The Kiplinger Letter

FORECASTS FOR MANAGEMENT DECISIONMAKING

1100 13th Street NW, Washington, DC 20005 • kiplinger.com • **Vol. 89, No. 23**

Dear Client: Washington, June 8, 2012

ECONOMIC FORECASTS

↑	**GDP growth** 2% in '12, with spring's lull yielding to a second-half pickup
↑	**Interest rates** 10-year Treasuries near 2% by year-end; 2.5% in '13
↓	**Inflation** 2% in '12 after hitting 3% in '11, in spite of an energy bump
↓	**Unemployment** Around 8% by year-end, despite possible upticks earlier
↑	**Crude oil** Highly volatile; trading at \$90-\$95/bbl. by fall
↑	**Trade** Deficit climbing by 11% in '12; export growth slowing slightly

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As anxiety about the economy mounts...
The 2012 presidential race is tightening. Where it was once President Obama's election to lose, Republican challenger Mitt Romney is closing the gap.

POLITICS

Obama can still pull out a win in Nov...
But the prospect is less probable than it was just a few weeks ago. Some of his support is fading amid dismal job creation numbers, tepid GDP growth, concerns about Europe and a nervous stock market. But there are some positives, too: Falling gas prices. Signs of life for housing. New orders for industries.

How will the White House race play out?
The economy this summer will be crucial in determining whether Obama wins another term or is the fourth incumbent to lose in 36 years.

The key: How voters *perceive* the economy come Sept. After that, perceptions rarely change.

OK or good: Incumbents win. Bad: They lose. It's a simple formula, but it stands the test of time when a major foreign policy crisis doesn't intervene.

The actual numbers don't matter that much. The economy was doing well by Election Day in 1992, but voters had decided it wasn't. So Democrat Bill Clinton ousted George H.W. Bush...with lots of help from Ross Perot.

This summer, these key events will shape perceptions of the economy:

The June 17 election in Greece. If Greece leaves the euro and chaos ensues, the global economy will take a hit, which will be felt to a lesser extent in the U.S. Also, a June 18-19 meeting in Mexico of 20 top global economies, focusing on Europe.

A possible Obama-called summit with German Chancellor Angela Merkel. It's a risky move, but it could help the president if it delays Greece's euro departure or prompts European leaders to ensure that the mess doesn't spread to Spain or Italy.

The Commerce Dept.'s July 27 report on GDP...the second-quarter number and a look at the past three years. A downward revision of growth will help Romney. An upward adjustment won't necessarily help Obama, but it won't hurt him.

The government's monthly employment reports for June, July and Aug. A sustained surge in new jobs is unlikely, but a one-month jump may happen. At the moment, five of six key states have below-average unemployment rates... N.H., Iowa, Va., Ohio and Colo. Only Fla., at 8.7%, tops the 8.2% national rate. Not coincidentally, Obama is doing better in the first five states than he is in Fla.

Also on the watch list: Consumer confidence, which is closely tied to jobs.
And wage growth. It's lagging inflation, and that's likely to continue.

This feels like a tipping point. The economy can take the race either way.
Not much the president or the challenger can do but sweat out the summer.

The Kiplinger Letter (ISSN 1528-7130) is published weekly for \$117/one year, \$199/two years, \$263/three years by The Kiplinger Washington Editors, 1100 13th St. NW, Suite 750, Washington, DC 20005-4051.
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EURO BAILOUT

If financial meltdown across the Atlantic seriously threatens the U.S... Washington *will* ride to Europe's aid, no matter what policymakers say now. You can count on it, even if Congress balks at steps the president may want to take; even if Romney wins in Nov. and swears he won't put American taxpayers on the line.

The Federal Reserve has the tools and the authority to use them, if need be. Though Chairman Ben Bernanke has ruled out lending directly to European banks, the Fed can funnel dollars to the European Central Bank, backstopping ECB lending. And it can effectively guarantee euro-denominated debt by pledging the Fed's support for an international effort to promote growth, indirectly propping up an ECB bailout of euro zone debtors. Bernanke has also nixed any direct guarantees of euro debt.

Such moves would surely prompt a political backlash. But as a lame duck... Bernanke's term ends in Jan. 2014, and the Senate won't confirm reappointment... he'd brave it to stave off recession, with or without an explicit White House OK.

FINANCE

Public firms will find it tougher to bury losses in their financial statements. A new accounting rule requires firms to list unrealized losses and gains... from fluctuations in the value of securities, changes in the value of pension assets, foreign exchange transactions and the like...more prominently, at the top of the report. Many companies typically listed those figures only in a secondary income statement deep within the fine print. Now they'll be right next to the report on net income. Wall Street types always knew where to look. The new rule will help those who didn't.

There's a slugfest under way between the world's largest stock exchanges... the New York Stock Exchange and the Nasdaq. Profits at both are being strained by fewer listings and lower trading volumes, heating up competition between the two. Nasdaq's bungling of Facebook's recent initial public offering threw oil on the fire, spurring the NYSE to make a renewed pitch for the social media company's listing.

The competition is a boon for any firm contemplating an IPO or able to switch its listing from one exchange to another as the rivals sweeten deals to lure more listings. So far this year, seven listings have fled Nasdaq for the NYSE; three have switched in the other direction. The two giants also face competition from smaller public exchanges and from an increase in trades executed off-exchange.

Meanwhile, many small community banks are deregistering with the SEC, sparing them the cost and hassle of complying with the SEC's reporting requirements. Up to 300 banks are qualified to deregister their shares with the federal agency because they have fewer than 1,200 shareholders...the new threshold, up from 300.

The move can save banks a bundle...as much as $200,000 a year.

SOCIAL MEDIA

Some useful guidance from Uncle Sam on allowable social media policies: The National Labor Relations Board says policies can include warnings to employees, reminding them that there are risks involved in posting content online and that employees are solely responsible for what they elect to post online. NLRB also says an employer can require employees who use Twitter, Facebook or other such media to include a disclaimer noting that views expressed are personal and not those of the company. The guidance, which includes examples of policies that don't run afoul of the law, can be found at *kiplinger.com/letterlinks/smguidelines*.

As more and more employers delve into job seekers' social media histories... Web entrepreneurs see a business opportunity. One new firm, BrandYourself, gives people a way to put their best foot forward by manipulating search engine results through search engine optimization...boosting the best info about them to the top of a search engine's first page of results. The first three links are free. After that, the firm charges a fee for additional links. Any negative info will still appear online but farther down the list...few employers take the time to comb through every page.

THE ECONOMY

Additional Federal Reserve stimulus isn't imminent. Here's why: The jury's still out on how much the economy has slowed. Three months of ebbing job creation is a concern, but other economic signals are more positive: Still-solid business and consumer confidence, retail spending and factory orders. The Fed doesn't like to act until the economic picture is clear, and it still isn't.

The Fed typically doesn't make sudden and dramatic shifts in its outlook. Six weeks ago, only three of the 17 policy-setting Fed officials said a third round of quantitative easing might be needed if the economy worsened. A like number predicted that inflation in 2012 would require growth-slowing interest rate hikes.

And the Fed's not sure that more easing would work. Options are limited. Buying more bonds, as the Fed did in 2008, is out...it would add to the Fed's debt, outraging Republicans. Long-term interest rates are already at rock bottom, so continuing to swap short-term bonds for long-term ones may be pointless.

U.S. DEBT

Expect lawmakers to use a familiar blueprint to address the debt in 2013: The Simpson-Bowles plan, which has been gathering dust since 2010. Its ambitious call for $4 trillion in cuts was first praised, then largely ignored by politicians on both sides of the aisle as fierce partisanship blocked its path.

Leaders from both parties see it as a starting point for new debt talks after the rancor of this congressional session and the 2012 election cycle fades.

Both Obama and Romney will embrace the general thrust of the proposal but will refrain from debating specific provisions in advance of the election. Romney especially must tread lightly around its pairing of revenue and cuts to reach the $4-trillion target over 10 years. Two-thirds of the debt reduction would come from spending cuts. The rest would be from new revenue or tax hikes.

A debt deal will be a bitter pill to swallow, but something has to be done... eventually. Simpson-Bowles allows for a quick restart of the debate next year... after this year's brutal lame-duck session, which will bring just a temporary fix.

HUMAN RESOURCES

How closely does your company monitor its prescription drug program? Fraud costs health insurers and employers more than $72 billion a year. Narcotic painkillers, Ritalin and other stimulants, antianxiety meds such as Xanax, sleep aids and other classes of drugs are vulnerable to diversion to the illegal market.

And there are other worries: Workplace injuries and potential legal liability if a worker using a prescription drug provided under an employer's plan causes an accident. Check with your firm's pharmacy benefit manager to make sure that it's keeping an eye out for unusual use patterns, restricting too-early refills, etc.

TECH

Fuel cells are headed for the nation's highways. General Motors and Delphi are involved with efforts to put them into cars and commercial trucks, providing drivers with power that's cheaper than gasoline, with few or no emissions. About 50,000 fuel-cell-powered cars could be tooling down Calif. roads by 2015, helping to meet the state's zero emissions mandate. The truck cells, at least at first, would be used as power sources in truck cabs while trucks were parked at rest stops.

The cells are already a hit with businesses, generating clean power on-site for stores such as Walmart and powering forklifts at warehouses and seaports.

TRAFFIC FINES

Beware the surge in speed traps and police checkpoints this summer. Highway patrols and police departments of all sizes will step up efforts to curb speeding and other traffic no-no's by writing more tickets. Improving safety is the stated goal, of course. But it's no coincidence that the moves are coming as municipal, county and state revenues continue to suffer in the weak economy.

Don't count anymore on the cops spotting you five to 10 miles over the limit.

RAW MATERIALS Look for most commodity prices to slip a bit more before rebounding on better growth prospects toward year-end. Until then, Europe's debt woes and fear of a global slowdown will weigh on everything from energy to metals.

The price of a barrel of oil may fall into the mid-$70s in coming weeks, vs. today's low-$80s and the high of nearly $109 this past March. Why? Oil output by Saudi Arabia, the U.S. and others is still surging in the face of softening demand. As supply and demand come into better balance this summer, helped by sanctions on oil exports from Iran, the price will stabilize before climbing to $90-$95 by the fall. Of course, any flare-up over Iran's nuclear ambitions would bring a sudden spike.

Gasoline pump prices will ease further this summer. The average price, now at $3.56 per gallon for regular unleaded, could go as low as $3.30 by mid-July.

Diesel, ditto. It'll slide to $3.70 a gallon, on average, from today's $3.85.

Natural gas will remain a bargain, struggling to crest $3 per million Btu... British thermal units...even as drillers try to perk up prices by trimming production. The extremely high levels of natural gas in storage will take a while to work off.

Metals, for the most part, will drift lower in the next few weeks as China and other materials-hungry emerging markets throttle back industrial production.

Figure on more softness for copper, steel, nickel and aluminum. But by Dec. or so, dwindling stockpiles and rising mining costs should lift copper above today's price of $7,500 a ton, perhaps sharply. More-muted increases are on tap for steel, nickel and aluminum...not too hard on users' budgets.

One metal that'll keep benefiting from uncertainty: Gold. For investors, gold is often a safe haven during times of turmoil in currency and equity markets. The price will rise in times of volatility, ease in calmer periods, but generally trend up.

SEABED MINING At long last, the Senate is poised to ratify the Law of the Sea Treaty, an international agreement governing commercial ocean navigation routes, deep-seabed mining, and oil and natural gas drilling in international waters. While over 162 nations have OK'd it, the U.S. has been a conspicuous holdout. Senate conservatives have held that approval would diminish U.S. sovereignty.

The thumbs-up will let the U.S. lay claim to a treasure trove of minerals and fossil fuel deposits on the Arctic Sea floor beyond U.S. waters near Alaska. U.S. mining and drilling firms are champing at the bit to get in on the action... loath to cede such a rich bed of potential profits to Russia and other countries.

Obama and Romney both support ratification to help U.S. businesses. The required two-thirds majority of senators will OK the treaty early next year.

SABER RATTLING Washington's already cool relations with Moscow are about to get frostier. The Obama administration is miffed that Russia is sitting on its hands while its biggest Middle East ally, Syria, brutally cracks down on civilians there. And Moscow is still in a snit over the U.S.-built missile defense system in Europe.

The U.S. wants Russia to help remove Syria's leader, but it won't do so, for fear of alienating its wealthy, cash-paying customers in the Middle East.

Yours very truly,

Knight Kiplinger

June 8, 2012 THE KIPLINGER WASHINGTON EDITORS

P.S. We hope you enjoy the debut issue of *Kiplinger's Investing for Income*, which accompanies this Letter. To download a free copy of our new publication for colleagues, customers and friends, please go to *kiplinger.com/go/invest*.