



## ANALYTICS INVESTMENT ADVISORS, LLC

### The American Economy

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*“The greedy drive of the scrambling private sector is not as pernicious to civilizations as the collective ennui produced by vast cadres of lethargic and unaccountable public servants doing supposedly civil work.”*

Arnold J. Toynbee

*“Luckily, dysfunction in Washington is only one side of America’s economy.”*

The Economist<sup>i</sup>

Victor Davis Hanson recently wrote an article titled: “How to Weaken an Economy”,<sup>ii</sup> where he takes a historical perspective to postulate, that if one deliberately tried to “ruin” the American economy, what policies would serve that objective. The commonalities he conjectured are as follows.

- Create an unaccountable and intrusive government in constant need of more money to pursue more social goals. The more the federal government mandates, the less employers profit, hiring fewer employees, and the more citizens are shielded from a capital-creating, free market system.
- Make laws malleable to ensure capriciousness and unpredictability for employers and investors. Moreover, redefine laws based on what is socially useful where creditors are deemed reimbursable based on nobility rather than contractual law.
- Heighten cynicism in the sense that: “Why should I follow the rules if nobody else does?” Distrust and fatalism, were no small element in successfully ruining Greece.
- Invest in remedial education where grades and test scores count little for college admission, with the aim not to turn out graduates with expertise or knowledge to build a strong economy, but rather to graduate students that are invested in a similar ideology of redistribution.
- Redefine the notion of profit, getting ahead, and being rich and successful as analogous to cheating, proof of unfairness or shameful. In this context, compensation is seen as capricious, not taking into account education, knowledge, level of experience, hard work or comportment.
- Manifest division, domestic wars so to speak, along so many fault lines that concerns about pressing issues such as slow or non-existent growth and massive debt give way to social issues such as of gay marriage, discrimination, or banning semi-automatic assault weapons.
- Borrow as much money as possible, and think of all the ways in which deficits are good; i.e., spreading wealth through entitlements, requiring higher taxes from the wealthy, or inflation that erodes wrongfully accumulated wealth.

- Foster the idea that people with no resources deserve the use of free or low cost currency, while the few who have money don't deserve to profit from it.
- Find ways to discourage private gas and oil production through more federal regulation, and cancellation of innovative projects like the Keystone pipeline, to insure steep import fees and vulnerability to Persian Gulf oil, while at the same time, declaring fracking and horizontal drilling synonymous with pollution and destroying the environment, while spending billions to subsidize wind and solar power which have been proven to be a catastrophic misallocation of America's resources. All of these efforts are manifest to increase the cost of energy and slow the economy.
- And finally, double down on these policies once they have been determined to be successful in slowing growth.

There is no doubt that the U.S. economy is growing at an unprecedented historically slow 1% to 2% annual rate, and joblessness is historically high; 11.1% if one takes into account the lowest participation rate (63.3%) since May 1979. I leave it to the reader to discern the correlation between current government policies, its motivation, and the obvious outcome.

In spite of the currently austere economic situation, the following paragraphs provide reason for optimism in the sense that many states are not waiting for federal help, but rather are adopting sweeping reforms as they vie to attract investments, streamline regulation, improve education, and foster innovation.

#### *Investments*

America remains the world's biggest spender on research and development (R&D). In absolute terms, investment in R&D has grown rapidly, and the number of patents issued is at its historic peak relative to the population. While half of all patents are issued to foreigners, according to a Brookings study, those granted to Americans are getting many more claims and citations. Moreover, 27 of the 30 universities that produce the research most frequently cited in academic journals are American; and, while the federal government is responsible for only 31% of America's R&D, it pays for over half of America's basic research.

This mixture of government-funded basic research, built on and deployed by business, lies behind two of the innovations that are doing most to help America out of its current economic doldrums; hydraulic fracturing and horizontal drilling, which are giving a massive boost to the oil and gas industry, and hence the broader economy.

#### *Energy*

The shale gas and oil bonanza is transforming America's energy potential. Pennsylvania is one of several states enjoying a shale-gas boom, along with Arkansas, Louisiana, Oklahoma and Texas. Shale-gas production in the United States has risen fourfold between 2007 and 2010. With a 20% increase in that period, the United States is now the largest gas producer worldwide, causing gas prices to plummet from over \$13 per million British Thermal Units (mmbtu) in 2008 to \$1 to \$2 last year. Cheap gas translates into cheap electricity, since America's marginal power supplies tend to come from gas-fired plants. For example, in 2011, according to the International Energy Agency (IEA), American factories paid half the going rate for electricity compared to Chile and Mexico, and a quarter of the Italian rate.

Furthermore, the steep drop in the price of natural gas has driven American drillers to hunt for more oil. Applying the same technique to oil trapped in tiny rock pores as to gas laden shales, entrepreneurs have managed to increase America's oil production by a third over the past four years by 7 million barrels per day. By the end of the year British Petroleum (BP) predicts that America will overtake Russia and Saudi Arabia to become the world's biggest producer of oil and biofuels. Inexpensive energy

is cited as an important contributing factor by those who predict a manufacturing renaissance in America, the potential impact of which is not always given proper consideration in longer term economic growth projections.

### *Education*

America's Schools are getting the biggest overhaul in decades as many states have gone beyond the changes demanded by the federal government. For example; 23 states have adopted teacher evaluation tied to students' performance, 43 states now permit charter schools, and 45 states have instigated a new curriculum for English and mathematics, referred to as the "common core". Moreover, there is a growing trend to allow students to start accumulating college credits while in high school and overhauling vocational training to better serve local businesses, who often cite as one of their biggest concerns a suitable worker shortage and the resulting inability of America to lure and retain investors without a better educated workforce.

Raising standards for both students and teachers is also the goal of President Obama's Race to the Top (RTT), which award grants on a competitive basis to states and school districts that present the best plans for improvement, for which nineteen states have received RTT awards. This overall effort and ability to track performance of individual schools and intervene when necessary was made possible by President Bush's rigorous No Child Left Behind initiative. The effectiveness of these combined efforts will not be clear until the results of national tests, due to be conducted later this year, allow a comparative measure of each state's progress. In the meantime it is evident that schools nationwide realize the importance of taking steps to provide a smarter product to be competitive. This is resulting in a dramatic acceleration of reform in America's public schools.

### *In Search of Solutions*

Reforms at the state and local level point the way for improving the national business climate. America's 50 states are consciously and vigorously competing to find the best formula for regulation, education, innovation and taxes, and introducing reforms to that end.

The governor of Kansas, Sam Brownback, notes that his state is winning residents from California, which has the country's highest personal tax rate, and losing them to Texas, that has none. He argues that lower tax states grow faster, create more jobs and generate more revenue than-high tax states. This competition and willingness to tackle many of America's deficient business environments, in conjunction with America's entrepreneurs' natural proclivity to stimulate the economy through innovation, is and will continue to create positive systemic change, a process that can only be defeated through deliberate sabotage by dueling Washington politicians.

Sadly, as the beginning paragraphs indicate, this notion is not inconceivable. So far, however, Congress and the White House have stopped short of serious self-harm, and should eventually do more to confront rising deficit spending and begin to reduce America's \$17 trillion public and private debt.

As such, our investment strategy is to utilize exchange traded funds (ETFs) to stay invested in the general market and sectors that have the potential to outperform; namely, pharmaceuticals, housing, consumer discretionary, biotechnology and financial. A breakdown of the risk adjusted rates of return for different investment strategies offered by Analytics Investment Advisors, LLC as a fiduciary investment advisor for calendar year 2012 and the Q1 2013 are summarized below.

**Conservative Strategy:** Conservative investors prepared to accept lower returns to protect capital and initial investment (Risk Score: 0-110).

**Cautious Strategy:** Investors seeking better than basic returns but with low risk and emphasis on preservation of wealth (Risk Score: 111-200).

**Moderate Strategy:** Prudent investors desiring a balanced portfolio designed to accomplish medium to long term financial goals and an investment strategy which accounts for taxes and inflation. Calculated risk is acceptable to achieve good returns (Risk Score: 201-290).

**Assertive Strategy:** Assertive investors with sufficient income to invest mostly for capital growth. Higher volatility, moderate risk, and more aggressive investments are acceptable to accumulate wealth over time (Risk Score: 291-390).

**Aggressive Strategy:** Aggressive investors intending to compromise portfolio balance in pursuit of higher long term returns. Security of capital is secondary to potential wealth accumulation (Risk Score: 391-450).

	Calendar Year 2012				YTD 3/31/2013
	Return*	Alpha	Beta	Sharpe Ratio	Return*
S&P 500	13.41%				10.02%
Cautious	8.53%	4.48	0.6	1.22	7.30%
Moderate	10.51%	6.58	1.03	1.13	11.19%
Assertive	17.10%	8.43	0.94	1.26	13.44%
Aggressive	22.70%	2.12	1.24	0.81	16.10%

Alpha Difference between portfolio actual return and the expected return.

Beta Expected change in portfolio return per 1% change in market index return.

Sharpe Ratio A measure of risk-adjusted return showing excess return per unit of total risk.

\* Net of Fees

## Endnotes

<sup>i</sup> *The Economist*, March 16<sup>th</sup> – 22<sup>nd</sup> - 2013; page 13, after page 48.

<sup>ii</sup> <http://pjmedia.com/victordavishanson/how-to-weaken-an-economy/>.