

Memorandum

To: Clients, Associates & Friends of Pro@ctive Advisory
From: Mark L. Wyssbrod, Managing Member
Date: January 24, 2014
Re: Economic observations: Unemployment divergence and 2014 predictions

In this memorandum, you will receive information about the following:

- Unemployment divergence
- Printing money leads to inflation, right?
- 2014 predictions

Please contact me should you have any questions. Each day provides us opportunities, our job is to take advantage of the best opportunities.

Unemployment divergence

Good news the unemployment rate has fallen from 10.0% in October 2009 to 6.7% in December 2013! This is the lowest rate since October 2008 when the unemployment rate was creeping up. Perhaps the falling unemployment rate is not as rosy as it may appear. For instance, the rate has fallen over the past several months due to individuals choosing to remove themselves from the labor pool. When individuals remove themselves from the labor pool they are no longer looking for employment. Without employment they do not earn compensation and have limited, if any, purchasing power.

The December job creation was only 74,000. This is the smallest job creation amount since January 2011. A part of this might be weather related, due to the government shut-down or delays in hiring due to the Federal Reserve discussion tapering (reduction in bond purchases).

The labor participation rate of individuals in the working age groups was 62.8%. In January 2003, the labor participation rate was 66.4%. The rate has steadily been falling since the Great Recession \ Small Business Depression began.

You might want to believe the individuals dropping out of the labor force are heading into retirement. Unfortunately, it appears to be the 20-to-30 year olds which are no longer participating. This means fewer individuals are receiving the experience and knowledge of business and industry. This may affect our economy in 5 – 20 years when we ask where leadership and solutions are. The older demographics continue to be fully employed. This may

be due to having to save for retirement or due to staying employed during higher income years. Or as one author quibbled, it may be due to having to support the younger generation which is not employed.

Finally, the U-6 or under employment measures the individuals who can and want to work more and/or are not in the ideal job in the economy for them (i.e. college graduate in finance working in a low-end service job). The U-6 and U-3 (unemployment rate) generally is about 6 points. So when the U-3 decreases, generally speaking so does the U-6 rate. However, the gap appears to be widening. This might indicate stress is occurring in the labor markets.

Month	U-3	U-6	Difference
January-13	7.9%	14.4%	6.5%
February-13	7.7%	14.3%	6.6%
March-13	7.5%	13.8%	6.3%
April-13	7.5%	13.9%	6.4%
May-13	7.5%	13.8%	6.3%
June-13	7.5%	14.3%	6.8%
July-13	7.3%	14.0%	6.7%
August-13	7.2%	13.6%	6.4%
September-13	7.2%	13.6%	6.4%
October-13	7.2%	13.7%	6.5%
November-13	7.0%	13.1%	6.1%
December-13	6.7%	13.1%	6.4%

On a positive note, if you are a professional with experience and knowledge and/or in technology your unemployment rate is ~3%. This means you are in demand!

Printing money leads to inflations, right?

The Federal Reserve has created (depending on which article you read) three plus trillion dollars in liquidity since 2008. At the same time the US Treasury has continued to print money. Both have resulted in an increase in money supply. Many individuals are initially thought that inflation would be the result. After all, creating money does not add value.

However, the US government statistics do not indicate any inflation problem at this time. In a matter of fact, inflation appears to be below their target. What factors might have influenced minimal inflation after this gorge of money creation? First, as mentioned above the percentage of individuals in the labor force has continued to decline for the past decade. When individuals

do not earn money they generally have minimal purchasing power. As demand for purchasing declines, so does price.

Second, during the past several years efficiency has increased significantly. New technologies and processes have reduced the amount of time, energy and resources needed to complete the same task. As efficiencies increased, prices have been able to remain stable or decline with profits increasing.

Third, businesses and individuals are deleveraging their balance sheets. Profits and income are being used to purchase assets (which have shown increase in prices) and to reduce debts. When the business or individual is purchasing assets and reducing debts they are not purchasing items. When they are not purchasing current items to consume or reinvest it lowers demand. Lower demand reduces pricing power.

Fourth, it appears as if commodity prices have peaked and have now fallen significantly. With lower commodity prices, low wage costs and increase in efficiency business can make solid profits even at lower prices.

There are many more possible reasons to this mega-complicated situation. My guess is inflation will begin to show up in statistics and reality by the end of 2016.

2014 Predictions

- Georgia 400 toll was removed right before Thanksgiving 2013 in its one and only location; by the end of 2014 Peach Pass lanes (new toll) will be from Buckhead to Cumming, Georgia resulting in a new toll over a wider area
- The 2014 economy will stabilize and provide opportunity for those who seek it. The stock market will be more volatile than the economy.
- The price of oil will drop to or below \$80 per barrel. This sounds great for when filling up your tank; however a lot of people have invested in oil and gas producers. The result may be a lower amount when filling up your tank, but individual's net worth may fall farther than their savings.
- Business owners will continue with low bid selection even though it destroys the overall value. The mindset of the average business owner is that they have not been compensated for the past 6-8 years so they need to be rewarded before their partners. This is primarily due to the pressures of being overleveraged as both a business and an individual.

- The Federal Reserve continues with quantitative easing for the next decade. The International Monetary Fund stated they have a major concern for deflation, not inflation, even with all of the money being printed and liquidity injected into our and the world's economy. This may signal continued liquidity assistance by the Federal Reserve and other countries central banks for years to come.
- Interest rates will remain low; however when small businesses will not be eligible for low rates as banks will place lending floors on loans (i.e. around ~6.5%). The banks will state this is due to "risk", but in reality it is due to profitability and small businesses need the money more than there is supply due to poor financial position and working capital needs for growth.
- Inflation will begin to show up in statistics (and reality) by the end of 2016 to 2018.

Conclusion

2014 appears to be a stable year for small businesses after multiple years of challenges and a slow recovery. As business owners and employees we must look for the best opportunities. Do not become distracted with administrivia or unimportant items, even though they may cause stress. Stay focused and surround yourself by the best clients, team members, associated and friends as you possibly can. Remove negative forces from your business and life.

It will be a great year!

Mark W.

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