Poor Economic Conditions but some Improvement in Asset Markets!

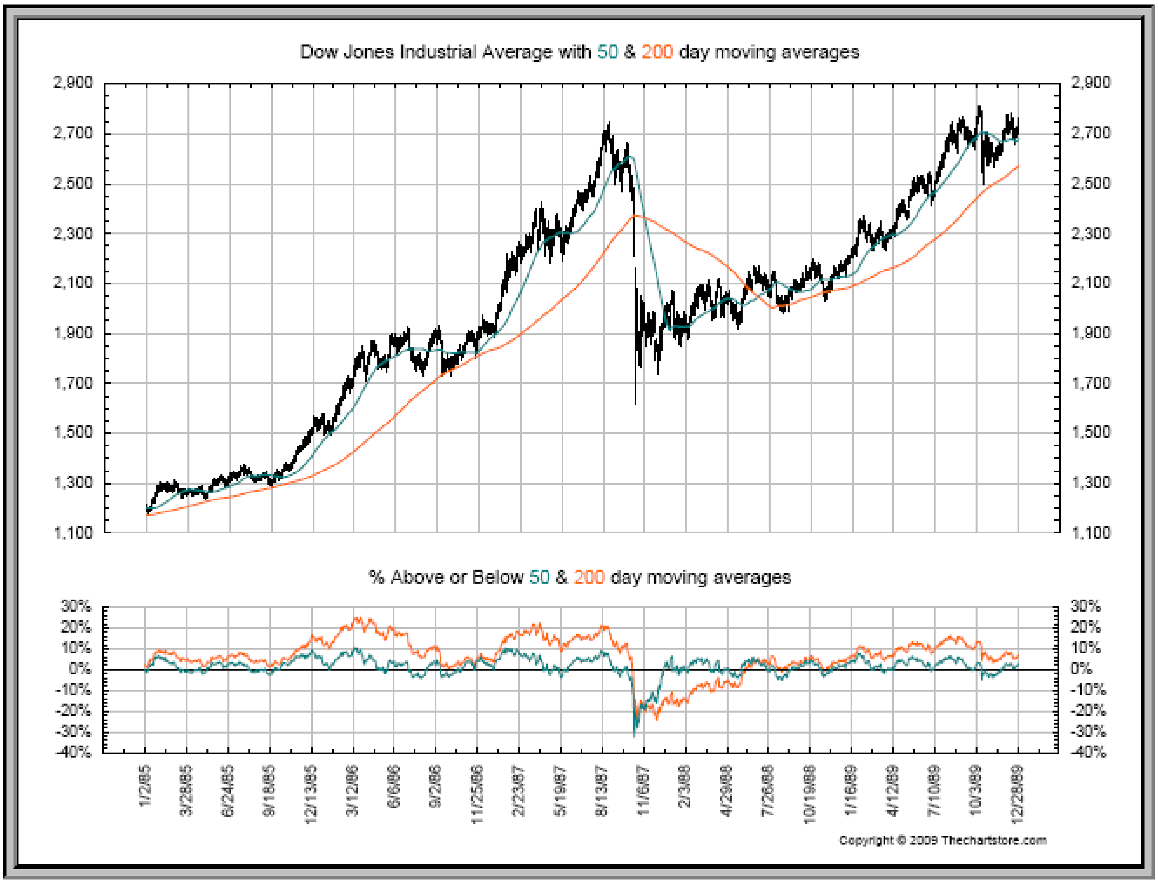
Marc Faber

> **"Fiction was invented the day Jonah arrived home and told his wife that he was three days late because he had been swallowed by a whale.**
>
> **Gabriel Garcia Marquez**

> **"There are certain professions in which the collective genius of the American people dominates the field: semiconductor design, fast food product differentiation, fire-control systems for air-to-air combat, and con artistry. That these are not, at the moment, sufficient to earn a current account surplus, is a problem being worked on, not least by the service exporters in the latter occupation."**
>
> **John Dizard, Financial Times**

Last month's comment pointed out "that stock markets around the world" were "very over-sold and that a powerful rally could occur at any time." Just how oversold markets were in early March was evident from stock market indices' distance from their 200-day moving average. By this measure the Dow Jones was more than 35% below its 200-day moving average and was more oversold than in the 1987 crash when at the trough on October 20, 1987 it fell 31.8% below its 200-day moving average. The record "oversold" reading by this measure occurred at the November 13, 1929 low when the Dow fell 40% below its 200-day moving average. Following the October 1929 low the Dow recovered almost 50% by the spring of 1930 before embarking on another 80% decline into 1932. And following the October 1987 Crash low the Dow recovered within 15 months to its previous high (see Figure 1). Since the low on March 6 at 6,469, the Dow rallied by 22% and the S&P 500 from a low of 666 rallied by 25% to the recent highs on March 27th. So, whereas I certainly do not expect any full stock market recovery within the next two years (after that we shall need to see how much money will be printed), I would not be surprised to see some further headway until the summer of 2009. Very near term the stock market has become overbought and should correct. But for the intermediate positive stance to be maintained, it is important that the November 2008 lows at 741 for the S&P 500 are not violated on the downside.

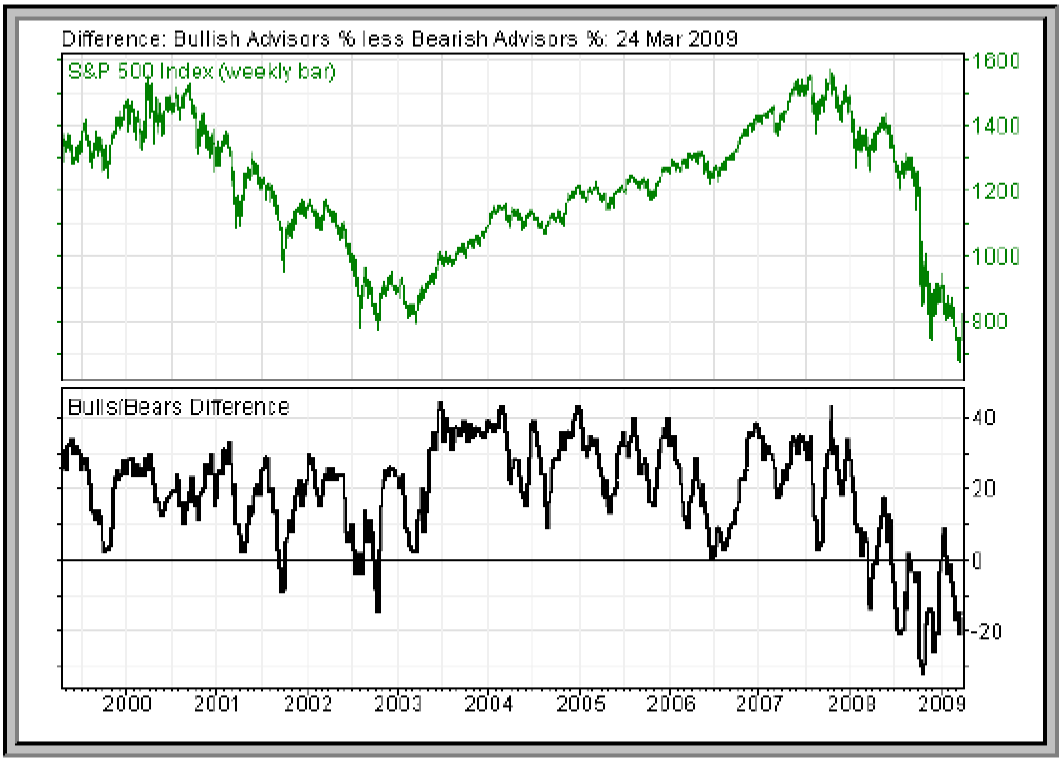
Figure 1: Dow Jones Industrial Average, 1985 – 1989



Source: Ron Griess, www.chartstore.com

I should add that when in late February 2009 major stock market indices broke below the November 21, 2008 low (S&P 500: 741, Dow Jones: 7476), sentiment turned extremely negative with many experts predicting a S&P Index of 400 to 500 and a Dow Jones of 4000 to 5000. And even as the rally from March 6 unfolded, sentiment remained rather negative (see Figure 2).

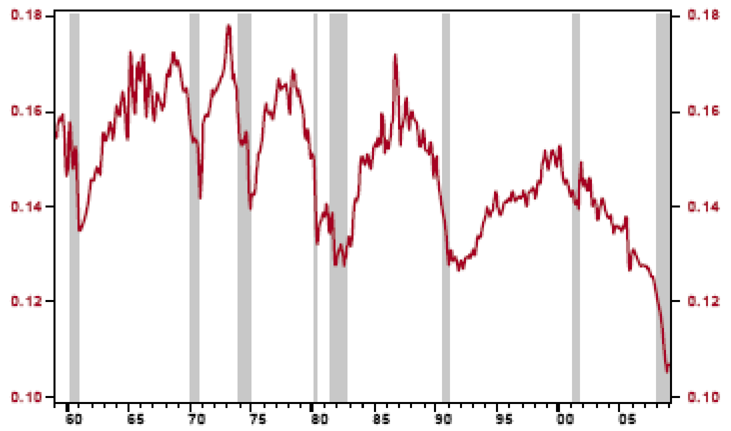
Figure 2: Investors' Sentiment Remains Negative



Source: Investors Intelligence, www.investorsintelligence.com

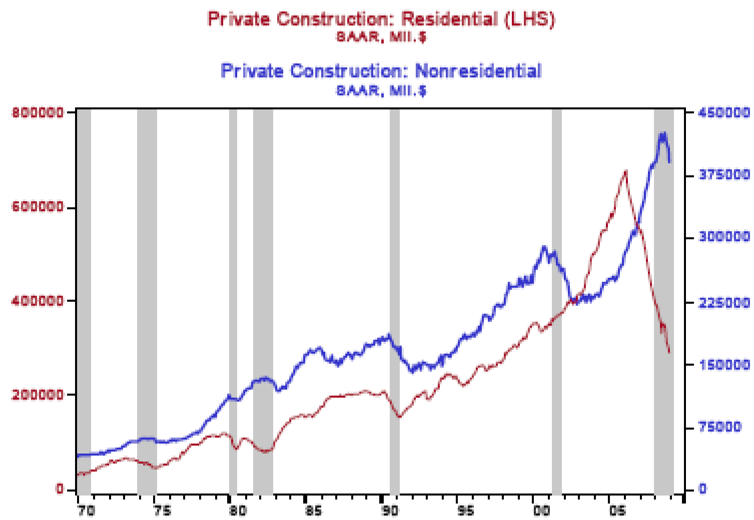
Mind you, sentiment has remained negative for good reasons. Globally, the economy weakened further in February with Japanese exports down almost 50% year-on-year. Moreover, an index by Merrill Lynch measuring the ratio of consumer durables to the sum of nondurables and service expenditures in the US continued to plunge (see Figure 3). According to David Rosenberg of Merrill Lynch, "the index is based on the simple principle that consumers don't pull the trigger on big ticket items unless they are sure of their financial situation. We have seen a pop in apparel sales as crisis-weary shoppers combed the post-holiday sale racks. Feel good movies, with popcorn, are a safe indulgent escape from the daily dose of blame-laying that dominates the TV airwaves and daily papers. But until the consumer decides that it is safe to slip behind the wheel of a brand-new auto, or pulls out the plastic and pop for that plasma, the recession is not over, in our view, not by a long shot." Another reason for pessimism about the economy is that whereas residential construction might stabilize, non-residential construction has only begun its contraction (see Figure 4).

Figure 3:
Ratio of Consumer Durables to the Sum of Nondurables and Services (3-month moving average), 1960 -2009



* Ratio of consumer durables to the sum of nondurables and services, 3-month moving average
Source: Banc of America Securities Merrill Lynch

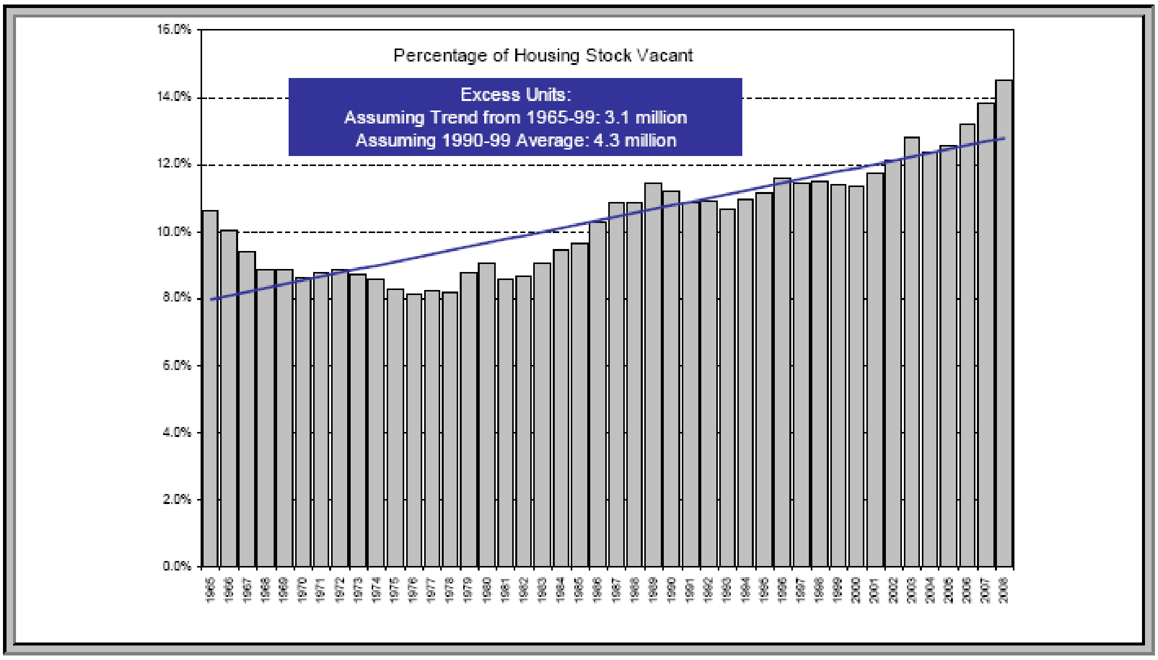
Figure 4:
Residential and Non-residential Private Consumption, 1970 - 2009



Source: David Rosenberg, Merrill Lynch

Please note how elevated both residential and non-residential construction became between 2004 and 2008! Moreover, with a record number of vacant homes one should not to expect a strong immediate recovery in residential construction (see Figure 5).

Figure 5:
14.5% of Housing Stock Is Vacant: Totaling 19 Million Units!



Source: Census Bureau, Zelman Associates

But, whereas the global economy has continued to deteriorate until this very date, there has been some improvement in the stock market's internals. As an example, the number of new 52-week lows has been contracting since October 10, 2008 when there were a record 2,901 new lows. For instance, Exxon Mobil bottomed out on that day and has since advanced by 25%. Then, on October 27, the FTSE/Xinhua China 25 Index Fund bottomed out and has since advanced by 50% (see Figure 6). (Japan's Nikkei Index made a low on October 28.) Later, on November 21, the second largest number of new lows occurred in the US for this secular bear market when most resource companies bottomed out. Since then many resource and mining companies such as Freeport-McMoRan, Newmont Mining and Ivanhoe have more than doubled in price (other stocks have also shown some price improvement: IBM is up 35% and Best Buy has risen from $16 to $38).

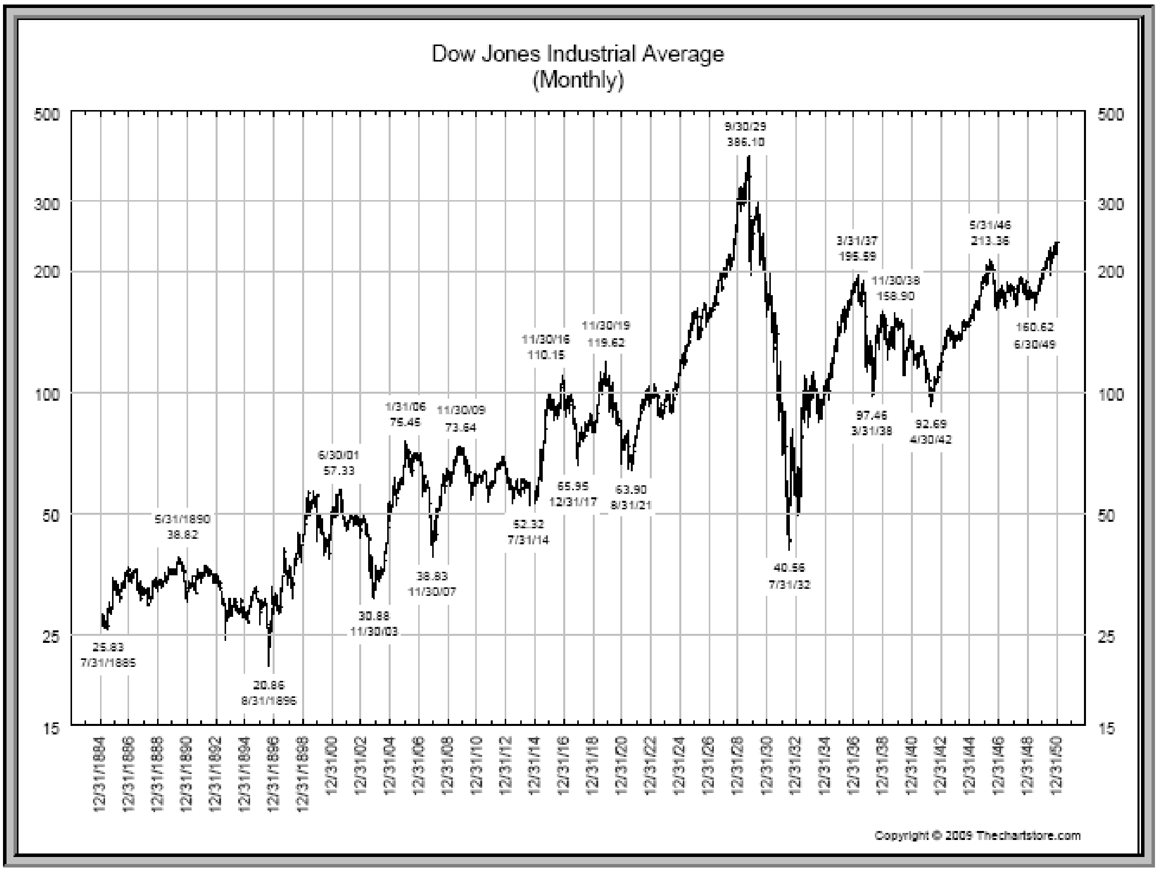
This is not to suggest that we have seen the final low in this bear market, but that independent of whether the market is heading up or down, volatility is likely to remain high and that market swings of 20% or more within a month or two will recur with high frequency. Mark Hulbert notes that in the decade of the 1930s, there were eight calendar months "in which the Dow Jones rose or fell by more than 20%. The month with the biggest Dow move was April 1933, when the Dow rose by 40.2%. In August 1932, the Dow rose by 34.8%. The biggest monthly losses during the decade were almost as big. The largest came in September 1931, when the Dow lost 30.7%. These monthly changes dwarf what has been seen in the current bear market" (largest monthly losses were minus 14.1% in October 2008 and minus 11.8% in February 2009).

Figure 6: FTSE/Xinhua China 25 Index Fund, 2007 - 2009

Source: www.decisionpoint.com

Aside from high volatility in the 1930s and currently being a feature of the financial environment there is another point to note. If you bought the Dow Jones in 1930 when the stock market was down 50% from its September 3, 1929 high at 386 (in other words, at a comparable level to where we were in early March) you would have endured another devastating decline to the July 1932 low when the Dow bottomed out at 40 (see Figure 7). However, already by 1937 you were in the money and with dividends included you would have had a reasonable return over the 1930s decade.

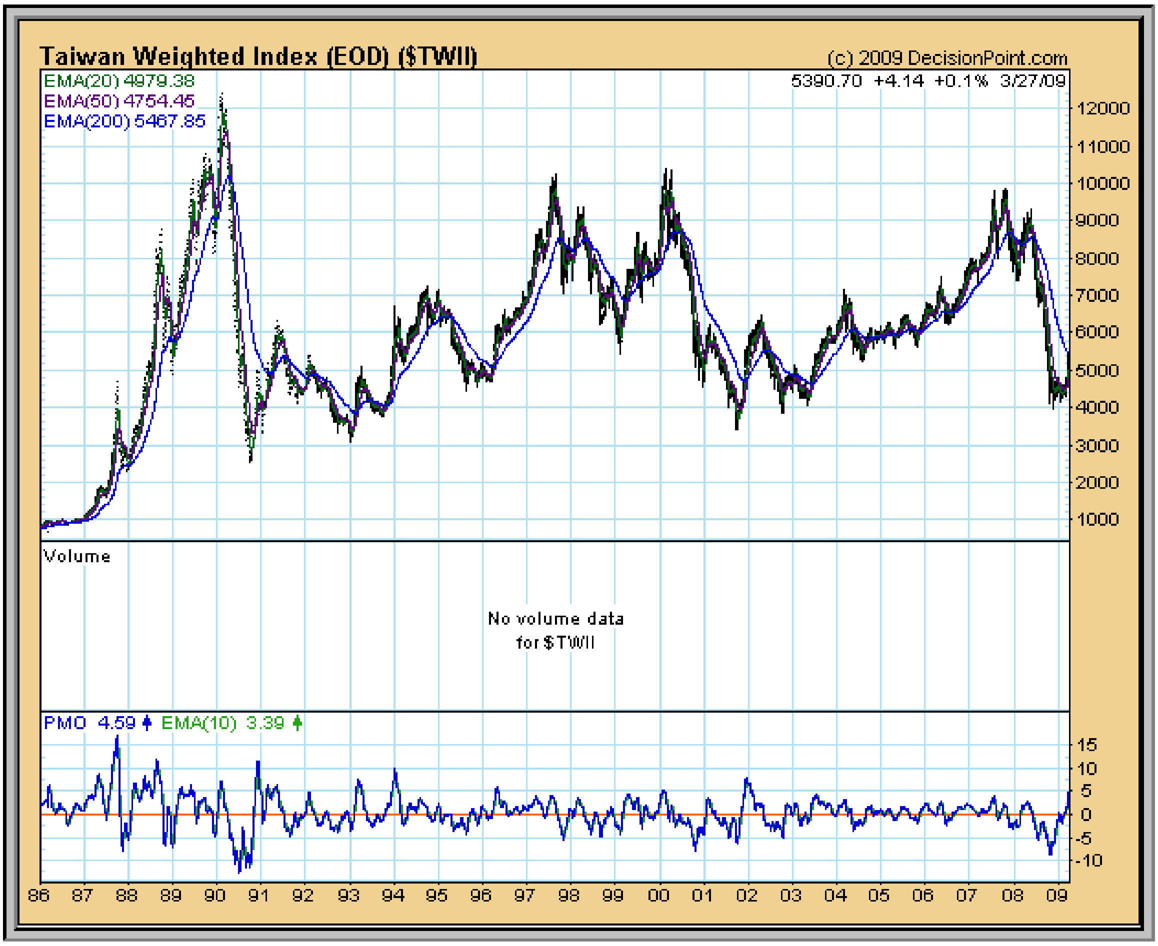
Figure 7: Dow Jones, 1885 - 1950



Source: Ron Griess, www.thechartstore.com

Moreover, if you bought the Dow Jones at around 60 – 70 where it had traded 15 to 20 years earlier (see Figure 7), you would have achieved in the 1930s and subsequently a very decent return. I am mentioning this because, as I have pointed out in earlier reports, many Asian stock markets including Japan, Korea, and Taiwan trade at levels not seen since the mid 1980s or early 1990s (see Figure 8).

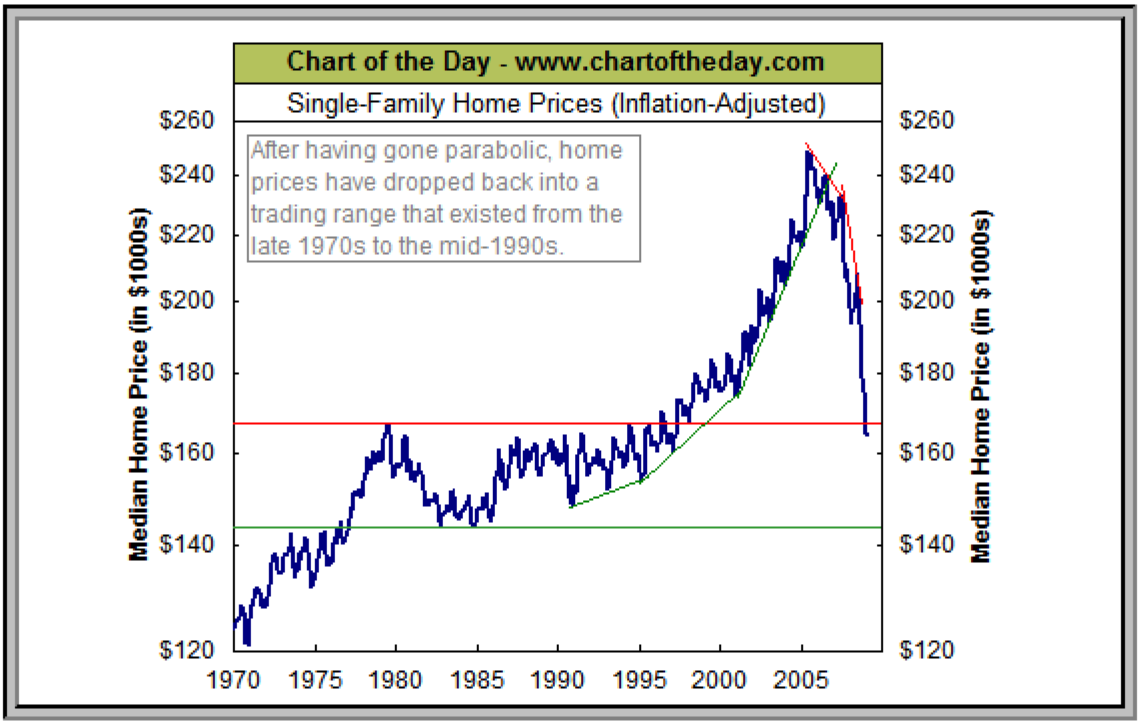
Figure 8: Taiwan Weighted Index, 1986 - 2009



Source: www.decisionpoint.com

Therefore, I continue to maintain that investors with a longer time horizon should slowly accumulate Asian stocks, Asian ETFs or Asian Funds. In addition, I should mention that the discussion about where asset markets will be in ten years might be of some intellectual interest, however, but it is not of much practical value. As can be seen from Figure 7 and 8, even if stock markets do not fully recover to their previous highs, large swings both up and down should offer investors plenty of opportunities to achieve some decent returns. Moreover, as I have shown above, an index such as the S&P 500 is composed of a multitude of different companies (in the case of the S&P 500 of 500 different companies), which can undergo big upward moves even against the overall index trend, which in the US – following the current rally - could remain on the downside. One of the reasons I am mentioning this is that I continuously get questions whether purchasing properties now is advisable. Like the stock market, the property market is extremely fragmented and property prices in one area or a specific location could move up despite an overall downward trend. In general, US real estate prices have adjusted to a more reasonable level over the last two years – certainly in real terms (see Figure 9). However, before jumping into real estate I would consider a few points: Although home prices are now more reasonable and affordability measures are quite favorable, the problem remains of huge inventories of unsold homes, which will take time to work off (see Figure 5). Also, if we look at Figure 9, we see that whereas inflation adjusted prices are more reasonable, they are not yet at the bargain levels we had in the mid 1980s. Also, following the last great housing boom in the late 1970s, which peaked out in 1980, home prices in real terms did not make any progress for 15 years. Still, they were a decent inflation hedge!

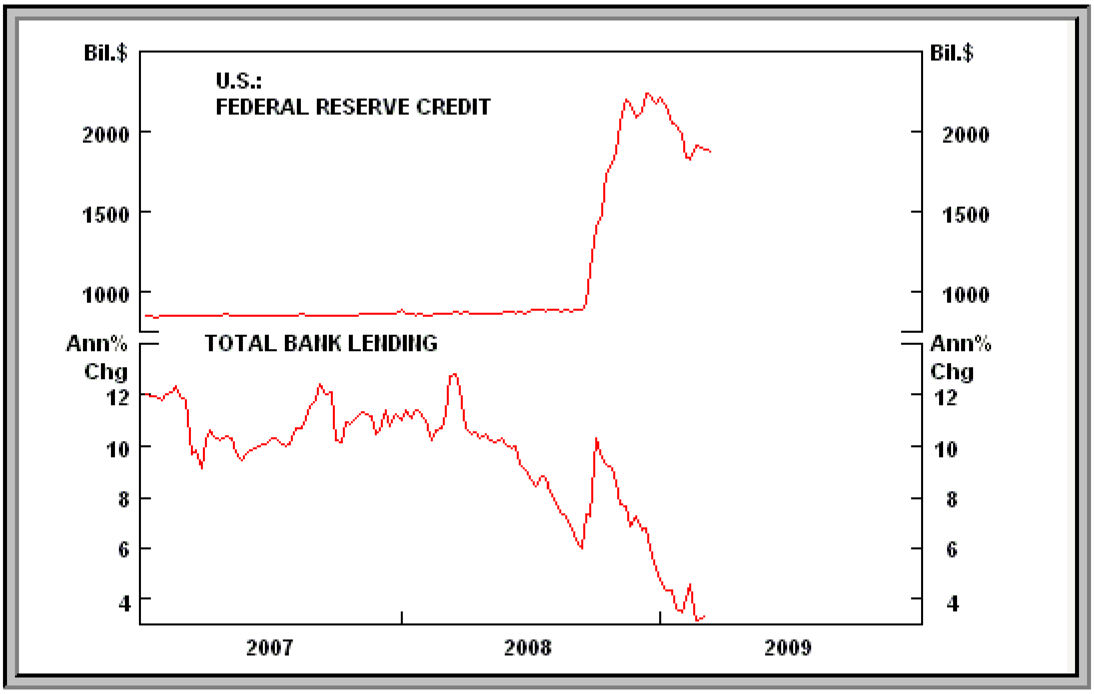
Figure 9: Inflation Adjusted Single Family Home Prices, 1970 - 2009



Source: www.chartoftheday.com

For sure I shall receive again a plethora of emails why inflation is not an issue and why under electronic banking and given the size of the bond market inflation will not be possible. But let me make the following observations. Under every paper money system in history, money lost purchasing power over time. "Printing money" is particularly easy in an electronic banking system. The central bank simply expands its balance sheet. Rest assured that the Fed's balance sheet will mushroom in the future as it will (be forced to) monetize the US government's bulging fiscal deficit (see Figure 10). Large fiscal deficits combined with ultra expansionary monetary policies have always been the ideal mixture for future high consumer price increases. Lastly, in strong, healthy, and growing economies, inflation is usually not a problem: saving rates and capital spending are high and there is an absence of fiscal deficits. Many investors misunderstand this concept.

Figure 10:
US Federal Reserve Credit and Total Bank Lending, 2007 - 2009



Source: The Bank Credit Analyst

However, inflation is always a problem in countries whose economies are imbalanced and structurally weak (lack of capital spending and savings, and excessive consumption leading to large trade and current account deficits) or are already in a recession. When a country is faced with a recession, every government thinks it is smart to do "something" about it. The response is usually to cut interest rates and to let fiscal deficits grow. Initially, this may not fuel inflation. However, the problem occurs when the economy is recovering and interest rates should be increased by the central bank in order to avoid excessive credit growth in the system. So, as was the case in the US after June 2004, interest rates are lifted, but only very slowly, with Fed fund rates lagging behind both nominal GDP growth rates and cost of living increases. Given the size of the government debt in three years' time and the size of fiscal deficits, which will not decline below $1 trillion, rest assured that the Fed will - as has been the case after 2001 until this very date – keep short rates artificially low. The unintended consequence of this policy was the credit and housing bubble in the last ten years. The next time around it will likely be something else that "inflates" since the excessive money creation will find a way to boost prices somewhere in the system (could be equities, commodities, precious metals, or foreign currencies whose economies have slower money printing machines). Personally, I am still betting that precious metals in the long-term will outperform equities in the US whereby there will be periods in the volatile environment I alluded to above during which equities could beat gold for some time (see Figure 11).

Figure 11: Dow Jones Compared to Gold, 1800 – 2009

Source: www.sharelynx.com

Please note that in the volatile 1930s equities outperformed gold repeatedly and in the last great gold bull market (1970 – 1980) equities significantly outperformed gold between December 1974 and August 1976 (as equities recovered and gold fell).

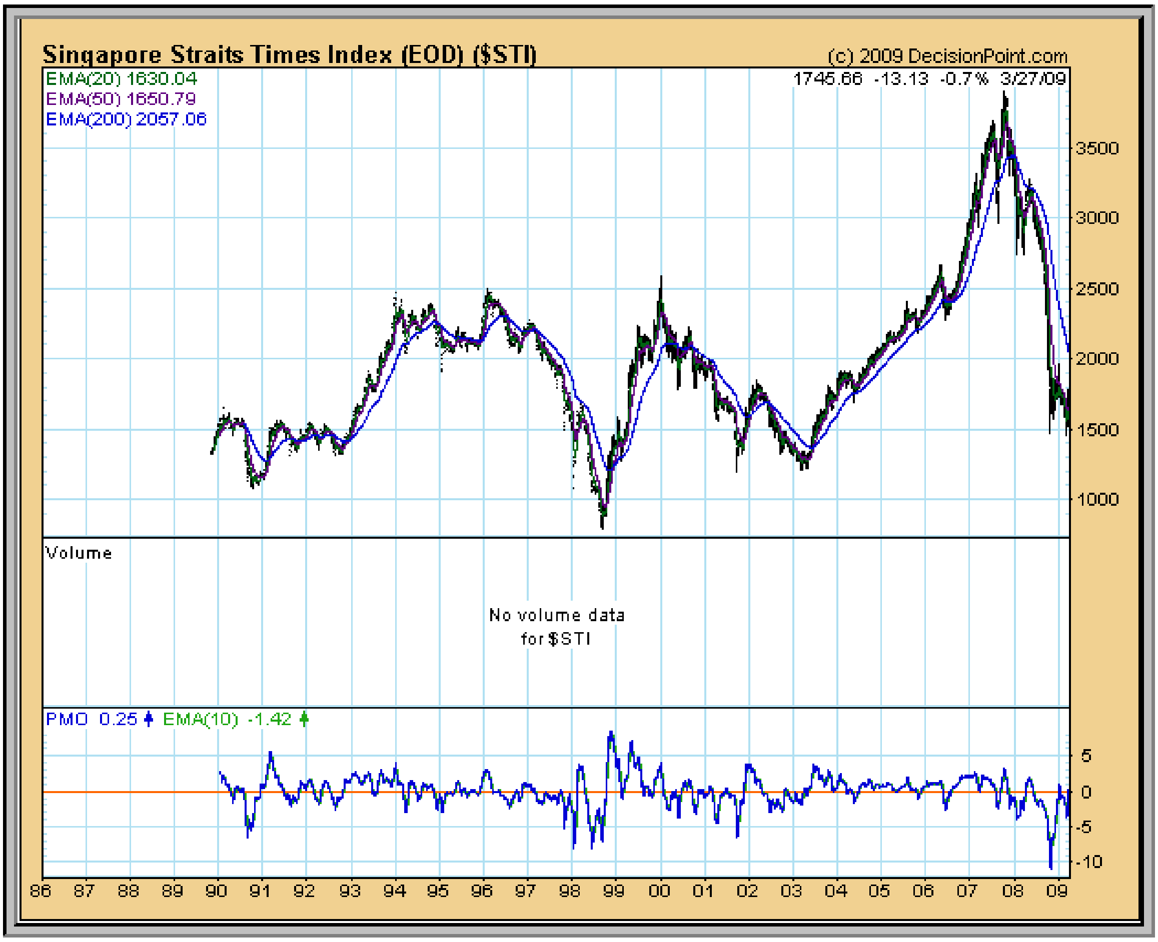
I should also like to attract my readers' attention to the following: Between 1800 and 1900 – specifically before the introduction of the Federal Reserve Board in 1913 - Dow Jones/Gold Ratio was remarkably constant. However, following the introduction of central banking, this ratio has undergone huge and increasing swings. Guess why? Because modern central banking and its propensity to print money does not lead to stable economic development, but to increasing economic and financial instability!

There is a last point I should like to make about consumer price increases. So far, the evidence of prices coming down is not very convincing. Education and health care costs continue to rise and the New York mass transit system just announced that the base rate on city subways and buses will rise from $2 to $2.50 (a 25% increase). Also, my friend Faizal Kalla who runs a wholesale consumer product business in South Africa confirmed what I had been suspecting; after rising strongly in the last two years, food prices have hardly declined despite lower agricultural prices. According to Kalla, "two or three grocery prices in South Africa have come down. In particular, cooking oil as this year saw a bumper sunflower crop. But on the other hand many food prices have not caught up from the supply chain. New price increases of 15% include Pepsi Cola, Nestle Coffees and now today Mittal has announced new price increases on tin plate of 79%. This will increase all tin foods by nearly 30% shortly. The South African Rand has declined and lower commodity prices have not benefited the consumer. Pharmaceutical prices have been steadily rising as the cost of imported raw materials have increased. This makes emerging market consumers very vulnerable to constant inflation. New car prices are expected to jump by nearly 20% shortly and fuel has increased by another 10% from the bottom. This presents a real disaster in the form of financial asset deflation and consumer price inflation in this country."

Now, I am aware that the US is not South Africa, but the point is really that given the severe asset deflation we had over the last 15 months, consumer prices have been very sticky and have failed to decline meaningfully. As Kalla observes, the combination of declining asset prices and rising consumer prices is not conducive for economic growth.

The above discussion about "inflation" was prompted by the question whether it was now a good time to buy a home. I think that whereas nationwide prices could decline somewhat more, in some areas of the US, bargains may be emerging as foreclosure sales have driven prices down below replacement cost. Also, rightly or wrongly – only the future will tell – I am deeply concerned that over the next few years consumer price increases will surprise on the up-side and that in time the value of paper currencies will continue to depreciate sharply. Consequently, investors who have substantial liquid assets should consider beginning to move some of their liquidity into hard assets such as commodities, precious metals, and real estate. Equities also offer an adequate hedge against inflation if purchased at reasonable valuations such as they now seem to exist in Asia and other emerging economies (see Figure 12 and also Figure 8).

Figure 12: Singapore Straits Times Index, 1986 – 2009



Source: www.decisionpoint.com

Take Singapore as an example. The economy is in recession. But given the country's strong financial position and political stability, Singapore stocks have probably adjusted sufficiently to the downside. This is not to say that stock prices in Singapore and in other Asian countries could not decline further, but that stock prices have adjusted into buying ranges where the probability to make some money in the next five to ten years on the long side is rather favorable.

Following the audacity I had last month to recommend diversifying out of US dollars into Australian and Canadian dollars and into Euros, I received numerous emails pointing out the dire economic conditions of these countries and why these currencies had no chance to appreciate against the US dollar. I have been positive about the US dollar for more than a year. But now, with all the money printing, I begin to have doubts (see Figure 13).

Figure 13: US Dollar Index, 2002 - 2009

Source: www.decisionpoint.com

I am aware that there is nothing particularly favorable about any currency in the world (sadly indeed) but if I were a US based investor and if I had all my assets tied to the US dollar, I would certainly use the US dollar rally over the last 12 months as an opportunity to diversify my assets into non-US dollar assets. When I look at Mr. Obama, Mr. Geithner, and Mr. Bernanke it is difficult to envision a scenario under which the US dollar would be in the long-term the world's strongest currency!

A friend of mine, David Urban, writes below about **Community Decay** in the US. Since I discussed real estate briefly above, I find his thoughts to be very topical. The economic geography of the world and within countries changes continuously. To purchase real estate in growing and prospering instead of decaying communities is important.

I am also enclosing a report by Michael Ballanger of Union Securities in Canada on junior mining companies (mjballanger@union-securities.com).

Community Decay in the United States

By David Urban (dcurban777@yahoo.com)

INTRODUCTION

Thefreedictionary.com defines a community as 'a group of people living in the same locality and under the same government.' This broad definition neatly fits the following treatise as we can apply it to small towns, rural regions, metropolitan cities or areas as large as states or even an entire country. Different ethnic, racial and religious groups all make up a community. Communities may start very small, with just a few families and expand over time. By working together to further their own and the communities' needs a community can advance over time. I would like to describe here a path that communities appear to be following in the United States.

Most communities begin as small trading and agricultural villages often growing over time adapting to the changing times and technological advancements over periods ranging from decades to centuries. As change begins to slow and stagnate, most communities in the United States begin to decay unless they take steps to precipitate a revival.

In Figure 1, I would like to present the five areas of community advancement. The five areas within the community are guideposts for how communities advance or decay over time. It is difficult to say how a community will decay or that each community in the United States will follow the same path for decay. Each community is inherently different and forces inside and outside the community can contribute to its ultimate success or failure. I would first like to discuss each area and some outside influences, after which I will use a few areas within the United States as an example to illustrate my point.

COMMUNITY DECAY MODEL

Starting with the agrarian community the primary focus is the production of foodstuffs to feed the local population. Over time marketplaces developed where residents would trade excess foodstuffs (meat, fish, fruits, vegetables, and herbs) with one another. As the agrarian community continued to move forward, the mining and manufacturing of goods began to spread and eventually became the centerpiece of the community.

The mining and manufacturing industries produce items used for a variety of purposes including shelter, coinage, tools, etc. The mining and manufacturing industries supported each other to the extent that certain mined items were used to provide power to manufacturing plants and the populace (coal and timber.) Other mined items were used to support the infrastructure necessary to move materials to manufacturing centers or markets where they could be sold. In turn, the use of mined materials in manufacturing helped by increasing the efficiency of the mining industry (railroads, railcars, drills, mining equipment, etc.)

In areas where communities sprung up around mining and manufacturing centers educational services began to increase as children from the working families sought schooling. Where educational services were strongest, communities advanced via increased research and development. Increasing efficiency lowered manufacturing costs, while research and development led to the invention of more complex products, creating a virtuous circle where the community as a whole benefitted greatly.

As wealth in the community grew, financial services sprung up to serve the needs of the businesses and families in and around the community. Financial services grew from being community based providing access to credit and banking services to regional-based supporting the expansion of the community. Financial service companies then began to expand their reach overseas starting with communities where former residents moved to pursue opportunities that are more attractive. Eventually financial services morphed into the financial markets we have today.

As manufacturing and mining centers face the competitive forces of depletion and lower cost competition, financial services gain a greater share of the overall economy. Financial services grow over time and the debasement of currencies occurs along with ‘financial innovation’ eventually consuming a significant part of the communities’ functions. Ultimately, financial services collapse and without a strong educational background to help diversify the economy, the community moves into the final phase.

Healthcare is the final step in the pyramid. When a community begins to age, the needs of the elderly begin to consume a significant portion of the economy. Without proper diversification into different areas of the pyramid, the highly educated will leave the community to pursue more attractive opportunities elsewhere; leaving behind individuals focused on the care of the remaining populace.

THE IMPORTANCE OF EDUCATION

Although education may be placed in the middle of the pyramid, it feeds all areas allowing a community to advance and maintain an advantage. Proper education creates research and technological advancements allowing communities to move up, down, and diversify across the pyramid.

In the agrarian area, the focus may be on maintaining the family farm with little or no organized schooling. If the family does not learn and adapt, the farm will eventually collapse over time. External factors such as a drought may eventually be the cause although a lack of crop diversity and rotation may hurt as well. Proper education and knowledge of farming can help mitigate any outside influences and give the community the ability to succeed going forward. An example of advances in agriculture is the ability to create healthier crops and higher acreage yields.

Manufacturing and mining typically consumes more workers when compared with a farm, and those workers will often live in close proximity to their place of work creating small communities. Over time, educational services began leading to technological advancements in the future.

For mining, one can use Canada as an example where companies are revisiting old mines from the 1970's using new technology to make more accurate projections about the mineral wealth lying underground.

Research in the financial markets has allowed for greater information flow to investors. During the early 20th century, fundamental analysis was the primary means of equity research. In following decades, technical analysis, which was first looked upon as heresy, became more accepted. Currently, quantitative analysis has moved to the forefront as advances in computing technology allow for faster distribution of information and decision-making.

In healthcare, technological advances allow for the creation of drugs that cure diseases once thought to be terminal many years ago.

If the community does not properly utilize educational services, the highly educated will move to pursue attractive opportunities elsewhere using the knowledge they have accumulated.

As the population begins to decline over time, the community enters a period where certain communities eventually they fade into history unless they can make significant changes to resuscitate the community.

ADMINISTRATIVE SUPPORT

Each area needs a strong administrative structure to succeed. A strong administrative structure must delicately balance the needs of the populace and capital formation encouraging the flow of capital within communities and between market participants.

A weak administrative structure increases the chance for inequities leaving the community open to problems such as fraud and corruption. An example of fraud due to a weak administrative structure in the United States is the Madoff scandal, a Ponzi scheme that perpetuated itself over several years before collapsing.

A comparative example between strong and weak administration would be the regulation that followed the 1987 stock market crash when compared with Sarbanes-Oxley regulation following the collapse of Enron. The regulation following the stock market collapse of 1987 put into place trading curbs on the major exchanges and did very little to inhibit capital formation. Sarbanes-Oxley however, set a burden on the backs of small and medium sized businesses. In the following years, small businesses decided to go private and overseas businesses chose not to list in the United States as Hong Kong and London became more hospitable environments.

UNIONS

Unions served a vital role in the United States during the Industrial Revolution providing a voice for the workers to help stem abusive managements. Over time as they gained power over the businesses a distinct lack of management and business savvy caused communities to stagnate and decline. This is not to say that unions are the cause every time but without proper working partnership unions and businesses find it difficult to succeed.

The United Auto Workers (UAW) fought hard to gain strong benefit packages for their workers. However, General Motors, Ford, and Chrysler are now struggling due to the massive amount of legacy costs carried on their books. However, the benefit packages played an important role in the creation of a strong educational system that has led to technological advancements, innovation, and economic diversification.

The National Football League (NFL) has had tremendous growth by becoming partners with their player's union and both sides benefitted. The current problems over the contract stem not from differences between the players and owners but disagreements between the owners themselves. For the most part, a constructive relationship has allowed the NFL to thrive.

WAR

War can also hasten the decline of a community. One might think of war as a purely personal endeavor when in reality war can be waged on many different types of fronts. The best-known case of war is physical war between communities but war can take the shape of political war with two or more parties dividing a community holding back the efforts of a community to advance. Economic war is possible between communities competing for manufacturing, financial or healthcare services provided by corporations.

An example of economic war would be the hollowing out of the United States manufacturing and services area with jobs moving overseas to lower cost destinations. Even the countries to which the jobs were outsourced are facing economic warfare over jobs, as companies seek lower cost manufacturing and service opportunities.

INFRASTRUCTURE

Infrastructure plays a vital role in a community's development. A strong infrastructure allows for efficient movement of goods and services across the community. Roads, highways, bridges, and rail lines are necessary for a community to advance and realize efficiency gains. As a community expands road infrastructure experiences stress due to increased traffic and inventive methods are required to maintain efficiency. This leads to the development of subway, bus, and rail systems to more efficiently move people from one destination to the other. In the United States today there has been an exodus from most major cities to suburban communities by families looking for a better schools, an easier lifestyle, less troublesome commute, etc. As more and more families look to move to the suburbs, the original road infrastructure becomes inadequate and the transportation system needs to expand.

As time passes, infrastructure needs proper management and maintenance or else it will fall into disrepair and decay. This will cause inefficiencies to develop and give corporations a reason to move to other communities where they may find greater opportunities.

HISTORICAL DECLINE OF COMMUNITIES

Finding significant historical references looking back thousands of years is difficult. Most history does not provide the sort of detail needed properly to study the decline of communities. Some communities fell because of outside influences such as war, famine, disease, or failing to keep pace with technological advancements.

Looking back through history one can start with the Silk Road that was a major trading route between Asia, the Middle East, and Europe. Small communities were founded along the Silk Road as places to give weary travelers time to rest and trade before continuing their journey.

When a more expedient travel route by sea was discovered, the communities along the Silk Road started to decline with time. When the travelers started to diminish, the lack of diversification into other industries hastened the decline leading the communities to vanish into history.

Another factor in the decline of communities is wealth inequality. Where there is no functioning middle class in a community there is greater risk of collapse. A strong and vibrant middle class is necessary for capital formation to diversify the economy.

UNITED STATES

Currently, the United States stands at an important point in history. Communities that served the Industrial Revolution in the early 1900's and not properly diversified have reached a point where they are having a difficult time sustaining themselves. Without proper educational spending and diversification, certain communities have become open to decay and risk disappearing much like the communities along the Silk Road.

Certain communities are currently at risk from decay while others have found ways to diversify themselves and create much needed services that members of other communities can use.

NORTHEASTERN PENNSYLVANIA

In the early 1900's regional communities came into being to support the Industrial Revolution in areas such as Pennsylvania whose coal mining towns supplied the commodity necessary to power the rising factories and manufacturing industries. Many immigrants from Eastern Europe settled in this community and provided the backbone for a burgeoning mining industry.

Shortly thereafter, manufacturing businesses sprang up. Some to serve the mining industry and others to produce small products sold up and down the eastern seaboard. The power of unions began to rise and as managements failed to address the changing landscape, the mining industry began to shrink in size while new industries such as education, medical, and financial rose up to take its place.

The lack of a strong educational area led to other communities rising through technological advancement and the ability to offer more efficient operations; leaving the mining and manufacturing industry to decline while financial services began to take a greater role.

The Savings & Loan crisis in the mid to late 1980's caused a collapse in the regional financial industry that led to all of the major regional banks being purchased by financial institutions from larger communities. The fall of the regional banking industry, a hollowed out mining and manufacturing base, combined with no new industry rising up to fill the void left the healthcare and education industries as the largest industries of the local economies.

The educational area continues to survive but is not a growth industry. Local colleges are small and provide an adequate education for the needs of the local community. Advanced students will pursue more attractive educational opportunities in other communities and advanced graduates will typically leave for more attractive opportunities elsewhere leaving behind the rest to live and work in local industries.

The medical industry remains as a significant elderly population is cared for until they pass on. No significant healthcare research is being done in the community, just hospitalization and care for the elderly.

Due to the lack of a sophisticated population, it is unlikely that a new industry will develop in the community. Some small mines continue to this day but they are not nearly the size that would interest larger mining companies. Manufacturing and financial services are unlikely to enter the community due to the lack of a skilled workforce.

As the population continues to decline, people working in the healthcare industry will do well compared with their peers in the community. Those not working in the industry will eventually move away to pursue more attractive opportunities elsewhere. This will hasten the decline until the community eventually fades into obscurity, as did the many towns along the Silk Road.

I believe this will be the template for other communities across the US where technology has advanced and communities have not kept up with the changing times.

MICHIGAN

Michigan was originally an agrarian area but rapidly grew though the boom in manufacturing caused by a growing automotive industry. As foreign competitors sprouted up and surpassed the domestic industry in terms of quality and value, areas of Michigan fell upon difficulties. Diversification has followed into such industries as education and medical but the difficulties felt by Ford, General Motors, and Chrysler have sent ripples throughout the state.

Major communities such as Detroit have fallen on hard times along with the automakers. The automakers reaped the benefits of a burgeoning middle class but the lack of proper diversification meant that as the automotive industry fell upon hard times so did the community. The recent foray into casinos is not likely to provide the boost that people expect. Most visitors are not the suburbanites who have disposable income to spend and vacationing in Detroit is not on everyone's to do list. A weak administrative structure without forward thinking leadership ensures that the decline in the Detroit community is likely to continue well into the future.

Educational services across the state have flourished and the University of Michigan has become as one of the top universities in the nation. A strong set of complementary state and private schools exist, some of which provide excellent educational opportunities as well.

The community surrounding the University of Michigan is providing a strong base to allow for proper diversification ensuring the future success of the community. Educational and research opportunities coming out of the university structure have attracted large drug makers and others eager to take advantage of the strong talent base. The research area can lead to the potential for increased manufacturing moving communities in Michigan back up the pyramid.

The transition back to a solid manufacturing base will be difficult and casualties will occur along the way. During a recent drive through western Michigan, the amount of empty storefronts in many small towns struck me. It reminded me of the small towns in my area whose businesses closed due to lower population levels as people moved away to pursue more attractive opportunities and the entrance of larger competitors from other communities. It is likely that the surviving communities in Michigan will be those close to the strong educational areas rather than the former manufacturing areas.

NORTH CAROLINA

North Carolina is a state where the economy originally consisted of agrarian communities back in the 18th century.

In 1799, the first gold nugget in the United States was discovered in Cabarrus County and that jump-started the mining industry. Over the next two hundred years, manufacturing would pick up and steadily grow and although facing competitive pressures from overseas, continue to be a significant portion of the economy.

Educational services began to rise and the state now enjoys a strong educational infrastructure consisting of such well-known universities as North Carolina and Duke among others.

Financial services came into the forefront in the post-S&L era as NationsBank and First Union rose to prominence becoming some of the largest financial institutions at the time. Both banks have gone on to merge with competitors but the Charlotte area is one of the top financial hubs in the US.

Later, pharmaceutical industries set up research and development facilities in the state taking advantage of the rich talent offered up by the universities. The Research Triangle Park was founded attracting talent from the strong university system and is a leading area in healthcare research.

North Carolina as a whole has benefitted from a strong educational area allowing various communities to diversify and maintain a solid economic base.

OTHER COMMUNITIES

Communities in states such as California that has strong educational, manufacturing, and financial services but a weak administrative structure will find it difficult in the coming years. The constant mismanagement is a significant impediment to growth causing decay as businesses and talent flee the communities for more attractive opportunities elsewhere.

The Midwestern communities along the Mississippi river will continue to do well into the future as those communities serve as the breadbasket to the world. Excellent schools and universities will continue the progress made and those communities should do well relatively speaking despite a reliance on the agrarian area.

Florida is one community where healthcare can remain an attractive area long into the future. As retirees look to enjoy a slower and quieter pace during their twilight years, one can expect that the communities in Florida will enjoy a consistent demand for healthcare services. Retirees will continue to flock to the community and replace those who have passed on.

STEMMING THE DECLINE

It is not to say that communities cannot hold back economic decay but a significant amount depends on the ability of community leaders to invest properly in the future at all levels.

As the foreign automakers setup plants in the United States they moved into areas of the country where a skilled labor force was available to fill the need. This allowed these communities to move back up the pyramid and economically diversify.

Immigrants can help to stem the tide as well as they move in and start new businesses but without a strong manufacturing or financial base upon which to build the resurgent communities will only fall back toward economic decay and ultimately collapse much like a counter trend rally in a bear market.

INVESTMENT OPPORTUNITIES

Communities who are well diversified can attract the necessary capital at all levels to support their development. When a community begins to decay, capital formation becomes more difficult and can lead to a collapse of that particular area.

For investors, as one area begins to develop opportunity's lie where one can move into an area early on and realize significant profit potential over the long-term horizon. The key early on is to identify which companies within a given area have the greatest long-term potential.

Organic foods have seen steady demand over the past decade and farmers have responded with increasing the supply of locally grown and organic foods within the agrarian area.

In the manufacturing area one would invest in companies who are pushing the envelope with relation to new technologies becoming commonplace in the community.

The financial area is difficult now but there are banks that were not caught up in the whirlwind of derivative and subprime activity. These banks will lead the move up during the next cycle providing credit to communities across the country.

In healthcare, one may look for drug companies with a number of products focused on preserving the quality of life for seniors. A second area is the retirement community that provides necessary services for a retiree to live out their life.

SUMMARY

As the United States government appears ready to produce a substantial stimulus package one needs to keep in mind that certain communities in the country will not rebound due to the economic realities inherent in the local communities. The key is recognizing which communities should be rebuilt with an eye toward providing future manufacturing, mining, and financial services while others are left behind.

Non-agrarian, non-manufacturing areas, which do not provide the necessary financial or medical services, should be allowed to wither as the forgotten communities throughout history. While this is an unfortunate circumstance, many communities in the past provided their services building up the current infrastructure of the world only to disappear as time passed just as many of the communities along the Silk Road.

The manufacturing base has been hollowed out with most production moving overseas to lower cost facilities. Without a strong manufacturing base, it will be difficult to create opportunities that can start to revive communities nationwide.

While there are pockets of strong universities and educational facilities around the country, the cost of education has been rising at such a pace that an affordable education will soon be out of the grasp for most of the population. The lack of a strong educational infrastructure will make it difficult for a large number of communities to survive in the coming century.

Without a strong educational base, the middle class is at risk of collapse over the coming century, as quality well-paying jobs will become out of the reach for most of the population as well-educated people overseas fill those opportunities.

Financial services have had problems since the turn of the century with the deflating of the technology bubble, the advent of Sarbanes-Oxley, and the collapse of the mortgage and leverage bubbles. One can safely say that the large money center banks would be bankrupt without government support.

With an aging population, healthcare services are on the verge of growing at a much larger rate going forward as the need to care for an aging population increases. Certain areas such as Florida will do well in terms of healthcare as new resident's move to enjoy a simpler lifestyle in their golden years replacing current residents who have passed on.

As the United States begins to move forward in the new century it will be important to focus on the communities that have a significant chance of surviving and allow other communities to disappear into history as many of the communities in the past.