Caldwell Trust Company

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Investment letter

Policy-makers waver as U.S. shifts to new economic model

The dictionary defines "paradigm" as a noun that means "example, pattern, or theory of something new or untried." We think it is an apt term to describe what appears to be a major transformation of America's economy into something different than it has ever been.

Whatever name you use to describe it, there is an undeniable attempt underway to test economic approaches that differ radically from those that have been the foundation for the U.S. economy for the past couple of hundred years. This new model brings into question far too many fundamental issues to cover in one letter, so we'll take aim here at the one that is most critical now: unprecedented fiscal deficits that exponentially add to the national debt and bring the role of the U.S. dollar into question around the world.

All sovereign nations can print and borrow money. However, when the European Union was formed in 1993, certain countries handed over that right to a new central bank, the European Central Bank (ECB), as a condition of membership. While only 16 of the European Union's 27 members use the Euro, each nation runs a separate budget to pay the costs of defense and desired social programs. But all must operate under very specific fiscal deficit restrictions. When these rules force a member nation such as Greece to either restrict internal social spending or exact painful tax increases on its citizens, pressures mount between that country's policy goals and the ECB's rules mandating economic restrictions for the violating nation.

Lack of restrictions. No such external restrictions exist for the U.S. It only needs to abide by its own rules and those that Congress granted the Federal Reserve, as an agency acting independently of political influence, to operate as the central bank for all member banks. The U.S. federal budget is solely the business of its elected representatives and chief executive, who in turn answer only to voters regarding spending and tax policies, as do most other democratic nations.

Because the U.S. dollar still serves as the primary "reserve" currency backing most other currencies in the world, our fiscal tax and spending deficits reflect on the acceptability of the dollar. What we do has enormous ramifications that can and do impact the economies and currencies of nations around the globe.

It is that role that we now examine, as the U.S. materially shifts away from its past comparatively restrictive deficit and debt management to seemingly unchecked fiscal deficits, unprecedented currency issuance and increasing federal control of the economy. Here are some points that bring into stark contrast the differences between the past and now.

Deficits. Then. The U.S. briefly operated with a surplus in the 1990s before Washington budgeted for a $400+ billion deficit in 2008. Economists considered that a very worrisome number, as it climbed to about 4% of the total GDP. **Now.** For the latest fiscal year ended, the deficit was $1.4 trillion, or a little over 10% of GDP, and official estimates are for trillion dollar annual deficits to continue for years to come.

Debt. Then. The gross national debt in 2000 was around $5.6 trillion. **Now.** It's close to $12 trillion.

Foreign-owned debt. "Total public debt" is the national debt after subtracting what is owned by the U.S. itself and held by the Federal Reserve. **Then.** In 2000 about a quarter of all public debt outstanding was foreign-owned. **Now.** The most recent figures indicate that ownership is closer to half.

This high rate of foreign debt ownership means that the continued acceptability of our debt is critical—and debt acceptability is totally dependent on dollar acceptability. Yes, the dollar is still the world's currency of choice. Most goods and services traders, including oil-producing nations, freely convert payments received into dollars, and lately excess liquidity is moving to dollars out of both the Yen and the Euro. But just how much will a dollar buy today?

Value of the dollar. Crandall, Pierce & Company, a highly regarded investment researcher in operation since the 1920s, has been charting changes in the dollar's purchasing power since 1974 using the "real" price of gold (adjusted for inflation) as a proxy. They remove the confusion caused by daily references to exchange rates between the dollar and other currencies, which misrepresent the dollar's actual purchasing power. Their chart (page 2) illustrates a steady decline from 2000 to 2010 in how much a dollar can buy.

This downtrend presents special challenges for today's U.S. policy makers. It adversely impacts nations that peg their currencies to the dollar as well as individuals and investors. It leaves businesses trying to find ways to offset steadily rising costs of raw materials needed for the production process, yet still report a profit.

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Unfettered spending drives down the value of the dollar vs. gold

All these parts of our "new" economy—record deficits, massive debt issuance, the dollar's declining purchasing power—are a major departure from the long-accepted, classical theories of what nations must do to survive and prosper economically. One such classicist is prominent New York University professor Nouriel Roubini, a former Treasury Department insider-economist. He recently opined that the divisive political climate in Washington is causing America to struggle in making up its mind about the direction it wants to take.

Inconsistent policies. On one hand, Congress approves record spending requiring massive new debt to try to forestall a recession. On the other, it proclaims that it knows full well that such huge spending must end. Roubini submits that the real political choices are these: Do we want to become a "Euro-zone" nation with large social programs, high fiscal deficits, double-digit unemployment rates and relatively slower rates of economic growth? Or do we want to return to what we did during the Reagan economic period and hopefully reproduce the advances of that era?

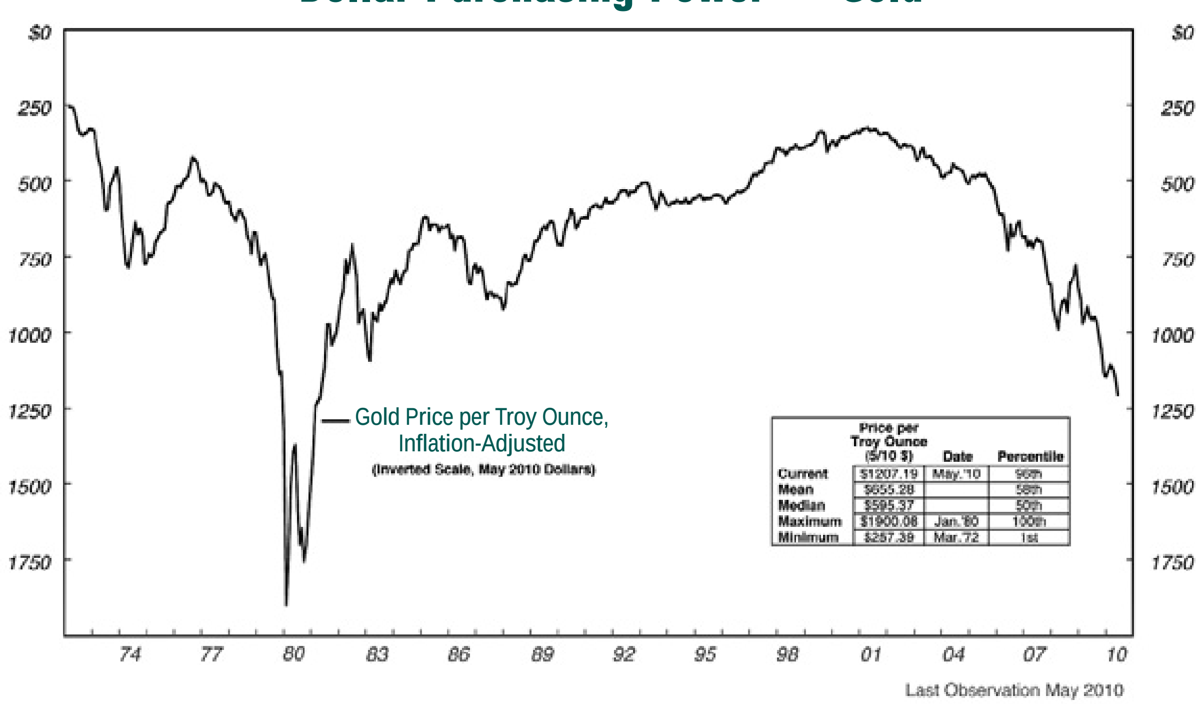
The risk of indecision. Roubini concluded that if America fails to make up its mind, we will eventually face the same financial conditions that European Union nations are experiencing because of the social and fiscal choices they have made. The wisdom of the political decision to see how far America can go on its new course of deficit spending, growing debt and currency issuance will either prove or disprove him.

Most certainly America has embarked upon a path to find out if free markets, in what is now a one-world economy, can and will allow us to stay on this course. The troubling concern is that much of what has already been put into play may prove to be irreversible as dependence on government benefits grows. History is replete with examples of such things having a way of sticking around once in place. An attempt to reverse them at this late date would be well-intended but unrealistic.

CONCLUSION

As this new paradigm develops within our economy, and as America better defines the direction it wishes to go economically, Caldwell Trust Company reaffirms its advice to its clients to 1) keep their stock exposure at the lower end of their comfort zone and 2) keep fixed-income investments short in maturity. The markets ahead will continue to be volatile, and they will overreact to both positive and negative news stories of the day as investors try to sort out what economic path our country is following.

Dollar Purchasing Power — Gold



NOTE: Percentiles are relative to all prices back to January 1972.
Line: Gold Price per Troy Ounce (Engelhard Industrial Bullion, Monthly Average) adjusted by inflation (Consumer Price Index)

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Caldwell in the Community

John Tufaro blends passions for kids and baseball at Miracle League

Photos provided by the Miracle League of Manasota; reprinted with permission.

For most of us, fantasy sports camps are usually just that—a fantasy—but trust officer John Tufaro actually got to attend one. Those who know him weren't surprised to hear that his wife Joann gave the dedicated Yankees fan a fantasy week to train with his favorite team not long ago. They probably won't be surprised, either, to hear that he's become a fan and board member of the Miracle League of Manasota, a newly formed 501(c)(3) organization that serves children in Manatee and Sarasota Counties. "It's great," Tufaro says. "It allows me to combine my passions for baseball and kids." Beyond the fundraising and administrative functions usually expected of board members in all organizations, John is looking forward to the chance for one-on-one mentoring with the kids.

The Miracle League of Manasota is the local chapter of the National Miracle League Association, which currently has more than 235 chapters serving 200,000 children and young adults with disabilities in the U.S. and Puerto Rico.

The mission of the Miracle League of Manasota is to provide accessible recreational opportunities for the 14,000 Sarasota and Manatee children with special needs so that they can participate in a team sport as a member of an organized baseball league, according to president Bob Mitchell. Their slogan says it all: ""Every Child Deserves a Chance to Play Baseball."

While other organizations may welcome special-needs children to their traditional facilities, the Miracle League chapters tailor their fields to the kids and their requirements with such features as a level field and rubberized surface. "The kids will be able to move on the field whether or not assistive devices may be needed," Mitchell says.

The Miracle League of Manasota will break ground for its $1.2 million field in October for a Spring 2011 completion. They kicked off their fundraising with a game in Bradenton on June 18. In addition, the William G. and Marie Selby Foundation in Sarasota has granted $50,000 and Sarasota County has approved funding of $500,000, which includes a playing field in Longwood Run, located just south of University Parkway, the county line.

Mitchell says, "We are happy to have John Tufaro bring his talents and his heart to our organization as a member of the board." John is also pleased. He says, "I can't wait to get started."

John Tufaro is based in Venice. To reach him, please call 941.493.3600 or email john@ctrust.com.

Caldwell News and Notes

Sonya Dlug is promoted to trust officer; Cathy Yax joins operations

Sonya Dlug has been promoted to trust officer, says R. G. "Kelly" Caldwell, Jr., CEO and president. Based in the Sarasota office, she works closely with vice president/trust officers Jan Miller and Bill Cunningham.

Sonya joined Caldwell Trust Company in 2003, working as an intern while attending then-Manatee Community College (now State College of Florida) and the University of South Florida. Upon graduation in 2005, she became a fulltime trust assistant and later a trust associate. She was promoted to the position of assistant trust officer in 2009.

Since joining Caldwell, Sonya has completed Florida Trust School programs sponsored by the Florida Bankers Association as well as seminars in fiduciary income tax, basics of probate practice, special needs trusts and estate tax planning.

To contact Sonya, please call 941.926.9336 or write to her at sonya@ctrust.com.

The newest member of Caldwell's staff is Cathy Yax, who has joined the operations department as operational assistant. She reports to Ashley Harrison in the Venice office.

Cathy brings 15 years of experience in banking, including work with now-vanished stalwarts Barnett Bank and Southeast Bank.

Cathy has the odd distinction of having no hometown. "I was an Army brat," she says. Although her parents were from Michigan, she grew up all over the world, chalking up residences in Georgia, Kentucky, Germany and a variety of other locations. Most recently, she and her husband John had been living in Jacksonville with their three sons when John's employer transferred him to Sarasota. That was 20 years ago. Since then they have acquired three grandchildren and a town to call home.

Cathy is available through 941.493.3600 or cathy@ctrust.com.

Staff Profile

Operations manager Ashley Harrison executes trades, manages cash

When operations manager Ashley Harrison came to Caldwell Trust Company as an independent contractor in February 2008, she could not have known she was finding a lifetime career. However, within three months she was a fulltime employee in the operations department, reporting to Marcia DeVries, chief financial officer and treasurer.

Caldwell trust officer Sonya Dlug had been sure her friend Ashley would be a good fit. The two had met while both were students at then-Manatee Community College (now State College of Florida) and deepened their friendship at the University of South Florida, where Ashley was earning a B.S. in finance.

While attending college, Ashley moved to Port Charlotte and began a three-year career in real estate. She next acquired trading experience when building a trading platform for a bond company out of Sarasota. At that point, Sonya encouraged her to contact Caldwell's CEO and president, R. G. "Kelly" Caldwell, Jr. With Ashley's consent, Sonya spoke with Kelly and arranged a meeting with Marcia. "Here I am, two-and-a-half years later," Ashley says.

Ashley runs the operations department. In this capacity she executes trades throughout the day, opens and closes accounts and manages the company's cash. She also works with "third parties"—banks and the various trading exchanges. In addition, she is corporate secretary for Caldwell's trust committee.

Kelly Caldwell says he's pleased that Ashley joined the company. "Executing trades and managing cash correctly are extremely critical components of our work," he says. "It's very reassuring to have someone as reliable as Ashley to implement those functions."

As many Sarasota natives, Ashley grew up on the water. She and fiancé Josh Schrock spend their spare time fishing and boating in their catamaran. She is also close to her family and pleased that they live nearby, allowing her to visit often.

"I spend a lot of time at Caldwell, too," she says. "I'm very challenged here and enjoy that. It's a good, family-oriented place."

Ashley is based in the Venice office. To reach her, please call 941.493.3600 or email ashley@ctrust.com.