

# The Hickory Group

## OUTLOOK & COMMENTARY

AUGUST 23, 2009

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## Data Discernment: All Signs Point to Further Stimulus Jobs ... Homes ... Deficits ... Health Care ... Bernanke ... SBUX

### Reflections

- A raft of recent economic data, central banker policy comments and White House deficit forecasts provide continuing evidence supporting our near- to medium-term negative outlook for the U.S. economy and the health/purchasing power of the U.S. consumer.
- We do scan economic data for upbeat data points to prove the U.S. economy has stopped declining and is preparing to rebound. However, our singular data point for U.S. economic health, the unemployment rate, continues to surprise to the downside (data herein). Hence, until we see stabilization in this data point our negative outlook will remain in place.
- We, like others, do not believe that short-term gyrations in public equity markets are sound measures of the state of the U.S. economy or the state of the U.S. consumer. The U.S. unemployment rate is the true measure of U.S. economic health: Employed persons purchase goods and services, save and invest and add to the virtuous cycle of value creation and the growth of GDP. No other data point tracks the base driver of U.S. economic health than persons employed.
- We remain quite concerned at the previous data point presented by Wal-Mart's negative growth of same store sales, portending the need for prolonged government stimulus/intervention. This significantly negative data point presents the following problem: The U.S. government's stimulus plans, which help to temporarily fill the hole in the U.S. economy created by a distressed consumer, cannot continue without risking serious, long-term U.S. dollar value destruction.
- **The question for analysts becomes:** "When does stimulus/intervention spending cause the U.S. to reach a tipping point where by (i) higher taxes for the foreseeable future are a necessity to meet entitlement needs and debt interest payments, (ii) interest rates remain artificially high to attract buyers of U.S. government bonds, and (iii) foreign central banks significantly decrease holdings of U.S. debt?"
- As we reflect upon the data herein, we remain convinced that businesses must sharpen their customer motivation programs. **Customers are one of the few sources of cash available in the U.S. Thus, now more than ever, motivating the customer is job one for all enterprises.**

## I. Report Highlights

- We have selected a number of diverse data points for consideration. These points, both quantitative and qualitative, support our view that this consumer driven 'Decection' is unlike any other economic period in U.S. history. The common theme, we believe, is a broken U.S. consumer who lacks the liquidity and savings/buying power to propel the U.S. economic engine.
- Our forecast remains unchanged: The U.S. consumer will be worse off by January 1, 2010 and is in significant need of liquidity from the lender of last resort: the U.S. government. We are pleased that certain other research groups at the Federal Reserve gathering in Jackson Hole, Wyoming spoke to this thesis and have made light of the critical need to supply the U.S. consumer with near-term liquidity to assist in servicing installment and mortgage debt as well meeting other basic needs.
- This urgent need stems from the massive loss of U.S. household wealth and the lack of consumer credit. As Martin Feldstein stated at the aforementioned Federal Reserve conference, approximately \$12 trillion of household wealth has been eviscerated since December 2007.

## Data Points

- **Jobs:** The U.S. government reported last week that the number of U.S. workers filing new claims for jobless benefits unexpectedly increased to a seasonally adjusted 576,000 for the week ending August 15, up from 561,000 the prior week. Economists polled by Reuters had forecast such claims to be 550,000. Consumer theme: Rising unemployment creates a dead man's spiral of negative sentiment, which certain media entities are boldly attempting to counter via magnification of good news and discounting negative news.
- **Homes:** Single-family home purchases climbed 7.2% to a 5.2 million annual rate, the highest annual rate since August 2007, according to the National Association of Realtors. However, this data point was offset by several temporary stimulants: (i) artificially low interest rates, (ii) tax credits which are set to expire by the end of 2009, and (iii) artificially low market prices (a significant number of homes sold were foreclosed properties). Consumer theme: A distressed consumer leaning heavily on various inducements and one-time credits to support purchases. Moreover, as purchasing assistance ends (tax credits and interest rate assistance), expect a middling to declining homes sales trajectory.
- **Deficits:** The White House's forecast for deficits during the period of 2010-2019 increased to c. \$9 trillion from estimates put forth in early 2009 of c. \$7 trillion. The initial forecast for a \$7 trillion deficit, released in the spring of 2009, relied on projections showing GDP decline of c. 1.2% for 2009, a figure that vastly misjudged economic realities. Consumer theme: the economic health of consumers was significantly worse than policy makers had predicted, despite substantial access to economic data. This negative deficit revision was forecasted in our July 29, 2009 report: "We fear that U.S. and European policy makers are listening to economists who don't fully comprehend the deep implications of the current consumer driven Decection."

## I. Report Highlights (*cont'd*)

### Data Points

- **Health Care:** The U.S. health care debate is certainly impassioned and makes for good political theater. **We stated in our report dated July 29, 2009,** “We do not believe a complete overhaul of the U.S. health care system that satisfies all needs is attainable on the first attempt due to the varying interests of all the parties at the table” Consumer theme: We stand by this comment and current actions on both sides of the political spectrum to date support our thesis. The ultimate outcome of the health care debate is higher consumer taxes due to increased government spending.
- **Bernanke comments:** “Strains persist in many financial markets across the globe,” Bernanke said in a speech at the Kansas City Fed’s annual symposium in Jackson Hole, Wyoming. “The economic recovery is likely to be relatively slow at first, with unemployment declining only gradually from high levels.” Consumer theme: Unemployment will continue to negatively impact consumer spending and consumer psychology. Further evidence of a possible dead man’s spiral of consumer sentiment.
- **Starbucks:** Starbucks plans to increase prices in order to offset lost revenue and provide strategic separation between its offerings and that of McDonald’s and Dunkin Donuts. According to press reports, some markets will see prices increase by c. 5 – 25 cents for various specialty coffees and additional items (espresso shots, milk). To make up for the increase, Starbucks commented that certain smaller beverage items without specialty ingredients will cost 5 - 10 cents less in some areas. Consumer theme: The price increase hurts consumers but helps Starbucks to create strategic separation. It is dangerous to compete with competitors on price, and Starbucks wisely asserts their premium position in the marketplace. There is value to premium pricing, and Starbucks is wise to follow this path.

## II. Near Term U.S. Policy Considerations

- We firmly believe the conversation for a second consumer liquidity/stimulus plan needs to begin as soon as possible. We believe this conversation will begin around December 1, 2009 in order to spur Christmas spending and help incumbents illustrate their sympathy to a battered electorate in time for the 2010 campaign season. Most likely, given political sensitivities to the term “stimulus”, politicians will use a more palatable term, such as “consumer investment” or “American renewal”.
- The back to school season is hopelessly negative for retailers. Thereto, we believe the best outcome for retailers is to reinvigorate their customer relationship software so as to better track consumers who do open their wallets so they can reach these persons with early Christmas shopping discounts
- The F.D.I.C. is facing a breach point regarding funding banking failures. Most likely private equity will gain needed concessions to begin large scale investment in the financial sector

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