



Job Growth....Much Ado About Nothing?

UNDERVALUED SECTORS

(CONSIDER!)

- LARGE CAP VALUE
- DIVIDEND STOCKS
- NATURAL GAS

OVERVALUED SECTORS (AVOID!)

- INTERNET
- HOME BUILDERS
- CALIFORNIA
MUNICIPAL BONDS
- TECHNOLOGY

The press has been generating a lot of news lately about the loss of jobs and its effect on the economy. The nine Democrats running for President do not help with the constant drumbeat on the lack of employment growth (in order to be heard, they must be louder and more outlandish than the next guy.) As the old saying goes, if your neighbor is unemployed the economy is in a recession, but if you are unemployed it must be a depression. As is almost always the case however, the real story is more complicated and the effect on the economy may not be as disastrous as feared.

Several trends converged to make current job growth look anemic.

The first was the extraordinary increase in jobs during the boom years in the 1990's when unemployment dropped to 3.8%, a historically unsustainable level. The second is the current level of unemployment at 6.1% which, while consistent with past periods of fast growth in the U.S. economy, looks terrible next to 3.8%.

The super-strong dollar of the late 1990's accelerated the loss of manufacturing jobs as they went to lower cost countries such as China, Mexico, and Southeast Asia. It is important to note that the trend of losing jobs overseas did not start in the 90's. In 1960, almost 30% of all jobs in this country were in manufacturing. The sector has seen a steady decline to the current level of approximately 11%.

The dollar has not been the only cause of this; U.S. Labor (especially California) is burdened by high wedge costs (Social Security, Medicare, health insurance and workers comp.) These jobs are lost forever, just as many farm jobs were lost for good a century ago. The workers have moved on to the service sector and many have started small businesses.

The same thing currently happening in manufacturing also happened 100 years ago with the family farm. The small high cost farm gave way to larger more efficient farms. Workers moved off the farm to take jobs in manufacturing. If the Presidents in the early twentieth century had legislated against workers leaving the farm to work in steel mills and auto plants, this country would have not become the economic powerhouse that it is today. The U.S. would still be a largely agrarian country similar to Argentina. Early in the last century, Argentina had a higher standard of living than the United States but we all know what happened to the land of the Gaucho.

This process is called creative destruction and is at the heart of our capitalist system. For the most part, we allow inefficient industries and companies to fail; from their ashes grow new industries that employ workers in fields that did not exist twenty years ago. The best recent example of this can be found on the East Coast. New England today is a leader in both computer and health sciences, yet not many years ago there was considerable angst when the textile mills closed because they were unable to compete on a global basis. Today a job in either of these new fields pays considerably more than a factory job in the mill.

The United States has a very flexible and well-trained work force that can adapt in short order to changes if left unhindered by government meddling. All consumers feel the benefits of this as inflation is kept under control and prices remain steady. We believe that the economy is strong and will get stronger coming out of the shallowest recession on record.

Growing & Protecting Your Wealth...



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Companies have invested in productivity instead of labor, which is why we are seeing the tremendous growth in productivity. Employment has always been a lagging indicator and is again this time. The keys to growth in this economy are the levels of the dollar, oil prices, and business investment. In other words, don't wait for job growth to resume to realize that the economy is back in full gear.

Municipal Bond Follow-up

After the last issue of the Counselor, we got several questions about Municipal Bonds and the various types of bonds. We will attempt brief descriptions and discussions about each type.

General Obligation Bonds

General obligation bonds are debt instruments issued by states, counties, towns, cities, and school districts. The issuers' general taxing powers secures them. These powers will vary depending on the issuer, for example school districts can usually levy only against property taxes, while a state may have income, sales, and other tax sources available to it. While these bonds have access to the tax revenue, the key question is do they have the first access or must they stand in line to some other entity? In most states such as New York they have the first claim, however in California the claim of the bondholders is secondary to education.

Revenue Bonds

Revenue bonds are issued for financings that are secured by the project itself. There are many type of revenue bonds such as Tobacco Settlement, Airport, Highway, Hospital, Housing, Public Power and Student Loan. Revenue bonds only have a limited source of repayment available to them, typically the revenue from the project that issued the bonds.

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Each type of bond has signals that indicate a decline in the creditworthiness of the issuer according to Frank J Fabozzi the author of The Handbook of Fixed Income Securities. If you hold general obligation bonds, investors should look for the following:

1. Declining property values and increasing delinquent taxpayers.
2. An annually increasing tax burden relative to other regions.
3. An increasing property tax rate in conjunction with a declining population.
4. Declines in the number and value of issued permits for new building construction.
5. Actual general fund revenues consistently falling below budgeted amounts.
6. Increasing end-of-year general fund deficits.
7. Budget expenditures increasing annually on excess of the inflation rate.
8. The unfunded pension liabilities are increasing.
9. General obligation debt increasing while property value is stagnant.
10. Declining economy (increased unemployment and declining personal income.)

For Revenue Bonds

1. Annually decreasing coverage of debt service by net revenues.
2. Regular use of debt reserve and other reserves by the issuer.
3. Growing financial dependence of the issuer on unpredictable federal and state-aid appropriations for meeting operating budget expenses.
4. Chronic lateness in supplying investors with annual audited financials.
5. Unanticipated cost overruns and schedule delays on capital construction projects.
6. Frequent or significant rate increases.
7. Deferring capital plant maintenance and improvements.
8. Excessive management turnovers.
9. Shrinking customer base
10. New and unanticipated competition.

The warning signs above for general obligations bonds are the primary reason we are concerned about California general obligation bonds. California has to varying degrees 8 of the 10 danger signs. If you own revenue bonds, it is important to review or have your investment professional review the health of the issuer.