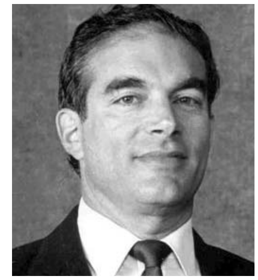
FOCUS ON THE ECONOMY



The Certainty of Uncertainty: The Economy

BY DR. MARK LEE LEVINE, CRE

NUMEROUS TELECASTS, RADIO COMMENTARIES, SPEECHES, NEWSPAPER ARTICLES, MAGAZINE ARTICLES, THE INTERNET, ETC. create great confusion when looking to opposing views on many economic issues that can and will impact future positions.

The following is a smattering of numerous articles and commentaries that support or attack the vitality of the U.S. economy. What is troublesome for the constituent is to attempt to reach a conclusion after examining many incongruities in these statements. Consider the following comments as evidence of the conflicting commentaries: "The market is great!" and "The market is depressed."

POSITIVE AND NEGATIVE POSITIONS: PARRY AND THRUST

POSITIVE:

1. POSITIVE: PRODUCTIVITY: Michael J. Mandel, in a commentary entitled,"Sure, the Trade Deficit Is Scary - But We Can Handle It," *Business Week* 41 (5/23/05), stated an overall positive position of the U.S. economy. Mr. Mandel conceded the position that there are "different points of view." In this article he stated: "Everyone has a favorite statistic, and those who are pessimistic about the U.S. economy love to cite the trade deficit." Mr. Mandel noted that although the trade deficit was substantially larger for 2004 than expected, and 2005 is running ahead of 2004, he was still not too concerned with the deficit.

Mr. Mandel raised the question as to what was more important: Big trade deficits, or high productivity? He concluded that productivity is the area of focus, because the net wealth of the United States is gigantic relative to what it was 10 years ago; therefore, we are in a more positive position. In fact, he concluded that the U.S. economy is getting a lot better. He conceded, by hedging somewhat, that the ability to deal with trade deficits will be dependent in part on the ability to continue efficient productivity and to maintain strong technology. He concluded that optimists are winning the race in the economy.

2. In an article by James C. Cooper and Kathleen Madigan, "Job Growth Will Get Over Its January Blahs," Business Week 25 (February 21, 2005), the authors concluded that the economy for 2005 would be expected to generate a significant amount of jobs; therefore, they concluded that 2005 will be a fairly solid business year.

The authors concluded on a positive note relative to year 2005: "Despite the slow January start, payrolls should post their best gain since 1999 and generate solid income

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Note: This article was written with a focus on the end of 2005. The 2006 position will follow in an upcoming issue.

growth for consumers, which will keep demand on the upswing."

3. POSITIVE: GROWTH: A summary article by editor Andrea Parker and economist Dr. Michael Bergmann, in the AMG Guaranty Trust Publication (February, 2005), prognosticated a positive, good, but not great, 2005. Their position was that growth for 2005 would probably be 3.7% for GDP (Gross Domestic Product).

The prognostication was that the Federal funds rate, the rate banks charge one another for overnight loans, will probably move to around 4% by the end of 2005. "The economic expansion will remain in tact; growth is slowing but will remain above trend for 2005, around 3.7%."

4. POSITIVE: BALANCE: If one desired a panoply of positive economic commentators on the 2005 economy, see one of the better articles which captured and summarized many of these positions in "Real Balance," *REALTOR*, Page 26 (January 2005). This article noted: "The winning combination of low interest rates, strong home price appreciation and moderate job growth that drove record-setting home sales last year will continue to fuel the home sales market this year."

A collection of economists was listed in this article, including David Lereah, Chief Economist for NAR (National Association of REALTORS), Paul Merski, Chief Economist, Independent Community Bankers of America; Mark Dotzour, Chief Economist, Real Estate Center, Texas A & M University; Frank Nothaft, Chief Economist, Freddie Mac; Doug Duncan, Chief Economists, Mortgage Bankers Association; and Steve Dunn, Chief Economist, C.B. Richard Ellis, Information Management. These professionals gave their comments as to the U.S. economy. They stressed the need for balance and equilibrium in residential and commercial markets.

The article concluded: "With home sales expected to sustain at near-record levels and the commercial sector looking up, economists say this year will be the picture of balance for real estate."

5. POSITIVE: NEXT 10 YEARS: For an overview of the economy of where it is now, and where it is going in the next ten years, see the article by Donald Ratajczak, "A Look Ahead At the Economy and Investments: 2005-2015," *Journal of Financial Service Professionals* 37 (January 2005). Dr. Ratajczak examined a number of factors that he considered very important in impacting the economy. These included: 1. Changes in productivity per labor input; 2. Changes in the employment rate; 3. Changes in hours worked per year; 4. Changes in the percentage of the working-age population; and 5. Growth of the working-age population.

After examining these factors, along with related economic issues, Dr. Ratajczak was rather positive. However, he admitted, like most good economists, that all of the prognostications, even if originally on target, could be modified by some of the unforeseen, major events that could change the prognostications. Dr. Ratajczak ended his article by stating: "I am glossing over looming problems such as medical costs for the aged, Social Security problems... U.S. competitiveness and the entire baby boom generation as retirees. But there are opportunities that will allow us to address these problems, if we find the will to do so."

6. POSITIVE MORTGAGE RATES: In the article by James C. Cooper and Kathleen Madigan, "The Walls Won't Come Tumbling Down," *Business Week* 25 (January 17, 2005), the authors noted that mortgage rates for 2005 will probably remain low enough to keep housing affordable and active.

The authors noted that, although housing has contributed to much of the strength during the last few years in the U.S. economy, it will not be the case for 2005. However, they added that it will probably not subtract much from the economy, either.

A discussion of the potential of bursting of the housing "bubble" was noted. The authors concluded that it was very unlikely that such housing bubble, if any, will burst.

7. POSITIVE: RECOVERY? Is there a wave of recovery? See the article by Delisle, James, Dr., "The Wave of Recovery: Capital Flows and Spatial Ripples," The *Appraisal Journal* 5 (Winter, 2005). Dr. Delisle noted major areas that impact the U.S. economy. With many problems behind us, many other issues remain that must be addressed for the year 2005. However, for 2005, Dr. Delisle commented that he believed there will be a moderately improving fundamental position in the real estate market. Dr. Delisle concluded: "As such, 2005 should see an extremely active real estate market with a balance of power beginning to shift from the seller to buyers, although such adjustment may be a prolonged process."

8. POSITIVE: HOUSING MARKET: In the Meyers Housing Market Study (April 4, 2005), the Study concluded that the Market is in fairly good shape. New home sales are fairly strong, and generally existing home sales also remain fairly strong. Rating various areas, the mortgage rates and median price for existing homes all rank at A+.

Unemployment was still fairly strong at B+. Many other parts of the market saw very strong grades, portending for an overall strong economy, as indicated in the Meyers Study.

(The Meyers 6/8/05 Study also supported this continuing trend of favorable interest rates, very good pricing for median-priced home sales [existing and new homes] and for inventory. However, the "affordability" category received a poor score from the Meyers Study. More and more potential homeowners cannot qualify to acquire a home, absent very favorable rates and strong financial incentives provided by builders, lenders and third parties.)

NEGATIVE:

1. NEGATIVE: IS THE WORLD ECONOMY SLOWING? According to views in an article, "Running Out of Puff," *The Economist* 63 (April 16, 2005), there are "... nascent signs of slowdown and worries about oil." Whether this article is correct as to the market, certainly there are signs that indicate a slowing within the market. A slowdown and reduction in oil prices are welcome signs in most parts of the world.

2. NEGATIVE: TRADE DEFICITS: Focus on the trade deficit continues. Authors James C. Cooper and Kathleen Madigan noted in their article, "Time to Cope With Co-Dependency," *Business Week* 29 (February 28, 2005), that there is a great deal of concern with the trade deficit and budget deficit.

The authors noted the trade deficit position, as expounded by Federal Reserve Chairman Alan Greenspan, when he stressed his concerns on numerous occasions early in 2005. The authors stated that one could argue there should be less demand for imports, given the weakening dollar. However, apparently that has not been the case. Mr. Greenspan covered this same point.

As to the import of the U.S. trade deficit, the authors concluded: "But whatever the mix of remedies, the trade gap has taken center stage, and don't expect it to go back into the shadows anytime soon." *Business Week* 30 (5/23/05). On this issue, Dr. Scott Anderson, Senior Economist with Wells Fargo Economics (June 7, 2005), noted that the rising cost of oil fans the fires of concern with inflation and the trade deficit.

3. NEGATIVE: FISCAL BUDGET: Dr. Cynthia Saltzman commented in her Note, "Federal Budget Deficits: It's Not If, But When They Matter," *Journal of Financial Service Professionals* 22 (March, 2005), that the trade deficit is huge; it should be of great concern.

According to Dr. Saltzman, the concern with fiscal budget issues was focused when there was testimony by Mr. Alan Greenspan before the U.S. House Budget Committee on February 25, 2005, and by subsequent comments by Mr. Greenspan. Dr. Saltzman noted our imports substantially exceed our exports, creating the U.S. trade deficit. This must change, at least in the opinion of Dr. Saltzman.

Dr. Saltzman also noted that the dollar has continued to drop in value over the last few months. The expectation is that such weakness in the U.S. dollar will continue, at least for the reasonably foreseeable future. Dr. Saltzman concluded that it is important for the U.S. Federal budget deficit to gradually be reduced and to reduce the financing of our Federal deficit by foreign funds. (More recent activity has shown the dollar gaining strength.)

4. NEGATIVE: PRODUCTIVITY: In an article by James C. Cooper and Kathleen Madigan, "A Job Market This Strong Comes With Strings," *Business Week* 33 (5/23/05), the authors concluded that productivity is slowing and one may be justified in being concerned with the potential of inflation.

The lead from the article noted the April 2005, U.S. Employment Report and that one should look to inflation and stagflation, since there have been many new jobs created, but there are also concerns with inflation. The authors concluded that the Fed will likely increase interest rates to rein in inflation. With the increase in jobs, and unemployment holding at 5% or less, the authors concluded that from an economic position, it is likely that inflation will be the big issue in 2005.

5. NEGATIVE: HOUSING BUBBLE: Much of the argument today on the residential side is whether the rapid pace of sales will continue and whether there is a housing "bubble" in many areas throughout the United States. In an article by Patricia Hill of the *Washington Times*, and the Report by RES Media, in http://www.RESmedia.com , the position by Chairman Greenspan is clear: "Federal Reserve Chairman Alan Greenspan yesterday (February 18, 2005), said he sees a housing bubble in 'certain areas' and suspects prices are vulnerable to declines, but they will not collapse in any way that threatens the economy." In Mr. Greenspan's opinion there is a bubble; and, in some areas that bubble will be problematic for many homeowners. According to the article, the Federal Reserve estimates that home values have doubled from $8 trillion to $16 trillion since 1996.

6. NEGATIVE: HOUSING MARKETS: TOO HOT? In an article by Opdyke, Jeff, "Hot Housing Markets Face New Risks," *The Wall Street Journal*, D2 (Wednesday, March 2, 2005), the author noted many areas in which housing is very risky and overpriced.

Mr. Opdyke stated: "Homeowners in the hottest markets are facing a greater chance that the value of their houses will decline, according to a new study, though risks have lessened slightly for the nation as a whole."

The ten most risky housing markets, as noted by Mr. Opdyke, regarding a Study by PMI Mortgage Insurance Company, are: "Boston-Cambridge-Quincy, MA-NH. San Jose-Sunnyvale-Santa Clara, CA. San Francisco-Oakland-Freemont, CA. San Diego-Carlsbad-San Marcos, CA. Providence-New Bedford-Fall River, RI-MA. Sacramento-Arden-Arcade-Roseville, CA. New York-northern New Jersey-Long Island, NY-NJ-PA. Los Angeles-Long Beach-Santa Ana, CA. Riverside-San Bernadino-Ontario, CA. Detroit-Warren-Livonia, MI."

Mr. Opdyke holds that these markets have substantial risk and appear to be overpriced. Whether this is a correct conclusion remains to be seen, since many comments over the years have referred to the California market as being overpriced; yet, the California real estate market seems to continue to rise in most locations.

7. NEGATIVE: HOME MARKET: BUY OR NOT BUY: In an interesting Note on the issue of whether one should buy or not buy, concern was expressed on the overpricing of the housing market. See the commentary, "To Buy Or Not To Buy? That Is the Question," *The Economist* 11 (March 5, 2005). This Commentary noted the confusion faced by many homebuyers or potential homebuyers on the question of whether to buy now and avoid missing out because of rising prices of homes. However, the article concluded that maybe there is too much risk with the potential of a housing "bubble." As such, the conclusion was: "Some day prices will fall relative to rents and wages. After they do, it will make sense to buy a home. Until they do, the smart money is on renting."

In another article addressing the same issue as to whether to buy or not to buy, now, see the article in *The Economist* 71 (March 5, 2005). The authors noted: "According to our latest house-price indicators, it is now much cheaper to rent than to buy a house in many countries."

8. NEGATIVE: STORM CLOUDS: An article, "Storm Clouds Ahead," *The Economist* (January 29, 2005) noted that the economy may seem bright presently, but with higher interest rates the economy may be very difficult in coming months and storm clouds seem to be rising. The article pointed out that some economists are puzzled by inconsistencies within the market as to inflation, pricing, long-term interest rates, etc.

On the gloomy side, one comment in the article stated: "The most gloomy theory is that America's economy is, in fact, rather more fragile than the current statistic suggests ...." Along with other theories, the article concluded that there may be great concern that long-term interest rates could rise sharply and very suddenly. (Page 28).

9. NEGATIVE: COLLYWOBBLES: The Collywobbles article, *The Economist* (February 24, 2005), referenced concerns within the financial market. One of the most telling comments was the reference to Mr. Alan Greenspan's concern: "The problem started last week, when Alan Greenspan, the Chairman of the Federal Reserve, professed himself puzzled by the 'conundrum' presented by the flattening yield curve: The more he raised short-term rates (6 times since 2004, by 25 basis points on each occasion), the more already-low long-term rates fall. Markets don't like it when the man who sets interest rates says he doesn't understand them." (As of July 2005, the Feds raised the rate 9 times in succession.)

Many argue this great concern as to uncertainty, especially by the brightest of our leaders, creates the "wobbling effect" within the market.

10. NEGATIVE: EDUCATION: Education, or lack thereof, and underproduction in the United States to produce enough engineers, scientists and others who will continue to foster and support the lead of the U.S. in many technical areas, continues to be of great concern.

In an article by William Symonds, *Business Week* 122 (January 10, 2005), the headline exemplified this concern: "U.S. Schools: Underperforming." The sub-headline noted: "The No-Child Left Behind Act isn't doing the trick and higher education costs are squeezing out lower-income students."

The argument is that if those in the lead in the U.S. do not change direction, the educational system is on a dangerous course. This was exemplified in a comment by Patrick Callan, President of the National Center for Public Policy and Higher Education: "We're on a collision course that could lead to a real decline in U.S. competitiveness...."

Mr. Symonds stated that the attempt to reverse the course of weakening higher education training within the United States is difficult; it requires, he said, very bold action. If we fail to act, results will be even more painful, noted Mr. Symonds.

11. NEGATIVE: RETIREMENT: Arguably, one of the most damaging issues that could impact the U.S. economy deals with retirement. Examining this issue was an article by Gleckman, Howard, "The Real Retirement Time Bomb," *Business Week* 72 (January 31, 2005). The argument in this article was that if there are not substantial, positive changes made, Medicare premiums will destroy Social Security.

The author noted that the U.S. government will not pick up the entire cost for seniors; and, unless changes are made, the retirees will have to accept a major reduction in their standard of living for health insurance. Mr. Gleckman noted that this is a trade-off that society may choose to make or not make. However, it appears that the issue, at least in Mr. Gleckman's view, is not being properly addressed. He concluded his article by saying: "… between Medicare and Social Security, both parties in Congress and President Bush have been moving forward with their eyes wide shut."

12. NEGATIVE: TAX CUTS: The concern with tax cuts and the impact on the fiscal budget remains a major issue.

Mr. Greenspan said that he favors tax cuts only if they are offset by appropriate changes to balance the spending position.

In Mr. Greenspan's position, the pay-as-you-go rules, as they are sometimes referred to, require a balance between the tax cut and the spending cut positions. Mr. Greenspan said: "I argued a year ago that my support for tax cuts is in the context of a pay-go-rule."

For a discussion of this issue and connected points, see the article by Stamper, Dustin, "'No Tax Cut Extensions Without Offsets,' Says Greenspan," *Tax Notes* 887 (February 21, 2005).

13. NEGATIVE: TAX CHANGES: DUMP THE SYSTEM? In a position clearly opposing the suggestion to dump the existing position, Federal Reserve Chairman Alan Greenspan and former Treasury Secretary James Baker support the view that one cannot realistically get rid of the existing tax system, even though it is "defective." Rather, it requires a major overhaul or change within the system. These were the conclusions in testimony before President Bush's Tax Reform Panel on March 3, 2005. See the article by Glenn, Heidi, "Greenspan, Baker Look Back to 1986 For Tax Reform Future," *Tax Notes* 1119 (March 7, 2005).

14. NEGATIVE: WEAK DOLLAR: See the article by Kuttner, Robert, "Bush's Worrisome Weak-Dollar Policy," *Business Week* 27 (March 14, 2005). Mr. Kuttner noted concern with the weakness in the U.S. dollar and the ability of the Bush Administration to properly control and deal with such weakness.

Mr. Kuttner stated: "The gap between the Bush Administration's expansive geopolitical goals and its relinquishing of financial stewardship is becoming unsustainable." Mr. Kuttner then referred to the comments made in South Korea as to the weakness of the U.S. dollar and consideration by the South Korean banks to look for other markets. Although this created some jitters for a short period of time, it did focus the issues, said Mr. Kuttner, on the "chilling reminder of the vulnerability of the dollar and the precarious position by the U.S."

15. NEGATIVE: INTEREST RATES: SLOW INCREASE? In an article by Cooper, James, and Madigan, Kathleen, "Time To Waive Goodbye To A 'Measured' Pace," Business Week 25 (March 28, 2005), the authors concluded that maybe, given the nature of the economy in its current state and the many issues on the plate for President Bush, it may be that the Fed may have to raise interest rates much more quickly than previously anticipated. The authors concluded: "The new question confronting the Fed is this: How fast should it take policy to neutral? Recent data on growth inflation hint that the Central Bank is moving too slowly. If that's true, then given the lag inherent in policy adjustments and the Fed's desire to act preemptively, any change in the policymakers' intentions will need to come soon."

16. NEGATIVE: VALUATION OF REALTY: See the article by Dr. Anthony Downs, CRE, "Why Selling Assets Now Makes Great Sense," *NREI* 124 (April, 2005), In this article, Dr. Downs stated that no one can predict the exact high point, but because most properties would enter in what he considers to be the peak of their earning power or renovation, one should seriously consider selling them now. In fact, he concluded that if owners wait too long in this peaking market, "... their fortunes could sour quickly."

CONCLUSION

One can examine the "parry-and-thrust" of the POSITIVE and NEGATIVE arguments within the economy, including arguments focusing on medical costs, Social Security, retirement funds, cost of oil, trade deficit, monetary and fiscal deficits, housing issues, currency concerns, war, terrorism, other conflicts, threats of nuclear positions, and many other items. Mixed signals are coming forth, thereby confusing sophisticated investors as well as, and most certainly, the novice investor. Confusion abounds. Inconsistent economic signals create problems when making investment decisions.

This means to many that money will remain on the sidelines, pending a clear, consistent direction that does not constantly result in an upside-downside viewing of the marketplace. As for now, many viewing the market consider that the only consistency in the market is inconsistency.■