The Week

WACHOVIA SECURITIES

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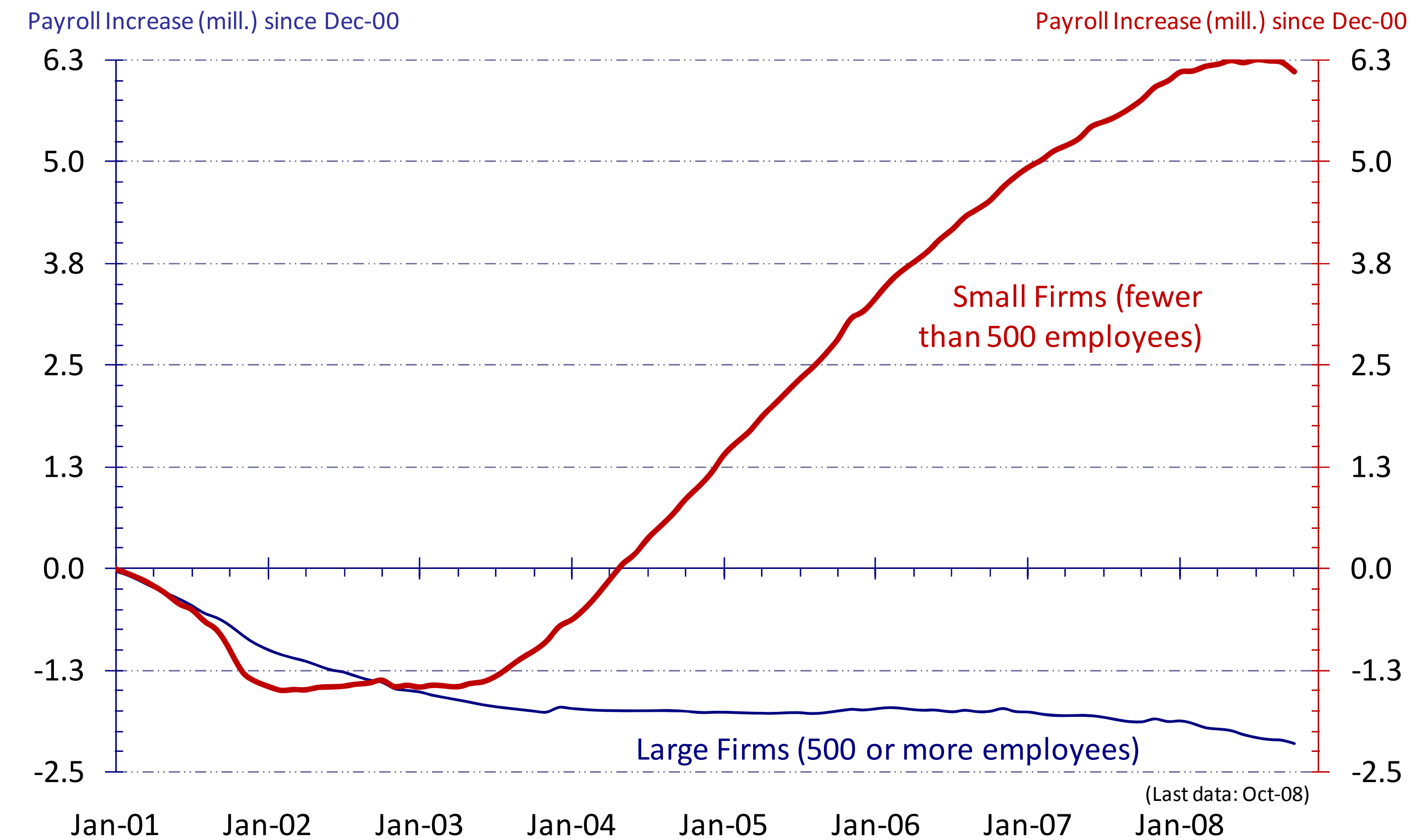
What Will Obama Explain in His "Fireside Chat?"

- Last week's interest rate cuts by the Bank of England (−1 ½% to 3%) and the European Central Bank (−½% to 3 ¼%) and China's announcement Sunday of a nearly $600 billion domestic stimulus plan help buttress our view that central bankers and policy makers around the world would cooperate with their U.S. counterparts to respond quickly to the financial crisis and a sharp contraction of consumer demand both here and abroad.
- President-elect Obama has already convened his "brain trust" of economic advisors, recognizing the current crisis as the "greatest economic challenge of our lifetime," and is signaling his support of additional economic stimulus even before his inauguration in January. We are not privy to Obama's plans to communicate the urgency of the situation – and the need for swift, decisive action – to the American people. But if there has ever been a need in the past 70 years for a president to revive Franklin Delano Roosevelt's "Fireside Chat" series of radio addresses directly to the populace – that time is now. There are few more talented advocates for the cause, in our view.
- With both the consumer and business sectors of the economy in turmoil, we are fortunate that the U.S. government maintains a strong credit rating, evidenced by a sub-4% yield on 10-year Treasurys. As we suggested in a prior edition of "The Week" (September 24, 2008), it seems likely that our national debt will rise significantly to help offset a decline in demand. We are not fond of Treasurys at current levels, as supply will probably increase significantly over the next several years, and inflation is a likely outcome of aggressive expansionary measures.
- At some point in the future, we may be called upon to invest in Treasurys as a patriotic measure. But we expect yields would be more attractive then, and we consider the protection and growth of individuals' savings and retirement plans a patriotic goal in itself. To that end, we favor high quality U.S. stocks in the long-term mix.
- For its part, China indicated that it will loosen credit conditions, cut taxes and embark on a massive infrastructure spending program in an effort to boost domestic demand and help offset weakening global economic conditions. China's package amounts to about 15% of its annual gross domestic product, and it will be spent over the next two years in 10 major areas, such as low-income housing, rural infrastructure and transportation.
- We are not sure what plans our Federal government may have to stimulate the economy apart from more rebate checks and possibly the extension of unemployment benefits beyond the normal time limits. But the first economic stimulus of 2008 amounted to $168 billion (1.2% of annual GDP), and while the second package is likely to be much larger, they still pale in comparison to China's plans.
- What would Obama explain in his own "fireside" series? Maybe he will explain why we need our government to run a larger deficit now, perhaps even larger than currently anticipated, given a likely shortfall in tax revenues. Maybe he will call on our government authorities to adopt the best practices of the private sector, to funnel needed funds toward worthwhile goals. It seems likely he will call upon numerous representatives of the private sector to advise and assist the government in the efficient design and application of these plans.
- One example is the plan advocated by Boone Pickens to push America toward energy independence, utilizing wind power and natural gas. Assessing the Pickens plan and other options should be a priority, in our view, and will likely mean increased investment in alternative energy, despite the recent drop in crude and product prices.
- Expenditures on improving the security, capacity and efficiency of our infrastructure – whether for transportation, energy production/transmission, communications, health care and education – are more worthwhile targets than more rebate checks, in our opinion. These are the areas where we will seek investment opportunities.

Small Firms Have Been Responsible for All Job Gains Over the Past Eight Years; But Recently, the US Economy's Main Engine of Job Creation Appears to be Sputtering …



Note: Series reflect the cumulative net change in aggregate payrolls since December 2000. Source: Automatic Data Processing.

Last week's steep rise in the unemployment rate (up +0.4% to 6.5%) was presaged by a weak report from Automatic Data Processing, a payroll specialist. ADP's tallies employment among a much larger sample of companies than the government survey compiled by the Bureau of Labor Statistics (BLS).

One helpful aspect of the ADP approach is their ability to measure payrolls and their growth among smaller firms; the BLS has struggled for decades with this challenge. The chart shows that total payrolls for firms with 500 or more employees never recovered following the last recession, and have recently turned lower again – losing about 430k jobs since November 2006. According to ADP, all of the job growth since the last recession has been seen in the smaller companies.

The importance of this divergence of job growth should not be lost on the Obama administration. Small firms have long been lauded as the main engine of US job creation, but the trend among larger companies' is probably not healthy in the long run. Firms of this size have more opportunities to outsource their production to less expensive regions, where a low corporate tax rate is but one aspect of the value proposition. A cut in the US corporate tax rate might slow the pace of job exports, and would likely boost foreign investment among firms looking to tap a well-educated and productive workforce.

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