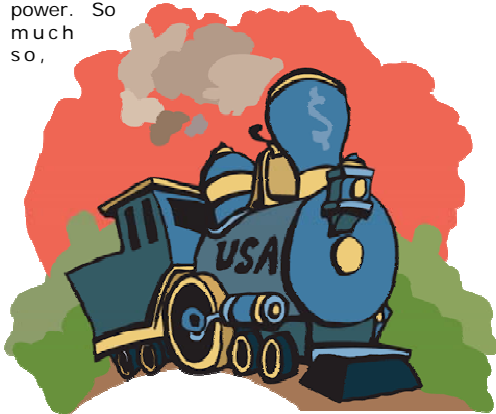


## "Trains and Boats and Planes"

If the USA has been the economic locomotive pulling the global economies into the new world, the American consumer has been the engineer bearing down on the throttle to squeeze out every last bit of power. So much so,



that we now spend 7% more than we produce each year. However according to the Sept. 14<sup>th</sup> issue of *The Economist*, the rich countries no longer dominate the global economy. Measured in purchasing power parity, the emerging economies now account for more than half of the total world output!

For as long as we can remember, the US either kick started growth or presaged contraction. Usually we were joined by our rich neighbors, Europe and Japan. But the slack in global demand due to their weary economic locomotives has been replaced by the rapid integration of China, India and other emerging economies, driving our global train forward.

This happened in the face of dramatic growth here at home. According to *Forbes*, the US economy grew by 30% in the five years since 9/11, while the world economy expanded by an unprecedented 47%. The global engines are firing on all cylinders!

In the past when the USA engine stalled, the rest of the global train was derailed. Remember last quarter's newsletter, "Blame it on Ben", how Ben Bernanke's mere words rocked the world markets? Although rocked, they weren't derailed. While the US and the other developed countries are still the behemoths in the railroad yard, they are now coupled with these new global titans.

It's difficult to conceive of the power that could be generated by 7/8<sup>ths</sup> of the world's population of these developing countries, but *The Economist* predicts that the 21<sup>st</sup> century "could see the fastest growth in average world income in the whole of history," a bold and revolutionary prediction. If so, new locomotives and extra muscle will be available to pull our global train to transport more and more cargo.

This may not happen smoothly. Big changes don't happen without friction, as we all know when stuck at the rail crossing watching the train gain speed with tugs and jerks. However if there are more economic engines that don't rely on the US consumer, many experts believe that there can be rapid global growth without the bone jarring rattling caused by poor tracks. But there could be a faulty switch down the line - protectionism, isolationism, governmental interference could derail this global growth spurt.

The resilience of the world economy sailing through the stormy waters of regional wars, terrorism, and soaring oil prices is the end result of the newfound flexibility and productivity of this global integration. Here at home our economic ship has been steaming ahead quite nicely while the recently rough seas have calmed down. The Fed has paused its interest rate hikes. Inflation worries have subsided somewhat. Gas prices have come down to almost palatable levels.



However, the old conundrum of the longer term interest rates going down while short term rates are high is back, while a new conundrum was born as the almighty dollar firms against most foreign currencies in the wake of our unsustainable trade deficit, requiring us to borrow \$2 billion each day from global neighbors.

How do we add ballast to prevent the further pitching of these unsustainable imbalances of our economic ship? Most experts admit that they don't know! However, some attribute globalization as the likely reason these imbalances can co-exist and believe that the development of these emerging economies will be the shipwright which will overtime right our own economic ship. Just as ships travel slowly, these issues take time to resolve. Our more immediate concern is the slowdown in our own economy here at home.

Everyone knows that uneasy feeling at the end of a long plane flight just before the landing. We feel uneasy because our economy is slowing down for a final approach. The Fed has been trying to engineer a soft landing. A soft landing occurs when the economy slows enough, so as to not rekindle inflation, but not too much to suppress future growth.

Some investors have that uneasy feeling that our flight path is too-steep to land safely, that the Fed already has slowed growth too much by raising the Fed Funds rate to 5¼%. They cite the cracks in the housing market, sputtering auto sales, the advertising slump, and the Philadelphia Fed's regional economic activity index nose-dive into negative territory denoting contraction as reasons to brace for the worst.

Other investors, although concerned, think we're coming in for a smooth landing with the S&P 500 near a 5-year high with the P/E ratio near its lowest level in that period, cash-flush corporations with projected earnings estimates hovering at 10% and an unemployment rate of less than 5%. And the Fed agrees. They expect the economy to expand by 3.25% to 3.5% this year, core inflation to average 2.25% to 2.5%, and the jobless rate to stay at 4.75% to 5%. Sounds like smooth air and a soft landing. But remember, the Fed is the pilot and they must reassure the passengers.

Investors, the Fed, economists, pundits, we're all in the same boat. No one really knows the long term results of these epic global events, nor can we foresee turbulence caused by air pockets. Our pilot must be cautious when he banks into our final approach. So too must we be cautious as our economy slows. For us caution doesn't mean conservatism. Caution means banking on that long-term, diversified investment strategy which cushions risks.

So let's not all assume the crash position, but rather buckle our safety belts for that extra degree of caution. We're charting new territory each day. Our current economic slowdown is just one segment of our



long journey. Our flexibility and resilience has made America the world's foremost economic power. Let's maintain a steady course to ride out the unavoidable turbulence that lay ahead.

But we can all hope for a soft-landing and smooth sailing into the new global world.



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4940 Washington Blvd.  
St. Louis, MO 63108  
(314) 367-6555