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MIP McKee Investment Planning

Recently, we have seen the markets move markedly lower. For the week, the Dow Jones Industrial Average was down 4%. For the quarter, the Dow was down 10%, the S&P 500 down 11.9% and the NASDAQ down 12%. The big-picture reason was continued fears that global growth will slow down in response to belt-tightening of governments, primarily in Europe and secondarily in China. The US unemployment reports were also cited as adding fuel to the selling fire.

In order to see if the "market's" rationale holds water, let's look at the situation without emotional headlines. The fact that European governments tightening of their overspending budgets is a positive step for global economies. Consumption will certainly fall in the short-term without previous levels of government spending and that is what the market's have focused upon. However, these "austerity measures" carry immensely positive intermediate and long-term implications. By definition, this will shrink the size and scope of government agencies, policies, and interference. The bigger the government budget, the more influence. As capitalists, we want small government. Furthermore, a bankrupt government hurts the companies inside their borders because governments, including their court systems, provide a framework for business transactions and fairness in trade.

Separately, China has also taken actions to reel in the expansion of credit. China recorded GDP growth of 9.3% in 2008 and 9.1% in 2009. More recently, China's GDP has been estimated at over 11% this year. The Chinese government believes that they don't need to stimulate their economy. I would agree. China is in a whole different situation than the US. China has 120 cities with populations of over 1 million people. China's overall population is estimated by the World Bank at over 1.3 BILLION people with a burgeoning middle class and a net savings rate of 30% per year. We have about 300 million people and have just last year started spending less than we earn. There are stark contrasts and economic policies SHOULD reflect that. If China acted like the US and allowed their economy to ratchet-up debt, overheat, and then collapse, it would make our "financial crisis" look like child's play. Thankfully, China's leaders recognize this and are acting accordingly, like responsible adults.

I have to add a quick note about India, population estimated at 1.1 BILLON. In May, India's exports rose 35% over last year. Now, that number is compared to a lackluster May 2009 number, but it is significant nonetheless. I would estimate that the percentage increase in exports will normalize back down to a 10-15% increase as we get into the 4th quarter of this year. That is due to the exceptionally strong 4th quarter experienced in 2009 and not an overall slowdown in the Indian economy, which continues to grow; GDP growth was 7.4% last year and is on track to hit 8.5% for 2010. With China allowing the Yuan to appreciate, India's exports will become more competitive with Chinese competitors. Indian market reforms continue at a measured pace with India's government announcement that it will begin to relax price controls on petroleum products (which will be a substantial benefit to our investment in Reliance Petroleum.)

Back in the US, the most recent jobs report showed that private companies added 83,000 workers last month. Now the headline read that we lost jobs, which we did. The temporary census workers fell off of the taxpayer's payroll (thankfully) and that eliminated over 110,000 jobs. In my mind, I am happy anytime we get more people out of government work and into private sector jobs.

Overall, the markets are behaving like spoiled brats who can't have their cake (unrealistic US GDP growth) and eat it too (balanced government budgets.) I am relieved and encouraged that some world leaders have stopped listening to our government's call for a softening of their austerity measures. We need responsible, financially stable governments in place to create the environment that fosters real economic growth. Now all we have to do is elect that type of government in the US. Until we get our house in order, we will continue to see wild swings the the value of US equities. When a good company gets undeservingly caught up in the mess, we will look for opportunities to buy them at bargain prices.

Note on BP: As a recent addition to our holdings (albeit limited), I wanted to give you a short overview. As of yesterday, the first relief well was within 600 feet of the planned intersection point. Right now, they are drilling the relief well in parallel to the leaking Macondo well, just 20 feet away, laterally. John Wright, the leader of the relief well drilling, has previously drilled 40 relief wells and has been successful in each of his previous attempts. As always, past performance is not a guarantee of future results, in well drilling and in investments. I am cautiously optimistic that the spewing oil will be shut down by the relief well in the next couple of weeks. Weather is a major concern. BP generates about $32 Billion PER YEAR in cash flow when oil is priced at $75/bbl. Their balance sheet is comprised of only 25% debt. Prior to the spill, they had $10 Billion in cash, of which they have spent about $2.9 Billion thus far. The rate of expenditures will drop somewhat when (or if) the well is contained. About two-fifths of the daily expenditures are related to the effort to stop the well, with the remainder on containment. All claims are now being funneled through a $20 Billion fund that BP has established. Provided that the well is stopped in the near future, I expect BP will gradually return to being fairly valued with other integrated oil companies.

That's it for now. I'm off to buy an new iPhone 4 from the Apple store in Orlando. I hadn't bought one yet but the talk about sketchy antenna reception is forcing me do do some market research. I'll let you know what I find.

Have a great 4th of July!!!

Best Regards,

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