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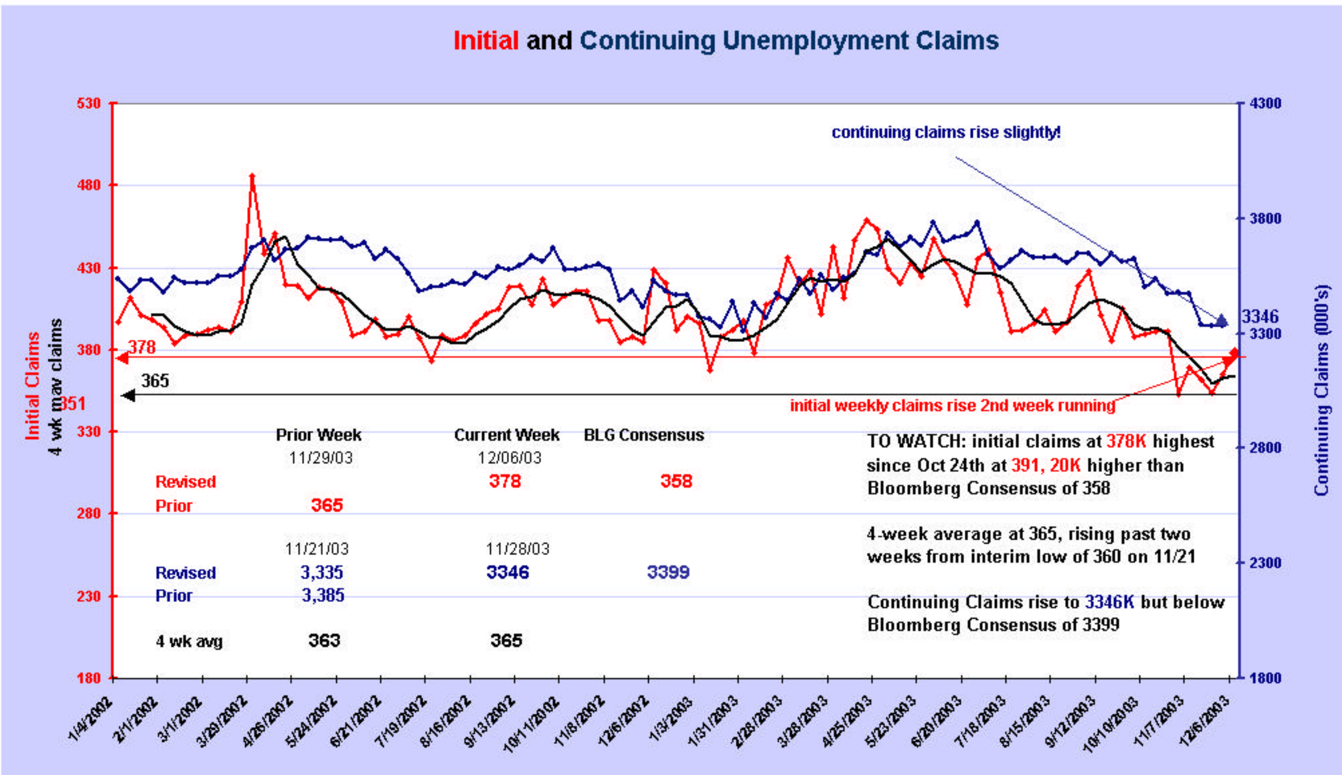
## Setback in Initial Claims for 2nd week in a row and better Retail Sales

## Changing Winds for 2004?




While initial claims data the past two weeks have 'worsened,' we suspect nothing 'real' is changing other than the weather, the Thanksgiving holiday, and the very gradually shifting economy. In other words, 'noise' prevents the real, long-term trends from emerging steadily on a week-by-week basis. We would, of course, be happier if the 4-week average claims continued its descent in an uninterrupted manner, but it has not. Longer term, continuing claims have not yet been perturbed from their recent path of improvement.

### Retail Sales

While the businessman (businessperson?) regains some animal spirits and makes the investment demand equation more a factor for 2004, the consumer is still driving the bus…even if his gas tank (personal income growth) seems to run perpetually on empty. Autos are shooting off the lots with the Commerce Department's calculation at 16.8 million while auto spokesmen say 17.7 million. Excluding autos, retail sales in November climbed 0.4% after a (revised upward) 'no change' in October. The recently released benchmark data on GDP suggest two abiding facts about American consumers…they don't save…and they have been saving less! Underlying the U.S. dollar's weakening position internationally that is a basic piece of economic demography

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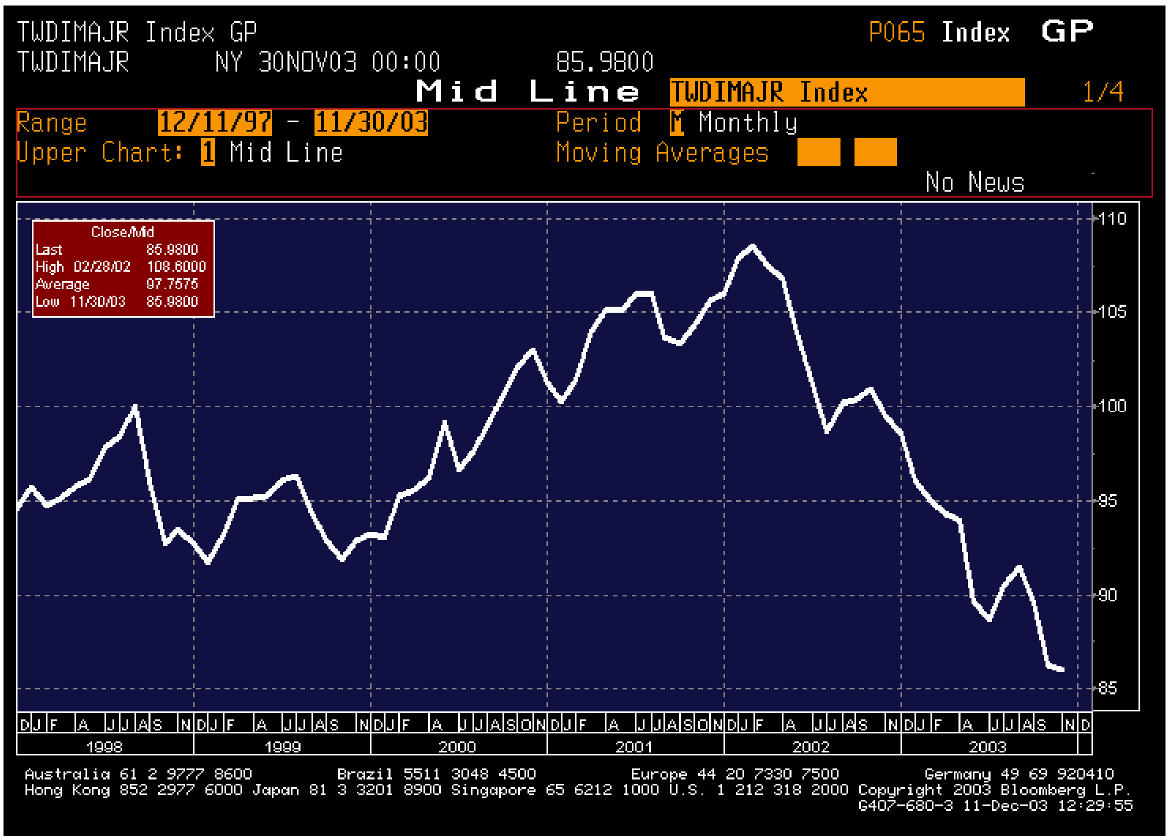
that distinguishes America from its competitors around the world. Virtually every other country can curse American foreign policy and our national political leaders and still pray that the American consumer doesn't stop his indulgence. It is one thing to tell nations abroad that they ought not to be so dependent upon U.S. imports; it is quite another to see them establish policies that stimulate domestic demand at the expense of export growth. Even the OPEC states that are reportedly withdrawing Dollar Deposits from the U.S. (and probably raising the Gold Price as a result) have this Manichean Dualism in their approach toward America. Hate America but love its consumers!




**Trade Weighted Dollar Index**

**(Major Trade Partners)**

The dollar is weakening (as it should) in international trade since its peak in February 2002. It started downhill just about the time that the U.S. slowly began to come out of its worst performance period in 2001 and just as U.S. fiscal policy began to point to an even more aggressive stance. If the dollar's course is influenced by comparative growth rates, the dollar bears will not be as rewarded in 2004 as they have been in 2H2002 and 2003. However, a weaker dollar does impart some price level implications for 2004: import prices will continue to rise and the prices of domestically produced import substitutes will also rise. Part of the deflationary bogeyman will be defeated by the exchange rate change---as it should be---and the pricing power of American businesses that compete against imports will also improve. Exports should also be stimulated---the more so if foreign trade partners of the U.S. actually allow their current account surpluses with the U.S. to wind down. It is impossible for a deficit country to improve its current account without the rest of the world relinquishing some part of its mercantilist practices that worships exports and prevents imports.

**Consumer Spending; the Dollar and Equity Prices in 2004**

The major 'surprise' of 2003 has been the steadfastness of the American Household to spend –out of income or out of cash liberated by capturing equity from mortgage refinancing. Both of these themes get lots of popular press and "talking heads" that preach the "disaster" just around the corner that arises from the profligacy of the American Household always get top billing in the media when singing this song. Bear in mind, however, that those who followed the 'doom and gloomers' in 2003 have equity results that are shameful.

Corporate earnings have sharply improved and equity prices have improved perhaps even more. The "unreasoned" optimism of the American Household has only been exceeded by equity buyers of high beta stocks. Growth outperformed Value by than more than 'just a tad.' The Prudent and Fearful are laggard performers this year. When Ursus appears, he does a lot of damage in a relatively short period, but he doesn't stay long probably because new SUV's run over his tracks and his preserve is encroached upon by new homes recently built on the edge of the forest.

Looking into the teeth of likely increases in prices and interest rates in 2004 (despite the Fed's "considerable period" doctrine), the issue for investors will be whether corporate earnings improvement will outweigh multiple deterioration that normally accompanies rising interest rates. Perhaps, with a weaker dollar, it should be the turn of internationally oriented U.S. companies to gain at the expense of strictly domestic providers. That would seem to be a quite reasonable inference, but isn't that also a bet on better macro policies from abroad? German export demand has sagged recently, not surprising when we look at dollar weakness. Will that push the ECB to become more aggressive? That may be a harder bet than betting against the American consumer!

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