

WSB FINANCIAL LTD.

PRESIDENT'S ECONOMIC REPORT

October 17, 2011

National Economy

Statistics & Trends

A. National.

1. Americans' primary concerns are focused on the falling standard of living and center on real income growth which is affected by lack of job opportunities, debt and waste.
2. The Census Bureau's review of household income has sobering statistics.
 - a. Average income for households fell 2.3%, to an inflation adjusted \$49,445 in 2010. That is 7.1% below its 1999 peak;
 - b. Earnings for males working full time fell to their lowest level due to inflation – since 1978;
 - c. Female income rose;
 - d. Americans living in poverty rose to 15.1%, and children living in poverty rose to 22%.
3. The Federal Reserve "flow of funds reports" disclosed that household's net worth in the second quarter fell \$149 billion dollars.

Given the continuing decline of home values and the drop in the stock market, the net worth of households probably have declined more.
4. A few important facts:
 - a. Total household debt relative to gross domestic product declined to 66% in the second quarter of 2011. That is down from the peak of 76%, reached in early 2009.

- b. However, the historical average is 37%, dating back to 1951.
 - c. The Federal Government debt is now 65% of G.D.P., the highest since WWII, the years of the '40's.
 - d. The above is based on the quarterly Federal Reserve report relative to households, businesses, and government debt as measured to G.D.P.
- 5. The Commerce Department advised that the Gross Domestic Product (G.D.P.) rose at a seasonably adjusted rate of 1.3% in the second quarter.
 - 6. The Commerce Department also reported that incomes of Americans fell 0.1% in August.

B. Consumer.

- 1. The Conference Board's Consumer Confidence Index dropped from 59.4% to 44.5% in August. The future expectation component fell 74.9 to 51.9. The present component fell from 35.7 to 33.3.
- 2. A further breakdown finds that 40.6% of respondents view current business conditions as "bad" and 88.2% expect conditions to get worse or stay the same for at least six months.
- 3. The University of Michigan Confidence Survey disclosed that consumers' outlook as to future expectations slipped to 47.0, the lowest since 1980, when consumers' expectations dropped to 44.4. The survey found that the consumers viewed current economic conditions better and the index rose from 68.7 to 74.5. Basically, what that is telling us is that the average American believes conditions will get worse.
- 4. Additional facts:
 - a. Consumer year over year spending is up 5.1%.
 - b. Year over year incomes however, are only up 1.2%.
 - c. The savings rate of people on the average dropped from 5.5% to 5.0% in July.

5. The Commerce Department reported that consumer spending rose 0.2% in August after growing 0.7% in July.
6. The Federal Reserve disclosed that consumer's credit rose \$12 billion in July. Revolving credit (credit cards) actually fell \$3.4 billion, suggesting that consumers are continuing to be cautious.

C. Employment.

1. Filing claims for unemployment for the week ending September 24 fell to 391,000, seasonably adjusted.
2. The Labor Department recently advised that:
 - a. unemployment dropped in 237 of the nation's largest cities.
 - b. it rose in 103.
 - c. stayed the same in 32.
3. The National Federation of Independent Business reported that in August 33% of small businesses reported few or no qualified applicants for job openings.
4. That percentage is up from 21% in December 2009.
5. Employment remains a critical factor in U.S. growth. However, there are a few lights that should give us some hope.
 - a. The Federal Reserve reported that 5 of its regions reported modest or slight growth; the seven other regions reported slow or sluggish growth.
 - b. The Labor Department reported that employers increased their employment postings for jobs to 3.23 million in July from 3.17 in June.
 - c. In total, the Department reported that there were 52.8% more job openings in July 2011 than two years ago.
 - d. Hiring, however, was up only 8.7%. The reason we hear is twofold: (1) employers cannot find workers with the skills they need (2) the wages are too low to attract applicants.
 - e. The Bureau of Labor reported that employers added 103,000 people to their payrolls in September. That is better than the 57,000 added in August.

- f. According to economists, the U.S. needs to add approximately 125,000 people to the payroll every month just to keep up with population growth.

Actually, if we are to make a dent in the unemployment situation, the U.S. needs to increase payrolls by about 200,000 a month.

- g. The Department of Labor recently advised that we need to add 6.6 million jobs just to regain pre-recession employment levels. That figure does not take in account people coming into the job market since then.

- h. In short, the U.S. jobs picture is bleak:

- (1) 14 million people are on unemployment.

- (2) millions are underemployed.

- (3) more than 6.2 million people, approximately 45% of those seeking employment have been doing so for more than six months.

- (4) unemployment for African Americans is running at 16%.

- (5) for those without a high school diploma, unemployment levels are at 14%, three times as high as those who have a college degree.

- (6) for teenagers, the rate approaches 25%.

- i. The average work week for employers rose 0.1 hours in September over August.

- j. In addition, hourly earnings increased slightly by 0.2%.

Services & Industries

General.

1. Caterpillar and Coca Cola business executives have recently criticized U.S. tax codes and the regulatory process as it relates to their corporate activities.

They are the latest of a growing number of companies claiming how hard it is to do business in the U.S.

2. Just ask the small business people in your local community and you will find many who say the U.S. is anti-business.
3. Americans spent 8.8 billion hours filling out U.S. government forms in 2010. An increase of approximately 19% from 2000. The source is the Office of Management of the Budget.
4. As the standard of living increases in countries that are this country's suppliers, Americans are finding foreign goods are not as cheap as they used to be.
5. A prime example is China.
6. There are seven industries which are susceptible currently to relocating some operations back to the U.S.
7. Some production areas that could be affected are furniture, electronics, electrical equipment, appliances, plaster and rubber products, and machinery and metal products. Mr. Hal Sirkin of Boston Consulting Group advises that in the area mentioned above with rising labor, materials and shipping costs the advantage is slowly tipping back to the U.S.
8. Paul Scott, Executive Director of the Alliance for American Manufacturing, has advised that American businesses are "reshoring", coming back home.
9. Example.
 - a. Otis Elevator Co. is moving operation from a plant in Mexico to a new plant in South Carolina.
 - b. This is also occurring with companies like G.E. and the Ford Motor Company.

Services.

1. The Institute for Supply Management advised that the nonmanufacturing index fell slightly in September to 53 from 53.3 in August; a reading above 50 indicates expansion.

2. The most important fact since the index measures the largest section of the American workforce is that we have still, as of September, avoided the double dip recession.
3. Its most recent high was 50.7 last February.
4. Service companies, i.e. hotels, restaurants, banks, etc. which employ 90% of the labor force have reduced payrolls in September, according to a survey done by the Institute of Supply Management.

Capital Goods.

1. Orders for U. S. factory goods fell in August, the Commerce Commission advises. The drop was small, only 0.2%.
2. However, non-defense capital goods orders, excluding aircraft, rose 0.9%.
3. Orders may fall in coming months because wholesale inventories are increasing.

Manufacturing.

1. Manufacturing, according to the Federal Reserve, continued to grow in August. The Fed's production index rose 0.5% in August, after increasing 0.6% in July.
2. The Institute for Supply Management advised that its manufacturing index rose to 51.6 from 50.0 in August; a reading over 50 indicates expansion.

Wholesale.

1. The Commerce Department reported that wholesale inventories rose 0.4% in August. They rose 0.8% in July.
2. This trend needs to be carefully watched. It indicates a slowdown in purchasers from retailers.

Retail.

- a. The International Council of Shopping centers advised that shopping center revenues increased 5.5% in September.

- b. Thomson Reuters advises that the 23 retailers it tracks reported a 5.1% rise in sales in stores open at least one year.
- c. However, the average vacancy in the top U.S. markets is 9.1%, according to Reis Inc's latest survey. It's the highest vacancy rate since 2000.
- d. A bell weather company whose activity is a barometer of future business activity is Fed Ex. Another is United Parcel Service. These cargo movers businesses have declined. Europe, Japan and the U.S. all posted double digit declines in cargo traffic compared to a year ago.
- e. Fed Ex is predicting, based on its analysis, slower retail sales during the holiday season coming up. Chief Executive, Fred Smith, expects its business during the holiday season to be down by 25 to 30%.
- f. Shopper Trak, which counts foot traffic at malls and studies economics to discover trends, is predicting that holiday sales in 2011 will increase 3% which is less than last year's 4.1%. That's about a 25% decline and would be a significant decline.

Commodities.

- 1. According to the Dow Jones – UBS Commodity Index declined on October 3rd, 14.7% to the lowest level since last October.
- 2. Prices in products like crude oil, copper and corn, as examples, have fallen sharply. Basically, it's a reflection of economic problems not only in the U.S., but in Europe and in Asia.
- 3. The U.S.D.A. in September has downgraded corn production to 161 bushels an acre, down from 170 bushels in August.
- 4. Ranchers are selling off heiffers because of continuing drought and feed costs.
 - a. The result will be higher beef costs next year.
 - b. The government is expecting a drop of 4.5% in beef production next year.

Housing.

1. For the consumer who owns a home the following are sobering facts:
 - a. One in five may have a mortgage on the home that is higher than the home's value.
 - b. The equity on average in a home has fallen from 59.7% in 2005 to 38.6% today.
2. Economists, builders, realtors, and lenders are of the opinion that the current state of economic affairs will depress home prices for years.
3. Home prices are expected to drop 2.5% this year and rise 1.1% annually through 2015, according to recent survey by 100 economists.
4. According to Standard and Poor's Case-Shiller 20 city index, home prices have fallen 31.6% since their peak in 2005.
5. Sales of previously owned homes in August rose 7.7% from July to a seasonably annual rate of 5.03 million, per the National Association of Realtors.
6. However, the National Association of Realtors advised that its index that tracks home sales contracts that have been entered in to but not closed, fell to 88.6 in August from 89.7 in July.
7. The National Association of Home Builders advised that its builder's sentiment index fell to 14 from 18. A reading below 50 indicates negative sentiment. The index has not reached 50 since April 2006. That is over 5 years ago.
8. The Commerce Department advised recently that single family housing starts fell by 1.4% in August from July to a seasonably adjusted annual rate of 417,000, which is the third lowest rate since April 2009.
9. It is reported by the Census Bureau, the rate of home ownership has fallen more in the past 10 years than since the Great Depression.
10. The number of owner-occupied housing units compared to all housing units declined by 1.1 percentage points to 65.1% and is expected to fall further.

11. The Commerce Department advised the median price for a new home in August was \$209,100 and was down 7.7% from a year earlier.
12. The Commerce Department reported that construction spending rose 1.4% from July to August this year.
13. Nationally, the Commerce Department reported that construction of new homes in September was in 571,000 on seasonably adjusted homes. That is a three month low. Construction of apartments also fell.
14. Home construction is reported to be at its lowest level in 50 years.
15. It also is reported that commercial building has declined due to the economy. The reason is that the shaky economy has made financing more difficult to obtain and there is general uncertainty about the future.
16. The hesitancy of banks to loan is also being seen in business buyouts and mergers.
17. Relative to new homes, Ian Shepherdson, Chief Economist at High Frequency Economics, appropriately stated:

“Still the market is dead and record low mortgage rates are not doing anything to help!”
18. Freddie Mac advised that the rate on the 30 year mortgage is down to 3.94%, the lowest rate ever. The 15 year rate also fell to 3.26% also a record.
19. Landlords raised rentals, Reis Inc. reported. Of the 82 markets it studied, only one; Las Vegas did not rise. Average effective rates rose 2.4%.
20. Vacancy rates for the third quarter of 2011 fell to 5.6%. That is a drop of 20% from a year ago.

The Dollar.

1. The dollar's current value, as foreign currencies have difficulties, in all probability will continue to grow.

2. This tends to occur during periods of financial turmoil and currently we have a lot of that in the world.
3. Basically, it is a reoccurrence of the “flight to safety” by currency investors.

Stocks & Bonds.

1. The Dow Jones was off 12.1% in the third quarter. This was the worst quarter since 2009.
2. A bear market is usually defined as a fall of stock prices of at least 20% with the decline lasting two months or more.

Imports & Exports.

1. U.S. import prices fell 0.4% in August, the second consecutive drop.
2. The shipment of twenty foot containers from Long Beach and Los Angeles rose to 305,509. That is up from a year before.
3. Imports are down 9% at these ports from a year ago to 643,388 containers. This indicates that Americans are not purchasing as much these days.
4. The trade gap narrowed in July pursuant to the Commerce Department. Exports rose 3.6% in July and imports declined 0.2%.
5. In July the deficit was \$44.8 billion compared to \$51.6 billion in June.

International Points of Interest.

1. As to financial conditions, the following expressions sum up the current abroad.
 - a. “This is the most serious financial crisis at least since 1930, if not ever.” The above is a quote from Mervyn King, Chief of the U.K. bank.

- b. German Chancellor, Angela Merkel and Jean-Claude Trichet also expressed serious concerns.
2. Inflation in the European common market area rose to 3% in August per European Union's statistics.
3. England's rate is reported to have risen 4.5%
4. China and India together account presently for 25% of the world's energy consumption. Just in 2000 it was 13% and by 2035 it is expected to rise to 33.3% of the world's consumption.

Local Economy

1. Employment.

- a. Unemployment in Springfield was 7.5% in August.
- b. The State reports that Illinois' jobless rate climbed to 9.9%. The jobless rate has climbed for the last four months.

2. Construction.

- a. Locally, the real estate construction market remains subdued. In August, 15 permits for single family buildings were issued, the same as last year.
- b. Since the first of the year, there were 87 single family permits issued compared to 78 for the same time period as last year's. Although more home were built the per building cost is down. From January through August of 2010 the cost averaged \$256,000 per unit versus in 2011, when the value was \$230,000 per unit. That is a drop of approximately 10%.

3. Agriculture.

- a. Corn prices dropped to their lowest point since last December.
- b. The reason is that it appears the U.S.D.A. miscalculated the amount of supply of corn on hand. In recent contact with 66,000 farmers and 9000 commercial storage facilities by the National Agricultural Statistics Services the supply on hand was approximately 200 million bushels higher; that is 23%.

- c. Estimating is difficult but an important function in planning. However, the degree of difference put in question the accuracy and reliability of governmental reporting.

4. New Business.

- a. Hy Vee Grocery chain may transform McArthur Blvd. This involves the old K-Mart building, the old bowling alley, and Title Max. They are proposing a grocery store, gasoline station, and convenience store.
- b. The jobs estimated to be created is 500.

Conclusion

What Americans need is confidence in their future.

It is obvious that short term policies will not solve the country's problems. Temporary tax breaks, short term stimuli and easy money will not cure the country's ills.

What will provide a cure is long-term growth in productivity. In addition, the U.S. must become less of a consumptive and self gratifying society.

The later has already started with consumers with their increase of savings and reduction of purchases of foreign imports, resulting in the reduction of our trade deficit. Let's hope it continues.

The country must also turn away from deficit spending and ruinous borrowing.

To do this, the country must have an ever increasing and sustained productivity growth, and increase in business investment, and better educated and functional workforce.

What must be done besides less self gratification of the consumer is the following:

1. Reduction of the multiple layers of taxes including corporate taxes. This can be paid for by closing the loopholes.
2. Reduction of entitlements. There is nothing free, somebody will always pay. There is no free lunch in life. It's time some of our citizens realize this fact.
3. A moratorium on new government controls and regulations. We need the least governmental interference as possible.

4. A careful control of inflationary factors. The increase in the money supply in the country has been so dramatic that inflation will be a potential problem in the not too distant future.

To get the confidence first discussed above, it is absolutely critical that we turn away from unsustainable budgets and trade deficits and return to an economy that grows at historical rates with low inflation.

More effective growth will provide the resources to pay for healthcare and sustenance needs of the less fortunate.

The factor that will either make or break our future is effective leadership commencing at all levels of structure from the family and throughout all levels of business and to the highest levels of government.