Economic Update

Broadleaf Partners, LLC

Silver and Gold, Silver and Gold
May 6, 2011

"Well, what do you think about our friend Cornelius? It seems all he thinks about are silver and gold."

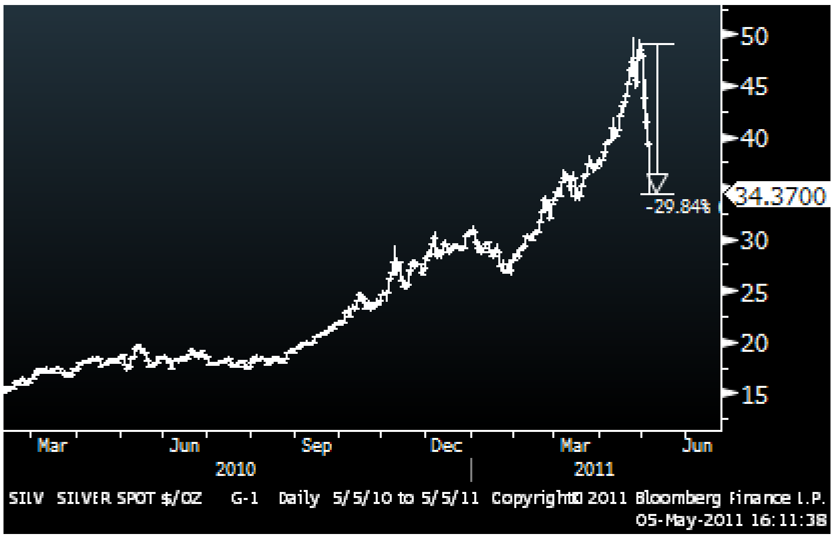
- *[Burl Ives in Rudolph the Red Nosed Reindeer]*

While the list of noteworthy subjects for an Economic Update have been growing recently, the classic 1964 Burl Ives song, "Silver and Gold", would seem to win the prize for Best in Show.

> *"How do you measure it's worth?,"* Snowman Ives asks in the YouTube clip, *"Just by the pleasure it brings here on earth."*

It is true that silver and gold may still look good on Christmas trees, on feminine hands, and perhaps some MTV videos, but the metals have also lost some luster in the dental profession (gold vs. porcelain crowns) and for anyone who uses a digital camera instead of old guard film. (Silver is used in film processing.)

As most know, silver shot to new highs last week (see chart below) amidst a frenzy for precious metals and perhaps, their perceived inflation hedging capacities. (See chart). This week, the story was a bit different, with the metal experiencing one of the most stunning drops since the Hunt Brothers tried to corner the silver market back in the early 1980's.



Having lived through the front cover of the tech bubble a decade ago, I've often been quick to comment on burgeoning asset bubbles, but I'll admit that I've not been

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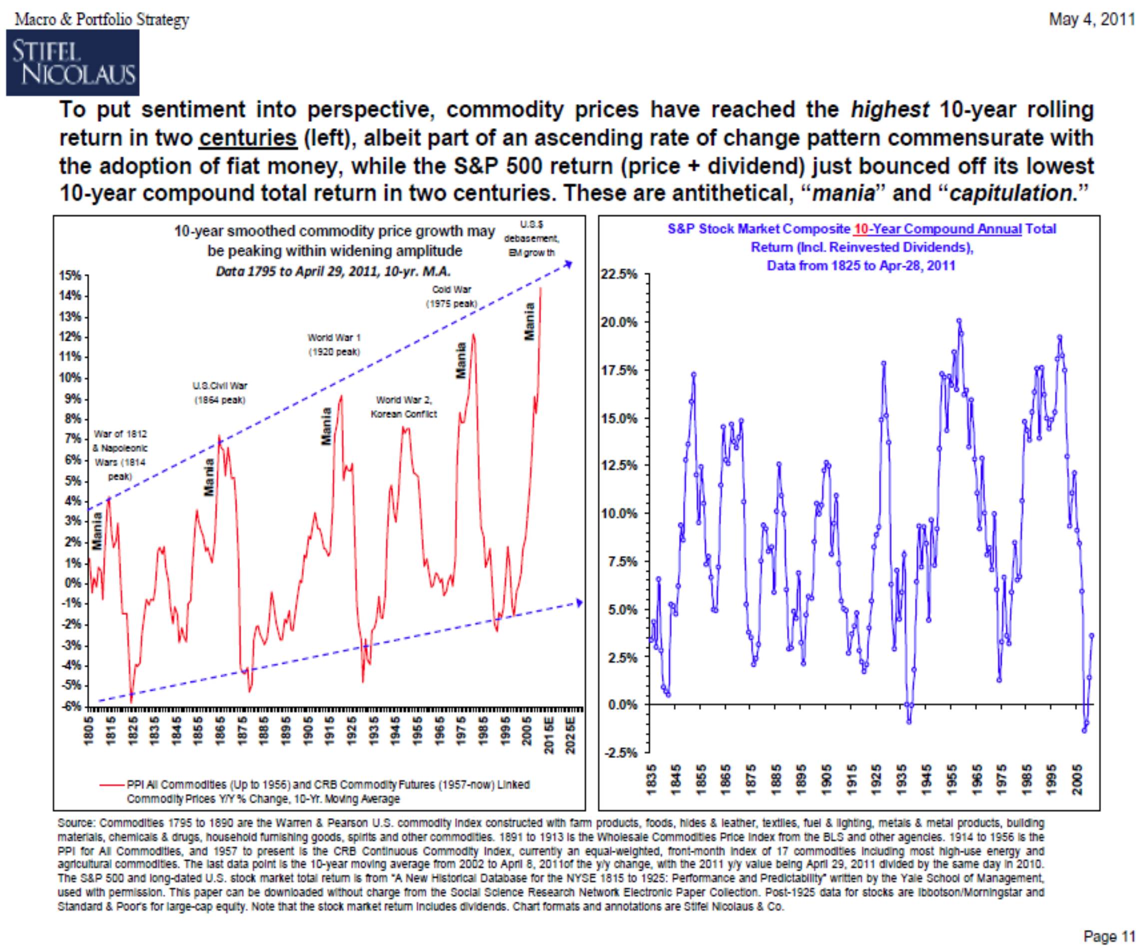
paying as much attention to precious metals lately. (As the readers of our [blog](#) know, I sold a one ounce gold Krugerrand my father in law gave my wife and me as a wedding gift for about $1250 one year ago. With gold at nearly $1500 today, I clearly left some profits on the table, but nevertheless recognized a fourfold return on the $350 I could have received had I sold it on our wedding day almost twenty years ago.)

Perhaps the most telling preference for commodities as an asset class is this classic chart from Barry Bannister at Stifel Nicolaus.



On the left, in red, Barry plots the 10 year trailing rates of return for commodities going back to the early 1800's and on the right are the same figures for common stocks. Over the last two hundred years, a couple of things stick out in these graphs. One, common stock and commodity returns appear to move in opposite directions from one another over time and two, the periods of outperformance for each appear to last for an average of about fifteen years, almost in clockwork fashion.

What this chart says is that if you were to buy a basket of commodities today, you would do so after the asset class has enjoyed its strongest ten year rate of return in nearly 200 years, a period which included the Industrial Revolution. In contrast, if you were to buy stocks today, you'd be buying them after one of their worst ten year periods in history. If you haven't yet gotten the picture, then I'll be blunt. Stocks are likely a better buy today than commodities.

The last time the ten year rate for commodity returns was near an all-time high was in the early 1980's, the time the Hunt Brothers tried to corner the silver market. It was also a miserable time for the economy and stock markets, with interest rates and inflation running at all-time highs. The Middle East hostage crisis was in full bore, gas prices were stratospheric, and Japan was budding as a major auto industry powerhouse.

The undoing of the U.S. as a major world Superpower was predicted by many, including one of my economic professors who wrote a best-selling book on the Japanese "keiritsu" system and warned of the end of the United States as a world superpower if we didn't change course and copy the Japanese' superior, industrial planning ways. He even gave my wife a verbal tongue lashing in the middle of class for suggesting that market competition would be a good thing for the industry, a memory that remains with her to this day. (Thank goodness she got the last laugh or I would still be feeling her scorn.)

Returning to the charts, we now know that buying stocks in the early 80's instead of commodities would have been the better choice by a long shot. Stocks enjoyed one of the strongest seventeen year bull runs in history and the economy improved remarkably.

Ronald Reagan, after defeating the highly intelligent but perhaps misguided Jimmy Carter, ushered in an economic period which promoted the free market enterprise system, whose roots not only went deeper within the United States, but were also planted in former Communist countries like the USSR following the fall of the Berlin Wall. While capitalism is never a perfect system, history repeatedly suggests that it is better than the alternatives.

President Obama seems to be moving towards the center in recent months, similar to what President Bill Clinton did in the early 1990's. No President, I'm told, has won a second term with an unemployment rate higher than 7.5% and I'll bet $4 gas doesn't help much either.

If you want unemployment to decrease, taking a kinder tone with business interests is likely a good place to start and it is encouraging to know that personal incentives do work for both sides of the aisle. President Obama also showed great resolve in going after Osama bin Laden without first notifying Pakistani authorities, who now in hindsight, may have forewarned him on the impending attack. No trial was necessary to know that bin Laden was guilty. And who knows what lives might be saved based on the hard drives recovered during the attack.

This morning the unemployment rate increased slightly to 9%, but private payrolls were a very pleasant surprise, growing more than 270k versus expectations for 200k. The private sector appears to be adding jobs.

Yesterday's same store sales for retailers in the month of April were also shockingly strong and for many were in the positive, double digit territory. In spite of never ending rain in the Midwest, tornados in the south, earthquakes in the Far East, and rocketing gas prices everywhere else, the consumer apparently failed to get the message and still went shopping. While it is entirely within the realm of reason that leading economic indicators will pause given these uncertainties, we maintain our belief that the recovery is durable and likely now moving into expansion territory. Higher private payrolls may be the underlying cause of sustained growth in retail sales and also improving business confidence in the political and regulatory environment.

What will Barry Bannister's chart look like in another fifteen years? Perhaps if history is a guide, stocks will have surprised everyone and be the gaga asset class of 2025, just as commodities are today.

To earn those returns, however, you must have faith in the enduring promise of personal incentives – both the potential for gain and, perhaps even more importantly, the chances of loss.

To get the returns of the future, you must buy stocks today.

It's a good day to be an American.

Kindest Regards,

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P.S. Good luck getting the song Silver and Gold out of your head.