

PURCELL | INVESTOR REPORT

Fourth Quarter 2011

Yea Boo, Yea Boo

“Yea boo, yea boo, it’s lots of fun to do. If you like it holler yea, if you don’t you holler boo.”

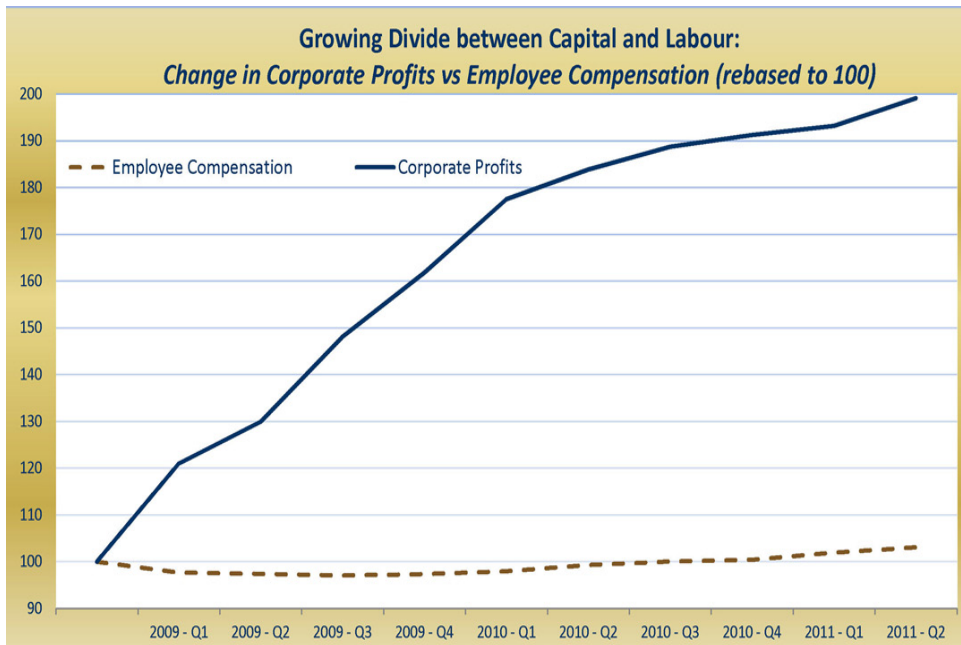
<http://www.youtube.com/watch?v=HwCeg6MuNvw>

Because of YouTube, our devoted readers will not have to miss out on hearing the above 50’s ditty that opens our first issue of *The Purcell Report* for 2012. They can now sing along, even if they didn’t have the chance back in the 50’s when we first heard it.

that example. Interesting.)

An article by Tyler Mordy of Hahn Investment Stewards, also points up wage issues and ties them to our economic cycle and its impact on future equity market returns. Mr. Mordy has kindly given us permission to quote him and use a few of his charts from an article entitled *Workers of the World Untied: Has Capitalism Come Undone?** (Chime in with a yea or boo as the mood strikes you.)

It is no secret that “In recent years, the most conspicuous feature of the financial landscape has been the growing divergence between US labour and corporate profit trends. . . Bulls and bears may dispute the causes or disagree on forecasts, but everyone will gape at the numbers. From the fourth quarter of 2008 to the second quarter of 2011, real domestic corporate earnings have surged by almost 100% while real employee compensation has risen by a mere 3%.” (See chart at left.) Got your



Source: Haver Analytics, Bureau of Economic Analysis.

Several paradoxes in the economy brought the ‘yea, boo’ phrase to mind. See what you think.

Our state, Washington, recently became the state with the highest minimum wage, \$9.04. (O.K., all workers: Yea! Certain small business owners: Boo!) To further complicate matters, a full time minimum wage job pays about \$18,660 a year, usually without benefits. (Boo!) According to the US Government web site, the poverty line for a family of three is \$18,530. (This must be the working poor we read about. Another boo?) This actually reminds us of Henry Ford who saw his factory workers also as consumers and decided it was good business to pay high enough wages so that they could also become his customers! That’s a 1908 idea, of course. (It turns out there are two Yeas and no Boos in

attention? Yea, boo or just *huh?*

Later in the article, Mordy even quotes Marx about the extraordinary advantage capital owners have over workers. (Is this blasphemy for a portfolio manager? Should we ask the children to leave the room? Yea or boo?) He does admit that political economy is not his usual domain but “rather our goal is the pragmatic stewardship of client capital.” (Yea!) “Yet, trends in returns on capital versus returns on labour – the central battleground of many



Please contact us to request our latest ADV disclosure brochure.

If your objectives or financial goals have changed,

Please contact your financial advisor or

PURCELL ADVISORY SERVICES, LLC

www.purcelladvisory.com

Phone (253) 627-8101 Toll-free (800) 730-6867 Fax (253) 627-8102

* First published in Index Universe’s *Journal of Indexes*.

... ideological debates – are inextricably linked with sustainable wealth creation. Even passive indexers and ETF enthusiasts must rely on a minimum level of balanced economic growth, and indeed a functioning capitalist system...” What has been created is a combination of “rising profits and stagnant income growth (which) cannot possibly last forever.” Corporate profits at an all time high! Yea! Wages making no headway at all! Boo!

“Also, on one point, let’s be clear. Capitalism, in its pure form, hardly exists today. If it did, government would also allow market discipline to work on the downside. Clearly, that has not been the observable case recently; witness banking bailouts, sovereign bond guarantees and numerous other government

interventions . . . the ‘socialization of losses’ and ‘privatization of gains’ is today’s status quo.” (Boo!)

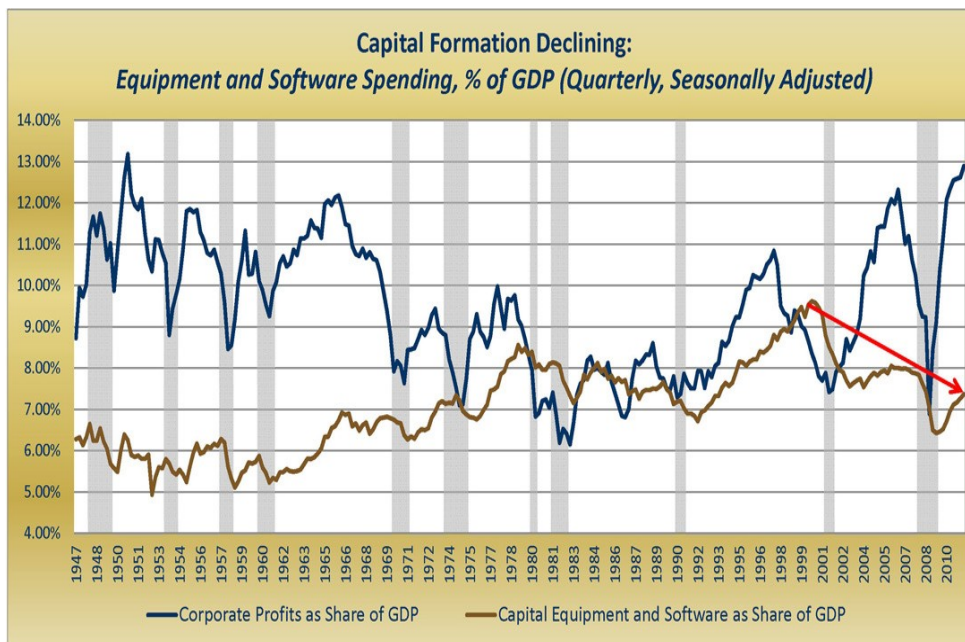
One more telling chart from Mordy (below left) shows that since the late 90’s, spending on capital equipment and software has significantly lagged earnings growth. “Over time, these actions deplete capital formation, reduce macro economic growth and ultimately contribute to a reduction in employment.” (What? Another Boo? We think so!)

Tyler Mordy’s complete article is on our website and can be accessed by this link: www.purcelladvisory.com/pdf/Tyler_Mordy_Article_1.pdf. (Yea!)

In closing, we’d like to point out that although

Mordy realizes corporations have high cash positions and healthy balance sheets, he doesn’t think that will lead to stronger domestic employment growth and higher incomes. (Boo!) He thinks “a more likely scenario is that corporations will emphasize overseas expansion instead of domestic investment.” (Another Boo!)

At Purcell, we are glad to be in the alternative investment arena where our tactical strategies can support advisors in being good stewards of their clients’ wealth. (Yea!) Looks like the country’s not out of the woods yet. (Boo!) Thanks, Tyler, for allowing us to share.



Source: Haver Analytics.

Here’s an excerpt from a Purcell Signal Provider’s quarterly comments.

The second half of November was a particularly tough time for quantitative strategies as we watched uncertainty over world financial markets expressed in big moves in US equities on very low volume. Although ours is not a news-driven strategy, the reaction of the markets to positive or negative news is magnified when there is little in the way of shock absorbing volume. The Thanksgiving holiday in the U.S. exemplified this phenomenon.

At times it is tempting to try to second-guess our rules-based investing procedures, but we are actually very pleased to be able remove the emotion from the decision making process each day. There are about three alternatives to rules-based investing: 1. Anticipate the drama and guess each day at the seemingly arbitrary short-term direction of the markets. 2. Buy and hold while gritting one’s teeth through the daily ups and downs and hope the long-term direction goes in your favor. 3. Throw up one’s hands, go to cash, and forfeit any opportunity for return.

Obviously, none of these alternatives offers the long-term edge that fully tested and implemented rules-based investment strategies such as ours offer. So, we continue to make our trades without compromising the integrity of our strategy, following the rules each day.

PURCELL BOOK OF THE QUARTER

Republic, Lost by Lawrence Lessig

Fresh from New Year's resolutions and mindful of the need to really focus on ideas that can make a difference, along comes Republic, Lost: How Money Corrupts Congress – and a Plan to Stop It by Lawrence Lessig.

Here's a resolution for you: Resolve to read one book in 2012 whose ideas can help shift public thinking away from government distrust and move the country forward, righting wrongs.

Lawrence Lessig is the director of the Edmond J. Safra Center for Ethics at Harvard. He was a professor of law at Stanford and clerked for Justice Antonin Scalia on the U.S. Supreme Court. Quite an impressive resume; we can assume he's a smart guy.

This book succinctly draws the most elusive but salient image of the decade: How can trust in government be regained? Lessig posits that the root cause of this and many of our problems is the dependence of politicians on money (Is that a surprise?). Congressional Representatives have to run for office every two years. The cost of running an election is huge and the money to pay for it is given by...largely corporations, of course. Our current system of campaign finance reverses the concept of a government responsible to the people (as in the Constitution) and changes it to being a government responsible to contributors. The infamous Citizen United corporation—as-a-person decision has only exacerbated the problem. We'll all get plenty of opportunity to see the results of that decision in the 2012 presidential election. Lessig attacks neither left nor right but is evenhanded to a fault. (That fault manifests itself by Lessig being a bit long-winded in order to show fairness in all points. Small weakness, however.)

Let's quote from the book: Speaking of congress, and the influence of campaign cash, Lessig says, 1. "We have a gaggle of good souls who have become dependent on a way that weakens the democracy," and 2. "We have a nation of good souls who see that dependency and assume the worst." And

another: "The public has lost faith in a system where the rules of the game seem tilted in favor of a few." And again: "As I've described, this book is a call for politics without politicians...we need a way to motivate citizens that doesn't in the end connect to some campaign for some important national office. It needs to be about ideals, or principles, not about a person..."

The common enemy of our republic for both right and left, is corruption and we must find a way to fight it, together.

Lessig also has some very interesting (if not maddening) points to make about, 1) Shrinking the size of government, 2) Simplifying the US tax system and, 3) Keeping the idea of efficient markets. (All very Reaganish, really.)

What he found about #1 is that members of Congress can have an interest in extending the reach of regulations because increasing the range of interests increases the number of folks who have an interest in influencing federal regulation and bring more lobbyists to congress's door, i.e. more campaign contributions.

#2. Simplifying our tax structure. This gambit quickly brings out the lobbyists of the software businesses whose survival depends on the complexity of taxes, not the efficiency of a system. And, of course, these lobbyists have campaign dollars to give and give – or, heaven forbid, withhold. Let us quote Lessig again: "To understand the nature of tax law in America, you have to understand one simple point: its complexity is a feature, not a bug."

And finally, #3. Keeping markets efficient. Lessig posits that, "Those in power...prefer to stay in power. They feel threatened by free markets" – even if it was free markets that gave them their power.

If you would like to take your New Year's resolution to its highest expression, ask Purcell for your copy of Republic, Lost, by calling (800) 730-6867 or email pas1@purcell.com. Start making a difference for us all. Thanks.