

Post War - Striving for Normalcy

“Everyone can recognize history when it happens. Everyone can recognize history after it has happened; but only the wise man knows at the moment what is vital and permanent, what is lasting and memorable.”

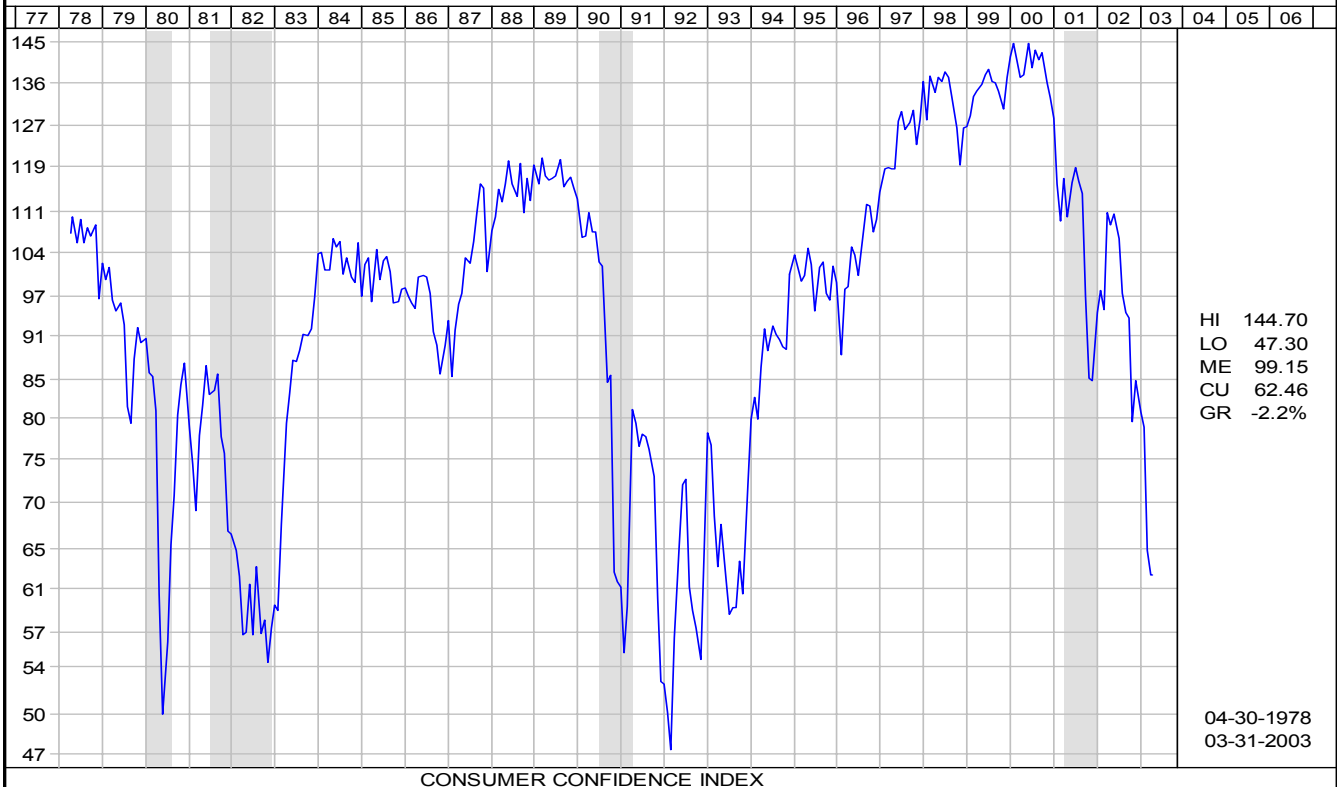
Winston Churchill, 1874-1965

While statues of Saddam Hussein are toppling in Iraq many people are struck by how quickly his regime crumbled. The Iraqi military proved largely ineffective against the far superior coalition forces and none of the pre-war worst fears materialized. There certainly remains much work to be done in Iraq, but as the daily war news begins to fade from newspapers' front pages, life in the U.S. should start to return to normal.

Now that victory can be claimed, where does our economy stand? The economy is growing, albeit slowly. Contrary to popular opinion, there are many companies with solid financial underpinnings that are doing well by posting respectable earnings growth and steady cash flows. The chart above shows that corporate profit growth over the last 30 years has averaged 6.6% and the current decline in profits is not as deep as many might expect given the massive decline in stock prices over the last three years.

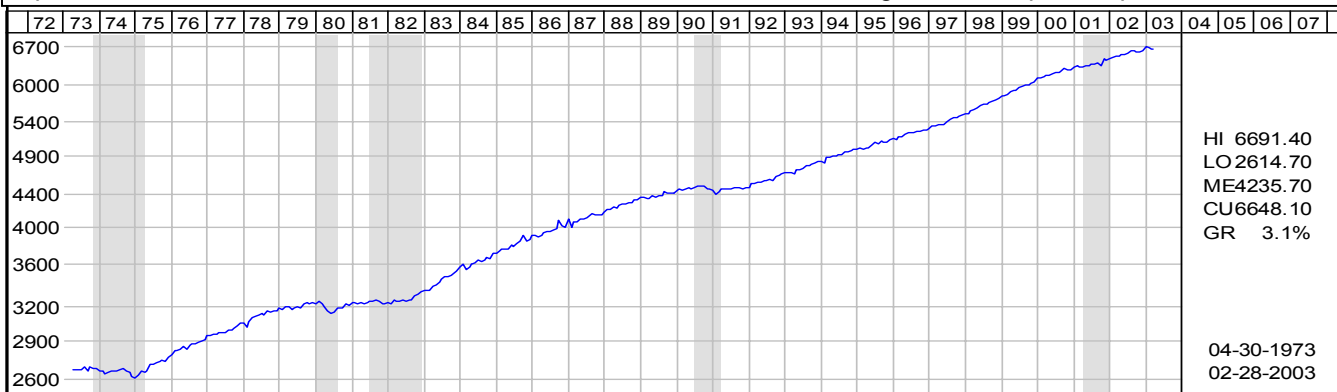
Interest rates are low, the price of oil has returned to reasonable levels and, importantly, inflation remains under control. Inflation is much more detrimental to the long-term prosperity of people than is recession. When in a recession, people work harder, spend less, and are more careful about the expenditures they do make. This is a self-correcting mechanism. In an inflationary environment, the incentive of people is not to work harder, but to speculate; not to borrow less, but to borrow more; not to spend less, but to spend more.

Perhaps the economy can find a way to realize its full potential. Of course, there are always numerous things that can setback economic growth. For one, the outbreak of SARS is having a severe impact in Hong Kong and other parts of Asia. If such an outbreak occurred here in the U.S. it could not only claim many lives, but also further sicken the economy. In addition, threats or hostile actions from countries like North Korea, Iran or Syria could also have a detrimental effect on the economy.

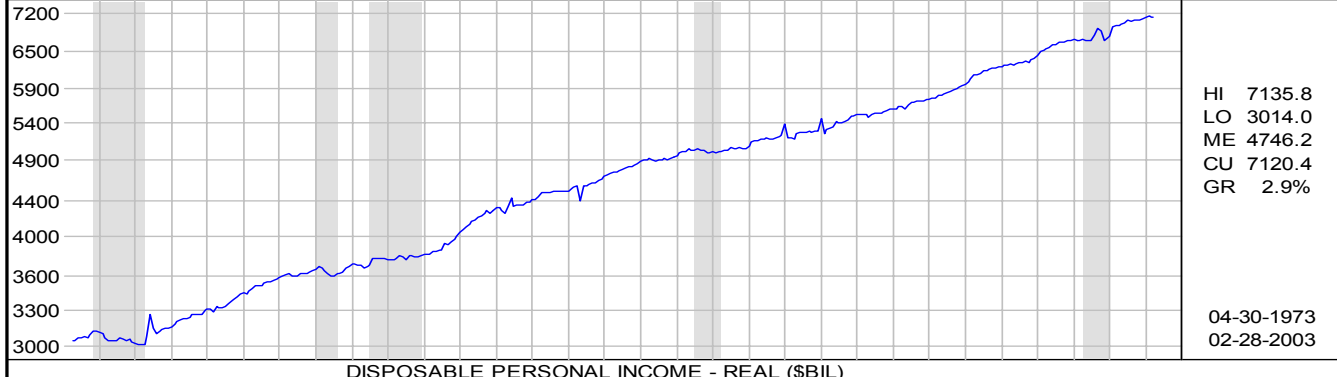


CONSUMER CONFIDENCE INDEX

Consumers account for about two-thirds of economic activity, thus they are the key to the success of the U.S. economy. Although consumer confidence has taken a beating over the last three years (see chart above), as consumers begin to unglue themselves from their televisions, they'll likely resume their prior levels of discretionary spending. The American consumer really has been quite reliable, in that income earned is income spent. Over at least the last 30 years this relationship has held (see charts below); personal consumption expenditures have increased at a rate of 3.1% and have tracked the 2.9% growth in disposable personal income.



PERSONAL CONSUMPTION EXP - REAL (\$BIL)



DISPOSABLE PERSONAL INCOME - REAL (\$BIL)

Madison Financial Advisors