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THE NEXT PRESIDENT

Once upon a time, I avoided writing about political issues, since I felt that they had little to do with the financial world.

However, in the past few years the connection between global politics and global financial well-being, which in fact was utterly linked, has now become utterly overt as well.

At the moment, the financial markets are tied closely to the upcoming US Presidential election for three major reasons.

- 1. The tone of the election is influencing U.S. consumer confidence and therefore the financial markets.**
- 2. There are major, justifiable fears of terrorist activities in advance of the election.**
- 3. Our choice of president will affect the U.S. government's course over the next four to eight years.**

The tone of the election is, to my eyes, an ongoing drag on the American nation. Hatred is cool these days. Any quick read of history will quickly reveal that many presidential contests have been even more negative than this. However, where once the American voters were most emotional about social and political rights and freedoms, they are now most concerned about entitlements.

Also, unlike the past, there is no escape from a national sense of anger and despair. I suppose it is due to the onslaught of media and Internet information we are all receiving, most of which is intended to elicit strong emotions from us. After all, they cannot make us buy a car if we do not feel the need strongly enough to buy. They cannot arrange our political behavior if they cannot elicit our basic emotions. Therefore, we are all buried in information seeking to create dissatisfaction, angst, and stress. Michael Moore and his counterpoints in the conservative talk radio ranks are not doing our nation any favors at all.

The result of a thousand chirping media voices generating alarm and dissatisfaction is that our own society is creating unhappiness and anger on a society-wide scale. As we become more and more artificially stressed by the hum of information, we become less able to think long term and more reactive to short term information. Many investors are now utterly preoccupied with the next few months, and many people have a negative perception about the economy which is not born out by economic statistics.

The problem is that people also make economic decisions based on their sense of well being. They hire employees, they buy cars, and they make investing decisions based on their perception of the economic future. More importantly, consumers and investors abhor confusion. Most of all, the financial markets are stalled due to uncertainty and loss of confidence. We will get past this, but it is important to remember that we are making ourselves afraid.

One fear we are all facing is the concern that there will be a major terrorist attack in North America before the American Presidential election. Following the terrorists' success against the Spanish election, I believe that such an effort is inevitable. If the terrorists do not launch some sort of assault, then they will lose their capacity to threaten us.

This could backfire rather badly for them. If they make no attempt, then they will be the Radicals who could not shoot straight. If they attempt but fail, people will fear them but perceive they can be defeated. Even if they are able to carry out an attack, there is no assurance that the American voters will respond as the terrorists desire.

Then again, perhaps it does not matter as much as we think who gets elected. Can you imagine a president elected after a terrorist attack who bends in any way to the terrorist agenda? Therefore I feel it is a good bet that the war against terror will drag on. Since we rely on part-time reservists for 40% of our ground troop manpower, and it appears that 30% of these troops will not re-enlist, whoever is President will probably preside over a new military draft. Aside from the moral and social issues of the war, this will probably end our employment problems.

The center of the political battle over the draft will be the perception that someone else should defend us. We have a national perception that war is acceptable as long as other people's sons fight it for us, and it does not affect our lives in any profound way. A draft will force the war and its execution onto the immediate center stage, where it should have been all along. Since we are now "Hatred Nation" it is going to get bumpy and loud.

As the 9/11 Commission discussed in its report, Iran was involved peripherally with the 9/11 attacks. Currently it is also the major supplier to the Shia insurgents in Iraq. Whoever is President will therefore decide to either confront Iran or withdraw from Iraq and allow it to collapse a'la Vietnam, which will prolong the simmering war on terror for decades. It has been the intentional and successful US strategy to "bookend" Iran with our troops in Afghanistan and Iraq, so confrontation is already underway. We are surrounding Iran, and they are developing nukes. It's an Arabian Standoff.

Why not attack the two bastions of terror, Saudi Arabia and Iran, directly? Because the government was afraid we would see oil at \$100 a barrel and they wished to avoid the appearance of an overt world war.

Another trend we will probably witness is that our armed forces will reconfigure themselves for a light-on-the-ground Iraqi-style war, and become the world's best anti-terrorist force. Since history tells us that the US always configures its ground military to fight the last war, the next war after terrorism will probably be extremely conventional and feature a need for armor and heavy weapons. But this probably will not happen for fifteen years.

Our national media-fueled polarization will find its expression in the next decade not only in the way the war develops, or in our consumption habits, but also in health care.

The next decade will see our medical technology extend potential life-span at an ever increasing rate, and at an ever-increasing cost. In addition, more and more Americans will become obese. Some studies indicate that one-third of Americans are already clinically obese. Lower-income Americans are especially prone to obesity. And, according to the National Institute of Health, "Obese individuals have a 50% to 100% increased risk of death from all causes, compared with normal-weight individuals." This means that in the next decade, some slenderer richer Americans will begin to live longer than other, obese Americans, and there will probably be a media-driven political catfight as obesity becomes the new tobacco.

Also medicine will inevitably advance new frontiers in technology that involves transplants and stem-cells. Disagreements about medical ethics will loom larger than ever before. Inexorably, however, the battle will center not only on ethics but also on entitlement.

As a result of this and other social demands, whoever is President will also probably be forced to raise taxes. One interesting aspect of President Bush's spending habits is that to my knowledge he has never met a federal program he did not like. Spending on non-essential programs has soared along with war costs. Perhaps he did this to simply stimulate the economy, but the net effect is that the deficit is soaring and will continue to soar.

Given the campaign promises I am hearing now, a Kerry Presidency would inevitably result in increased social spending as well. So, regardless of who is elected, Federal expenditures for medical and social programs should continue to grow in coming years. Result: future increasing federal taxes, and probably increased estate taxes as well.

As a result, whoever is president will probably preside over an era of rising interest rates. As the years pass, energy costs may decline, but the simple demand for money and the basic effect of larger deficits will drop the price of bonds and increase mortgage rates. So I expect real estate to slow down and possibly decline. Meanwhile, the stock market should improve with the economy and war-driven basic demand. "Old economy" stocks, possibly energy stocks, and health care stocks should all improve with the coming years.

It appears to me that most of these developments will occur despite whoever gets elected president. They are an inevitable product of history's marching on. Of course, when they happen, people will attempt to blame or credit the president or party in power, but all these major social agendas reflect more on the long term evolution of American society than they do upon short-term political agendas. I believe that most of the big stuff is the product of decades of social change, not the day-to-day decisions of a few elected cicadas.

So what do we do now? What do we do in the short run, just to get through the next half-year? Several diversifications provide investment venues which are likely to go UP if we have a geopolitical surprise such as a terrorist attack. These are energy stocks, precious metals stocks, and US Treasury notes. Unfortunately, with the possible exception of the US Treasury notes, these may also decline if bad times do not happen. That is why you will not see them dominating your portfolio.

We are also gradually rotating out of index funds and instead focusing your asset allocation on lower-risk balanced and value funds which have a history of thriving in tough times. We are especially interested in mutual funds which handled 2001's challenges with aplomb. Hopefully such attractive short term performance is a basic indication that it might do well in a coming disaster.

Above all else, we are still focused on your long term needs. If your investment dollars are invested conservatively and with an abundance of diversification, history tells us that your chances of success are excellent. ★