

## A Long Slog to Fix Unemployment



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Sometimes investors are right for the wrong reasons. We were apprehensive about credit in 2008. Underlying this were concerns about the dollar, the sustainability of the triple deficits (current account, trade and federal budget) and the associated interest of foreigners in continuing to take the other side of these situations. This was the heart of our apprehension, and we positioned accordingly. A global economic and credit crisis followed, worse than anything we expected. Yet we didn't anticipate that it would be financial institutions' leveraged positions in triple-A rated mortgages that would ignite it.

Former Fed Chairman Greenspan addressed this very issue in a speech early this year, pointing out that investors can hedge for possible events that concern them. And many market participants, looking at these same fears, did indeed shift positions in one market or another. What investors cannot do is set up an investment position for something unknown. An exogenous event cannot be anticipated. And no amount of regulatory reordering or the revamping of capital adequacy guidelines — both of which we will soon see — will ever fully protect us from such events.

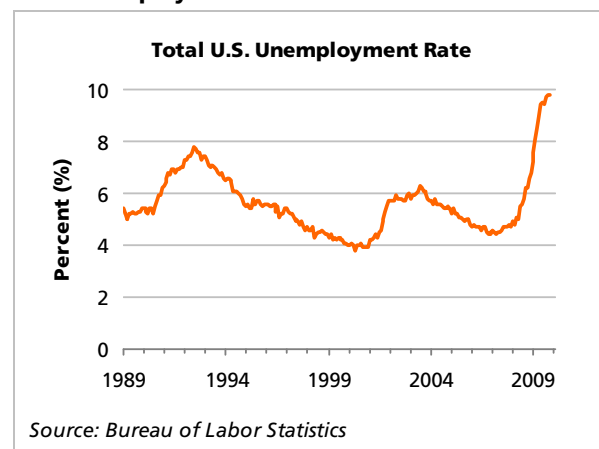
Now the economy has pulled back from an abyss, the apparent stability of housing prices being a necessary condition for that. The focus of investors is on the process and pathway to revitalize the global economic environment. Many anticipate a quick recovery, essentially an economic version of the coiled-spring rebound witnessed in credit and equity markets. Others are not so sure. Will growth come from the government, corporate spending, trade or the consumer?

It is obvious that the federal fiscal spigot will remain open, flooding the economy with jobs programs of one sort or another. At the same time, outside of the finance sector, corporate health is generally very good. Productivity gains and parsimonious hiring practices have made for good profitability. If corporate cash flow were channeled to capital expenditures, investments that would expand their businesses, additional jobs would be created. We are watching capital expenditures carefully to see how much they might grow. However, 70% capacity

utilization in the economy certainly provides for much slack, so it appears the easiest path is for companies to utilize their cash for share buybacks, dividend increases and acquisitions. M&A activity has clearly started.

This becomes problematic for job creation going forward. To return us to a full-employment economy, we need to create 15 million new jobs over the next five years. The U.S. economy has 139 million jobs, 8 million less than when the recession began. Our available work force is 154 million people, a number that is growing by about 1.5 million each year. The official unemployment rate, at 9.8%, is high and it is rising. If we add in "marginally attached" workers (those too discouraged to look for a job) and part-time workers (who can't find a full-time job) the rate is more like 17%.

### Total Unemployment Rate Just Hit 9.8%

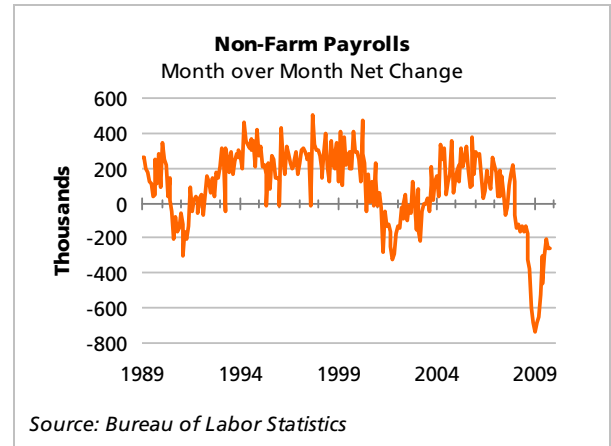


As things recover, companies are likely to extend the work week of those part-timers. Pushing them back to full-time hours may be good for them. Raising the average work week from 33 hours, which it is now, to 33.8 hours, where it was at the start of the recession, would be equivalent to hiring 3 million workers. However, this would only be adding hours, not adding new jobs. This is not good news for the new entrants to the labor market, or for the 4 million out of work from retail, construction, manufacturing or finance. As Bruce Springsteen said "These jobs are gone and they ain't comin' back."

To gain the jobs we need to create full employment, on a five year horizon, will require about 250,000 new jobs a month. From 1999 through 2008, we averaged 50,000 per month. In the 1990s, the average was 150,000 each month. Both of these figures are a long way from 250,000. If we average as many as 200,000 new jobs a month over the next two years, the unemployment rate will still be 9%.

A good understanding of economics is the foundation of our portfolio management approach. Learning and understanding what we can see and measure is a big part of that process. Yet it is realizing what we cannot see that gives us useful insights. Just as it was hard to expect large banks with triple-A rated mortgages crashing, right now it's hard for us to see how we get back to full employment. Maybe we are missing the additional jobs created by a more robust federal presence, but our focus is turning to the implications for consumer behavior and spending that a high unemployment rate of long standing will impart. ■

**Current Job Losses Stymie Full Employment Goal**



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