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DHJA
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Required Reading!

The scariest media event this summer is not Steven Spielberg's remake of *War of the Worlds*. That is a darn good movie and the action is intense and pretty scary. But if you want to be really frightened, you should read The World is Flat by Pulitzer Prize winning author Thomas L. Friedman. Unlike *War of the Worlds*, the book is not science fiction. In fact, it is brutal reality and that's what is scary. After I read it, I thought enough of it to buy a bunch of copies for the office and make it required reading.

The premise of the book is simply that there has been a convergence of events that has changed the economic dynamics of the world in one generation. The failure of Soviet communism, the opening of China, the move to a capitalist orientation in India, and the build out of the Internet on a global basis with the capital raised in the dot.com boom of the late 1990's has leveled the global economic playing field in one fell swoop. Hence the title, The World is Flat.

Your accountant sends your tax return to be done overnight by an outsourcing firm in India. Your doctor does the same with your CT scan. Global collaborative work at a high intellectual level is done with Internet file sharing. Movies are made with global collaborative efforts by groups connected by video conference over the Internet. This is the world today, and the trends are accelerating.

This is not a bad thing for global growth. Underemployed economies with educated people are growing dynamically in this "new world". They, in turn, are buying our consumer products and technology and, importantly, they are not going to start wars with their new best friend and trade partner, the USA.

But the scary part is that we are not preparing ourselves and our children for this "new world". There is a reverse brain drain in the USA. We have imported engineers and scientist for decades. Now they are going home. The number of technical graduates from U.S. universities has plummeted in the last twenty years.

Mr. Friedman is calling for an educational wake up call, similar to that which occurred in the late 1950's when the

Soviets put up the first Sputnik Satellite. He is calling for our political leaders to have the courage to tell the truth about how poorly we are preparing our children for this world. He is asking for a sense of urgency and a unity of purpose that seems very unlikely in the partisan political environment in the United States today. However, changing the competitive environment takes time. How competitive will we be in fifteen years if we don't start dealing with the issue in earnest today?

Folks in the investment management business are often asked what are the biggest risks out there. Well, for domestic U.S. companies, this is it. A U.S. population that is poorly educated and complacent in an increasingly competitive and capitalistic world economy doesn't augur well for domestic economic growth. On the other hand, U.S. multinationals like GE, Proctor & Gamble, PepsiCo, etc. are clearly in line to be winners as these newly wealthy economies buy our goods.

On a shorter term basis, the U.S. equity market remains stuck in the same trading range that it has been in for close to two years. Back in April, sentiment became sufficiently bearish to trigger a trading rally. As the market has recovered so has investor psychology. The spread between Bulls and Bears is up to +33%. This is not a position from which sustained uptrends spring. Monetary factors also would not seem to support a strong upward move from here - the Federal Reserve continues to raise rates and money supply growth is slow.

We would expect that an upside breakout will occur when the market begins to anticipate a reversal in Fed policy, to an accommodative stance and an expansion of monetary liquidity in the system. With GDP growth now slowing somewhat, the Federal Reserve could make this change next spring, after Chairman Greenspan's retirement. The markets will anticipate this as always by several months. There is a good chance that Santa Claus will bring some good news to the markets in late 2005.

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A copy of our Form ADV, Part II is available upon request.

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