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## Third Quarter Economic Commentary

*NOTE: Lest some of you become concerned that my economic and market commentaries are turning into a monthly political essay, I'm simply trying to point out why what's happening in the markets and economy is occurring. This is not an assault on anyone's politics, but an attempt to explain why Washington's policies and actions are causing the problems we're experiencing. Regardless of your political standing, there's clearly enough blame to go around. Now, enjoy this quarter's commentary.*

**A man walking along a road in the countryside comes across a shepherd and a huge flock of sheep. He tells the shepherd, "I will bet you \$100 against one of your sheep that I can tell you the exact number in this flock." The shepherd thinks it over; it's a big flock so he takes the bet. "973," says the man. The shepherd is astonished, because that is exactly right. Says "OK, I'm a man of my word, take an animal." Man picks one up and begins to walk away.**

**"Wait," cries the shepherd, "Let me have a chance to get even. Double or nothing that I can guess your exact occupation." The man accepts the bet. "You are an economist for a government think tank," says the shepherd. "Amazing!" responds the man, "You are exactly right! But tell me, how did you deduce that?"**

**"Well," says the shepherd, "put down my dog and I will tell you."**

At the risk of boring some readers to distraction, I feel compelled to offer a brief lesson in economics. Since I stayed awake for the majority of my college economics classes, I feel qualified to instruct on the subject. There won't be a quiz, so don't worry. But, it's important to understand what's driving the (and I use this next term generously) thinking in our nations capital these days. Here goes:

There are a variety of economic theories out there. Keynesian economics is founded on the belief that the essential problem of an underperforming economy is a lack of demand, and that government can therefore tax away (or borrow) a dollar from the private sector, give it to someone to spend, and thereby stimulate economic growth. To cite one example, the current Agriculture Secretary Tim Vilsack recently announced that some 46 million Americans are now on food stamps, a number that has risen in every

month of the current administration. Far from being appalled by this fact, Secretary Vilsack stressed great pride in his department's ability to "get the word out", and then goes on to make the astonishing statement that food stamps are job creators, claiming that every dollar spent on food stamps increases economic production by \$1.84. (Look it up.) The logic here is that we need

**everybody** to go on food stamps. The more food stamps, the more job creation and more economic growth. This economic approach requires you to ignore the fact that unemployment has continued to rise. (\*Before you take umbrage with my argument, I accept that many of those families on food stamps are legitimate recipients and that we have a moral duty to care for them. Respectfully, that's not the point. We're discussing economic growth here, not social issues.)

In another example of this approach, The Center for American Progress (stout Keynesians) held a forum this summer which concluded that raising the minimum wage would create more jobs. The higher peoples wages, this theory goes, the more they will spend, thereby creating more jobs and increasing economic prosperity. This requires you to believe that the more it costs an employer to hire a worker, the more workers he will hire. Ahem.

Finally, the plan now is to raise taxes on the 239,000 households with incomes of \$1 million or more, take this redistribution, and re-hire some people who've lost their jobs so they can spend more, create more jobs, etc. In other words, you don't have to grow your way out of economic malaise, you can redistribute your way to prosperity. This is nonsense in its highest form and ignores the fact that those 239,000 people make the vast majority of the country's hiring and corporate spending decisions.

What we have going on here is a classic football battle. On one team, we have legislation, taxation, and regulation arguing for redistribution to get us out of this mess. On the other team, we have entrepreneurship, innovation, and investment – which has remained largely suspended as it waits to see what plays its opponents will call. But the referees in Washington have called a long “time out”, and are standing at mid field arguing over who gets to flip the coin and whether they need new referee uniforms. As a result, we find ourselves in no man's land, which is where we'll remain until there is some clarity. Now, here's the kicker:

**Neither side has to “win” outright to get the economy moving again. Free markets just need to know what the rules are. Can someone please tell them?**

Entrepreneurs, innovators, and investors will do what needs to be done to get the economy moving again when they are given a clearer view of the landscape for taxes and regulation. And there is tremendous pent up demand in corporate America to begin investing, growing, and hiring. Standard & Poors projects that corporate earnings in 2012 will be *six times higher* than actual earnings were in 2008, a remarkable increase in our view. So we need the referees to blow the whistle and get the game underway.

With clear cut rules on taxes and regulation, corporate America can make a huge contribution to economic momentum. That's the best explanation I can provide for where we find ourselves today.

Meanwhile, the situation in Europe continues to worsen, driven largely by lack of progress on containing the problems in Greece and the Eurozone. As a result, the world markets are effectively pricing in another global recession, which explains why we've seen markets continue to decline. A recent Reuter's poll of 70 economists put the chances of another US recession at 31%, a little less than one-in-three. While the chances have risen slightly in the past few months, most of them do not see a US recession as a reality unless we encounter another “event shock”. The US economy is still slated to grow at 2.0% - 2.5% in 2012, and passage of the President's Jobs Bill could increase that to 3.4%-3.7%, according to Guy LeBas, the chief economist at Janney Montgomery. Much of this hinges on how Europe unfolds over the next few months, and what progress the Supercommittee makes on presenting a solid deficit reduction plan by November that can win Congressional approval. If progress is made on both fronts, 2012 could shape up to be an even better year than projected. If not, we expect more of the same. Stay tuned, and we'll update you as details become

available. And don't hesitate to call me personally if you have any questions or concerns. We're here to help.

See you next month,

A handwritten signature in black ink, appearing to read "Jeff Helms". The signature is fluid and cursive, with a long horizontal stroke extending to the right.

Jeff Helms, CFA