



L. R. Levin Consulting, L.L.C.

Newsletter

December 09



Will the Consumer Give US a Merry Christmas?

In each of the past four economic downturns the consumer has been the driving force of the recovery. With increasing buying power and the psychology of recovery releasing pent-up demand, the consumer lead a real increase in retail sales, triggering inventory replenishment and expansion, increasing production, and we were off to the races.

Is this time different? Will Santa stay home, perhaps confused by "global warming?" Home sales remained lackluster in November, with distress sales still making up more than 30% of the homes sold. With so many forced sales, even with the new home buyer credit, there was little price support in the market.

Las Vegas home prices, for example, remained down 34.5% in the third quarter. This type of housing performance gives little support to

retail sales. More like coal in your stocking than presents.

Did the first few days after Thanksgiving herald the return of the Christmas consumer to put the economy back on a strong footing?

For November, same store sales rose slightly less than 1%. While foot traffic was high, on Black Friday, consumers purchased primarily high discount items, foregoing impulse buys of higher margin items. Shoppers spent on average 8% less than last year.

Last November when the economy "went over the cliff" same store sales dropped 7.3%. So, while the popular press is much encouraged by the fact same store sales increased in November 2009, this fails to recognize we are still down more than 7.2%!

What this reflects is that unemployment continues to reduce real buying power. Even with the much publicized slight decrease in November unemployment, it remains at 10%.

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The plain fact is that the real unemployment number is 26.9 million Americans. It is significant that the percentage of people who have been unemployed for more than 27 weeks rose 2.7 percentage points to 38.3 percent in November.

As the length of time people are unemployed rises, it means their savings are being exhausted reducing their purchasing power and increasing foreclosures, etc. More than 2.3 million Americans have been out of a job for over one year.

The number of available jobs fell in construction, manufacturing, and information, with only temporary help services, health care, and the government adding jobs. To date, retail has not added the kind of Christmas jobs we normally see, merely 8,000 in November.

With last year the worst Christmas sales performance since World War II, it is little comfort to predict this year will be better. If the economy is to do more than stabilize at a low level, it will take a shift in government thinking. Real stimulus creating buying power in the pockets of all taxpayers and supporting small business recovery and expansion is needed.

Job creation comes from consumers buying from the private sector where the infrastructure already exists. For your business to see a sustainable change for the better over the next 18 months, watch to see if government reduces taxes across the board, accelerates depreciation of new equipment purchases by small business, and brings the deficit under control. See the **Managing For Success**, Article, **Why Is “Stimulus” A Key Component To A Dynamic Recovery?**

Perhaps it is the reality of what government has not done that caused Federal Reserve Chair, Ben Bernanke, to say this week, “Though we have begun to see some improvement in economic activity, *we still have some way to go before we can be assured the recovery will be self-sustaining.*”

Even Bernanke realizes the government’s current policies have not yet created the conditions that will let the economy stand on its own.

The problem is that the government, including Bernanke, may not realize that the best thing we could do is to stop doing things that retard the economy, and let the free market system work. That includes not destroying the value of the dollar.

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Should Santa Bring Us a Stronger Dollar For Christmas?

Treasury Secretary, Tim Geithner, says “We recognize the very important role of the U.S. in the global economy” and that “it is very important to the United States that we have a strong dollar.” Having said this, absolutely nothing is done to preserve the strength of the dollar, we assume because the government believes, as do consensus economists, letting the dollar deteriorate helps our economy.

Why let the dollar deteriorate? Most often we hear that if the dollar falls as compared to the European and Asian currencies, it makes our products less expensive for them. That should help exports. To some extent this works. ***But what should we export today?*** We no longer want heavy industry and labor intense production. So, we don't export cars, steel, etc. Most of our trading partners subsidize or protect their agriculture industry hurting our export of agricultural and food products.

Twenty years ago when our partners worried about the strong dol-

lar, we were a manufacturing powerhouse and a slight drop in the value of the dollar really stimulated our trade.

Today, however, it can do more harm than good. China, to increase its exports, has tied the yuan to the dollar, so when the dollar falls, it does not increase our sales to China. But as a major manufacturer, when the dollar falls it does increase China's sales to Europe and Asia.

Conversely, when the dollar falls, Europe and Asia find their exports to China and the U.S. hurt, because it means their goods cost more.

For America, the falling dollar is inflationary because it means non-Chinese goods cost more. From foreign cars to oil, our costs go up. While we do a lot of assembly here, we are now heavily dependent on foreign countries for manufactured goods.

Twenty years ago a weaker dollar would mean that we would buy more domestically and less foreign goods. While there is some of that, we manufacture too little here now for this to outweigh the impact of the increase in import costs.

If China were to uncouple the yuan from the dollar, the initial domestic impact would be to create a lot

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of inflation. Since we import far more than we export, even without uncoupling the yuan, the fall of the dollar has hurt the recovery, especially with the increase in petroleum prices taking buying power out of the economy.

The real damage is less visible. Current government policy is to keep interest rates low and pump liquidity into the financial markets. When coupled with a low value dollar, this encourages American entities borrowing here and investing the borrowed dollars abroad.

This helps the recoveries in Europe and China, but not America. Of even greater concern, as our currency deteriorates the willingness of foreign entities to purchase our government debt declines. China, India, Russia, Brazil, and others have all begun to express an interest in reducing their holdings of dollar denominated debt.

If this expression picks up steam and becomes a reality at a time when we are creating major growing deficits, it will cause interest rates to rise and materially injure our financial structure. India recently purchased a substantial amount of gold rather than dollar denominated securities. This should be a warning.

Our currency stopped being backed by gold during the depression. We first devalued the dollar from \$20.67 per ounce to \$35 per ounce and then eliminated ordinary citizen's ability to exchange dollars for gold. Foreign governments could still exchange dollars for gold at \$35 per ounce until 1971 when we were forced by shifting trade balances to end convertibility.

Today, the value of our dollar is set by the world's perception of the relative value of what the world produce for us as compares to what the world can buy from us or others with dollars.

Thus, if the dollar ceases to be the median of international trade or what we produce for export ceases to be of value for the world, so will the dollar. If the world wants less of our goods, than we want of theirs our dollar is less valuable to them.

There are consequences if the interest on our debt to foreign nations grows too large, our economy doesn't recover, we experience runaway inflation, or other similar mishaps. Let's hope the global community keeps believing in the value of the dollar.

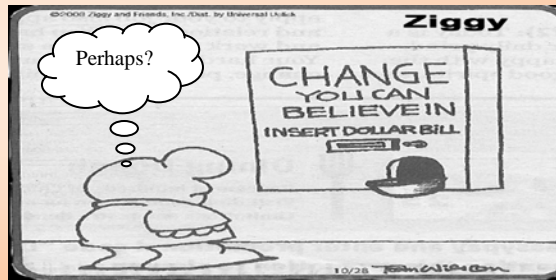
If Santa brought us a stronger dollar it might not be a bad present.

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Recent Cartoon



THE WISE OLD OWL

“Recovery” is continuing, and we should hit a plateau as we enter 2010. Various components of the economy will experience recovery at different times and with varying levels. Interest rates are at a 119 year low. Short term rates should stay low through 2010. As the excessive liquidity that the Fed has created begins to work its way into the economy we will see inflation begin to increase and rates rise.

This is a good time to make sure you have adequate fixed rate financing for the changes that will be occurring over the next 12 to 18 months. Determine how you will handle increasing economic activity as it occurs and put your financing in place now. For 2010, we should see from 2.5% to 6% inflation based upon current trend models. Plan now for how this will affect your raw materials availability and costs.

China has followed an aggressive stimulus policy and is beginning to face all the potential bubbles that come with it. That means a high potential for inflation and economic dislocation. If you either export to China or obtain supplies that are directly or indirectly sourced from China, plan how this will affect your operations over the next 12 to 18 months.

India has and will continue to experience supply side problems. This was evident in recent major labor disruptions. This brought supply problems for many American businesses, as well as disruption to many customer service operations.

Plan for the impact of many local and state governments materially increasing taxes and service fees through 2010 in order to handle their budget short falls. The mid-term elections could bring changes in how the local, state, and federal government approach the current economic cycle. Plan for both how their current or altered approach will affect your business over the next 12 to 18 months. Be ready to shift accordingly.

Our action step workshops are helping our clients tailor their strategic action plans for the next 12 months. Call us to learn more about how we can help you.



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