should be allowed to politicians or the family members of elected officials.

It is not so much term limits that affect the objectivity of our leaders as it is the monetary benefit they receive under the present system. Many qualified people do not go into public office because of the financial sacrifices that low paying salaries entail. In fact, politicians almost need to have donors because of the high cost of getting elected, living in Washington DC, and maintaining an informed research base.

I would propose that elected officials receive salaries commensurate with what they previously earned, over the last three years, excluding investment income. In that way, candidates would incur no personal financial gain or loss due to their desire to provide public service. A small surtax on the gross income of all taxpaying entities would remove the need for special interest money and put all lobbyists on equal footing as they would be prohibited from spending money to buy influence. Public officials have an honor bound pledge to serve and ought not to be privileged. They should drive their own cars and hunt for their own parking spaces. Elected officials at all levels should send their children to public schools, have their family's young adults serve in the nation's armed forces and avail their immediate families of public medical services.

The third area of our system that needs to be addressed is the widespread practice by politicians and their families of receiving financial rewards from cronyism. The halls of Congress are replete with consultants who are ex-officials and their ex-staff members. Last week, the former head of the U.S. Energy Department began selling foreign nuclear power plants to the U.S. government. This is a sign that we are in an unraveling period of the democracy that so many have died to protect. People ought to be banned for life from any situation where they or their families stand to personally gain from past government service.

A life devoted to politics was once considered a higher calling. In early Greece, voters were called upon to defend with their own persons the republic they formed. They were stakeholders at risk. Without that kind of personal risk, there is little sense of belonging or responsibility. Nevertheless, many talented citizens still yearn to serve the public but they are unable to pay to play, and they abhor the sell-out that the current system requires. The money that follows political power is a juggernaut that cannot be resisted by most individuals. We need help in putting an end to the rape and pillage of American public life by taking the money out of politics.

Similar to politics, I believe that the basic problems with our nation's medical system are driven by money issues. From my perspective, the greatest challenge to America's health care system is how to promote entrepreneurialism, where individual efforts can be rewarded in monetary terms, while not enabling corporations, whose primary motivation is profit. As long as health care is driven by corporate executives who care mostly about their own compensation, our nation's medical system is bound to grow worse.

Until the 1970's, doctors customarily donated one or two days of their work week to the public at no charge. They acted out of concern for individuals in need who lived in the local community. Many of today's doctors might like to do the same, but they cannot afford to do so because of liability risks and malpractice insurance costs. The players

who make delivery of personalized health care implausible now are: insurance and drug companies, medical malpractice lawyers, and a segment of medical professionals.

Insurance companies have been the lynchpin of our nation's medical system since the 1960's. By strange circumstances, the reimbursement, evaluation, and delivery process of medical services have fallen into the hands of bureaucratic behemoths in the private sector. There is no reason why this has to be so, and there is a general acknowledgement that the current system does not work. The difficulty of finding and paying for decent coverage is widespread. The insurance industry needs to be removed as quarterbacks of the medical process. They are administrators and should act only in a subordinate role, in much the same way that private contractors currently administer drivers' licenses in some locales.

It is easy to complain about drug companies' profits when patients pay through the nose for medications which cost pennies to produce. I am a firm believer in rewarding entrepreneurs. In many instances, drug companies have created life saving and life enhancing products. They need and deserve substantial profit incentives to continue to innovate and take risks. Patent protection periods, however, could be shortened so that low cost generics could come to market sooner.

It is well known that prescription drugs cost far less in many places outside the U.S. Drug companies charge higher prices here because they can get politicians to help them keep trade barriers intact through their lobbying efforts. This is a travesty of the free market system. The government should stay out of the drug business altogether and let consumers cross borders to shop.

Lawyers have no business impacting the practice of medicine. Because of the threat of large judgments being awarded to patients who suffer due to medical mistakes, the cost of liability insurance and the hassle of dealing with insurance issues have led some doctors to quit and others to consider leaving the profession. This has and will continue to drive up the costs for those remaining in the field. These costs are, of course, eventually passed along to consumers. Awards to injured parties should be capped at a reasonable level unless there is gross negligence. Everyone makes mistakes.

There is a place for entrepreneurship in the practice of medicine, but it ought not to drive the day-to-day delivery of normal health services. Doctors who desire a sane lifestyle by working forty to fifty hours a week should be satisfied with earning a comfortable living. Doctors who desire to earn more ought to have the opportunity to do so, but it is well recognized that many U.S. doctors' compensation levels are inordinately high relative to other parts of the world. Globally, most doctors do not make more than college professors. Compensation expectations need to be adjusted here in the U.S. so that the pursuit of wealth does not conflict with the practice of medicine.

A substantial portion of medical dollars spent during the typical American's life goes toward the expense of the last illness i.e. right before death. Heroic efforts, that is to say applying the latest in medical technology and drugs, are the norm in our current system.

Unfortunately, this practice puts many families deeply in debt. Those who cannot pay, pass their bill on to the rest of the public who is “insured”. One thing that can be one about this is for people to have a “Living Will” or “Right to Die” document in place. This allows relatives to follow specific instructions as to what kind of heroic efforts, if any, are to be used.

Urgent or critical care ought to be available to our entire population without onerous waits or huge bills. The savings we would reap from minimizing or capping insurance companies’ profits, requiring doctors to perform some public sector service, removing medical malpractice costs and allowing consumers the freedom to purchase drugs globally would be more than adequate to assure that decent medical care is available to everyone. For many daily aches and pains, alternative medicine has proved to be effective. Alternative therapies are slowly being brought into the mainstream. General wellness programs, including alternative methods, could also be funded by freed up funds as noted above. On the tax side, Medicare and Medicaid taxes on working people could be replaced with an across the board, flat tax surcharge on gross income. This would be applied to all persons and companies making a profit.

Businesses are not on the hook now, as most companies are reducing their health care coverage, forcing employees and retirees to pay most if not all of the costs for medical insurance. Medical insurers can and do routinely exclude certain illnesses and people from coverage at their own discretion. Why should they have so much power? If one of our country’s priorities was good medical care for everyone perhaps under a national umbrella health policy, we would be moving in the right direction. Let’s take the profit motives off center stage in the medical arena.

Personnel News

Rob: Not much to report from this bi-mountain traveler except that the Mt Taylor quad came off great, even without snow. Due to my extreme enjoyment of running on trails, I have signed up for the Leadville 100 mile trail run this coming August in Colorado. Our goats and sheep are gone from the farm but the Red Devon cows will stay. On the art front, I am looking forward to starting the last of the four walls of my non-denominational chapel project. Anyone interested in posing (clothed)?

Juliana: I will be participating in the April Birdathon 2006 as a member of the Audubon New Mexico team. A Birdathon means spending 24 hours counting the most number of species possible. This time of year is chosen because spring migration will be underway and we hope to spot over 100 species. What a great way to spend a weekend! I’m also looking forward to attending class at Cannon Trust School in May. The fact that the week long program will be held at Pepperdine University in Malibu is an additional reason to be excited!

Jeff: My daughter, Stephanie, recently got a kitten to add to our menagerie. The kitten is all black, quite feisty and lots of fun. Our older, male cat is tolerating the energetic kitten fairly well so far. I'm looking forward to warmer weather in which to do some landscaping and endless house projects over the summer.

Patricia: We now have integrated a paperless filing system into our office. Dana is hard at work scanning all of the documents into the new system. Please ask to take a look when you come by. I am enjoying the Spring in Albuquerque, as my yard is beginning to flourish. I spent most of last year working on it. It is nice to sit back and reap the rewards.

Dana: I recently returned from a Spring Break trip to Maui with my daughter. Needless to say, we reveled in its balmy and verdant lushness. I am a regular swimmer at Santa Fe City pools so it was a heavenly change to do laps across sparkly Kapalua bay with lots of colorful fish to accompany me. Did you know that you can hear the humpback whales singing to each other when you swim underwater?

Upcoming Events

The next tea will be held on Thursday, May 4th, from 3 to 5 p.m. at the Rikoon Carret offices in Santa Fe. Please RSVP at 989-3581 if you are able to join us.