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YOU CAN'T TRUST DOGS TO WATCH YOUR FOOD

My son Chip has a dog, a Border Collie-German Shepherd mix named Hendrix. (Yes, in honor of Jimi). Last Fall when Randy and I were in Chapel Hill intending to watch an unusual event called a Tar Heel football victory, we visited Chip's home where he prepared a wonderful Saturday breakfast buffet for us. The omelets, breakfast rolls, bacon and sausage were all carefully placed on the breakfast room table to cool while we discussed world and Tar Heel events in the living room, oblivious to the goings on of Hendrix. When we walked back into the breakfast room to collect our food, we were met with empty plates, and a dog with guilty eyes and a wagging tail. It reminded me that you can't take your eye off the ball in the investment world for one minute. And as I see it a large part of the reason for this recession in which we now find ourselves immersed can be laid at the feet of one of our federal watchdog agencies.

The Federal Reserve is "Fido." Your "food" to which it has helped itself without your knowledge is your investment and retirement wealth. I'm not particularly enamored of Ben Bernanke and His Boys. You may not realize it, but their easy money policy has helped to consume some of your eggs and bacon.

Nine months ago the Fed sought to maintain our economy's momentum by instituting the first of seven discount rate cuts. Since then we have seen the stock market drop 20% from its October highs. We've also seen the price of a barrel of oil more than double, food costs spiral out of control, the housing market turn into a disaster, the once-sterling reputation of the U.S. financial system be forever tarnished, and consumer confidence tumble to a 16-year low. And to add insult to injury, because of those aggressive rate cuts inflation has now reared its ugly head.

The stock market's performance for the month of June was off more than 8%. That was the worst June on record since the Great Depression. Ten months have passed since last September

when the Fed funds rate stood at 5.25%. Yet aggressive rate-cutting, taking that rate down to 2%, has calmed none of the seas on our storm-tossed national economy.

The New York-based Conference Board research group announced in late June that consumer confidence had fallen to its lowest level since February 1992. Our six straight months of job losses coupled with a precipitous decline in stock and home prices has been the left jab while the sudden rise in food and fuel prices has been the right uppercut, combining to leave the consumer with a gigantic headache.

The Federal Reserve's long round of rate cuts has done no favors to those dependent on oil either. Oil has doubled to more than \$140 a barrel in less than a year.

Rate cuts are not only inflationary but they weaken the dollar which then helps to send oil prices skyward. Oil is priced in dollars around the world so a falling dollar provides small incentive to oil-exporting countries to increase output or for foreign consumers to reduce their dependency on oil. If the dollar continues to fall, oil will continue to rise. On the other hand should the dollar strengthen, and it will if rates rise, there is a good chance that oil prices will fall.

Newton's Third Law of Motion posits that for every action there is an equal and opposite reaction. Global commodity prices have been the beneficiary of the Fed's easy money policies. When the dollar goes down, especially as fast as it has since last September, commodity prices spike, sending speculators to gamble on further dollar declines.

It is commonly reported that the rise in commodity prices is the result of rising global demand and greedy speculators. I'm not convinced. It seems to me the speculators are betting on the Fed's refusal to stop the free-fall of the dollar. Like oil, most commodity trading is denominated in dollars.

If the dollar had retained the same purchasing power as the euro this year, many economists advise the price of oil would be a good \$40 per barrel less today.

Any increase in energy and food prices is an indirect tax on our country's middle class workers. And yet this is the time when our economy needs a strong consumer to face the housing price debacle, but soaring energy and food prices have completely wiped out the consumer's savings.

Part of this country's credit crisis can be traced to an

overall lack of trust between lending and borrowing parties. Entrepreneurs and investors have stopped taking risks; banks have tightened lending requirements unduly, and the man-in-the-street now takes his disposable income and places it in the safety of U.S. Treasury bills or cash. Why should the Fed expect people to begin taking risks when it continues to debase the value of our money?

In point of fact this easy money policy is a long-term issue, going back to Alan Greenspan. The housing bubble was brought on in large measure by the Fed's years' long enormous credit subsidy. The Fed has flooded our financial system with liquidity since the Twin Towers fell on 9/11.

While the housing bubble was percolating, Greenspan and Company first dropped, then held rates at historically low levels for three years until Summer 2004. As housing started to sizzle, they made thirteen rate cuts, ultimately taking the rates down to 1.0%. The result? Banks thus had too much money to lend and not enough good people and places to lend it to. Consequently, they found bad people and places to lend the excess.

While it might be argued that the Bear Stearns rescue solved a liquidity and market confidence problem, the Fed's action certainly intimates that now no large money-center bank will be permitted to fail.

Hopefully, this Easy Money Era will soon end. The Fed's job is to be our country's protective German Shepherd in regard to the economy, but not to scarf our breakfast when our attention is diverted.

But there is another element. While oil is expensive, it's not nearly as expensive as some other liquids. Milk, Tropicana Orange Juice, Bud Light, Jack Daniels Whiskey and Chanel No. 5 perfume all cost more than a barrel of crude oil which sells for \$124.31 today. Do you know how much they cost relative to oil?*

Optimism and Corporate Tax Rates

Last week I took my 90 year-old mother, Sue Betty Sawyer, to her annual check-up with her heart doctor, Dr. James Hopkins. Mom told Dr. Hopkins she had little energy and was constantly tired. In response, he told us the story of a 100 year-old patient whom Dr. Hopkins was treating not too long ago. When

* According to *USA Today*, milk is \$147. Tropicana Orange Juice is \$226. Bud Light is \$302. Jack Daniels is \$3,568. Chanel No. 5 is \$102,144.

he asked, "How are you feeling Mrs. Davis?" she responded, "Not so good, doc. I've got so many aches and pains I feel like I'm 105 years old!" Now there's a real optimist. I wish our political leaders had that sense of optimism when it came to proposing corporate tax rates.

When it comes to tax policy, the lower the corporate income tax rate, the more optimistic I am for a healthy economy. *The Wall Street Journal* recently reported that the 2004 American Jobs Creation Act gave American companies a one-year window in 2005 to repatriate earnings from foreign subsidiaries at a tax rate of 5.25%. That rate was materially lower of course than the normal 35% U.S corporate tax rate that U.S. corporations typically would pay (less a credit for whatever foreign taxes they have paid on their earnings abroad).

Congress predicted \$200 billion would return to our shores, thanks to that bill. In reality we got 80% more. The IRS reported that more than 800 U.S. corporations repatriated \$362 billion dollars! Those repatriated dollars were the major reason that U.S. business investment grew close to 10% in 2005, which, coincidentally, was the highest year-over-year growth rate in more than ten years.

Some economists, politicians and Treasury officials opposed the measure when it was enacted, predicting it would lose revenue and would provide a tax holiday for profitable corporations. Congress's Joint Committee on Taxation predicted a mere \$2.8 billion dollars in tax revenue gains in 2005.

In the words of the *Journal*, "As always they underestimated how tax reductions change behavior." The tax, in fact, raised \$18 billion dollars which, of course, was six times more than the estimate. As the *Journal* put it, "Instead of getting 35% of nothing as U.S. companies kept their cash abroad, the Treasury took in 5.25% of the hundreds of billions the companies brought home." Keep that in mind the next time you hear a politician talk about increasing taxes on the "big, bad corporations."

Twenty five nations have enacted corporate income tax rate cuts since 2001. These include countries as disparate as Vietnam, Northern Ireland, Germany and Estonia. The motivation in each has been to boost that country's attractiveness as a location for international capital and investment. Those tax reductions now give the U.S. the unflattering distinction of having the world's highest corporate tax rate at 39.3% (35% federal plus a state average

of 4.3%).

Ireland has a corporate tax rate of 12.5% and still collects 3.6% of its GDP from corporate revenues. By contrast, the U.S. with its near 40% tax rate averages less than 2.5% of GDP through corporate tax receipts.

A high corporate tax rate drives capital offshore. And should politicians running for the U.S. presidency propose to increase the tax rate further still, capital flows will disappear from New York just as surely as a five pound rock dropped into Hoopes Reservoir will not soon be seen again.

There is no doubt that this behavior applies equally to individuals with respect to their income tax rates, capital gains and social security tax rates, too. So listen carefully to the proposals of the candidates.

Listen to the Music

Last month's winner was Mr. Wilmington, Fred Sears. In case there is anyone in my reading audience who doesn't know Fred, let me mention but a few of his biographical distinctions. He has been a Wilmington institution for forty years. He is a former 12-year Wilmington City Councilman; former Director of Wilmington's Finance Department; former Director of the Port of Wilmington; former President of Commerce Bank, Delaware; and now he's the President and CEO of the Delaware Community Foundation. Head Cheerleader for Wilmington and Delaware's economy, that's Fred.

Fred correctly put these original and cover artists with the songs that they made famous.

SONG	ORIGINAL ARTIST	COVER ARTIST
"Hound Dog"	Big Mama Thorton	Elvis Presley
"Breaking Up Is Hard To Do"	Neil Sedaka	Neil Sedaka (covered himself!)
"Handy Man"†	Del Shannon	James Taylor
"Dedicated To The One I Love"	The Shirelles	The Mamas and Papas
"Oh, Baby Baby"	Smokey Robinson and The Miracles	Linda Ronstadt

We also had Jersey Boy Steve Siegel among others, correctly guess the winners. Mr. Siegel, a nationally-recognized lawyer

† Pete Booker, who I put in his own, separate category as Music Quiz Professional, pointed out to me that the hit "Handy Man" was originally done by Jimmy Jones in 1960. I don't think anyone other than Pete would have known that, so I went with Del Shannon.

in the field of estate planning, also once represented one of the Shirelles.

This month's quiz deals with Eric Clapton. In a recent self-titled autobiography, Clapton candidly discussed the multiple bands with whom he played, the women with whom he had assignations, those he married, his twenty-year trials and tribulations with drugs and alcohol, the tragic death of his four year-old son, Conor, and the redemption and addiction-free life he's led for the last twenty-five years. For my money he is one of the top five all time guitar players in the history of rock and its roots, the blues.

I recognize some of you don't know Eric Clapton from Eric Sevareid. But the answers to this quiz should be a cinch for Clapton-era readers so I'd like to get lots of participation. Here it is:

1. Give me the name of one band of which he was a member. (He's been thrice enshrined in the Rock & Roll Hall of Fame, twice with bands and once individually. Pete Booker, you need to give me three).
2. Whose wife was he singing about in his famous song, "Layla"? (He later married the lady).
3. Tell me just one other song Clapton made famous.

Now if this isn't the easiest quiz I've ever thrown out there, I don't know what is.

Remember, the Westover Honor Code is in effect, so no internet searches are allowed. If needed, asking spouses, buddies and neighbors is encouraged. Previous winners are invited to play. The winner(s) receives a \$100 gift certificate to the restaurant of his or her choice. So eager am I to have you play, I'll even award two prizes for this quiz provided I get at least ten correct answers!

Best of luck! And remember, don't let Hendrix or his friends watch your food.

July 10th, 2008