

Something to Think About



OAKWORTH
CAPITAL BANK

COMMON CENTS

Last Thursday, I took my son on ‘party boat’ to presumably fish for sharks. Having been on this particular vessel before, I knew the tackle, and understood we wouldn’t be catching Jaws or any of his brothers and sisters. Still, my 10-year old had fantasies, if you can call them that, of landing a really big fish, and was simultaneously thrilled and nervous about the prospect.

For my part, I had a feeling we might be lucky to catch a few very small blacktips, or even a less threatening species. Basically, I felt if John and I could each haul 1 or 2 overboard, we should consider ourselves fortunate. There are only so many sharks you can catch in a couple of hours, and only so many whoppers with the provided equipment, if any.

I will cut to the chase, and tell you we went out about a mile; threw our lines over the side, and stared at the water for a couple of hours. I occasionally reeled my line in just to have something to do, and it wasn’t just us. Of the 30 or so people on the boat, only 1 shark, or any other fish for that matter, found its way on to the boat. A few people said they felt a bite or two; however, I am certain they didn’t know the difference between choppy water and fish.

When the first mate, who had spent the afternoon trying to ingratiate himself to folks, told us to bring up our lines and take off the bait, I was a mixture of surprised, frustrated, and relieved. My son was beyond disappointed, particularly after building it up in his mind to the degree he had. It was one thing to not catch something that could take off your hand; it was quite another to stare at the water for as long as we did.

On the way back, I started thinking like a business person. Clearly, the captain couldn’t help it if the fish weren’t biting where he took us. Further, it wasn’t too terribly experience, as far as fishing trips are concerned, but it still cost enough I felt a little cheated; not because we didn’t catch a fish, no, but because the entire boat only caught 1!

So, I turned to the guy next to me and said: “If this guy were smart, he would give us back \$5-10 or give us discounts for a future excursion on his boat.” Obviously, given the circumstances, he agreed, but neither of us thought the captain would do anything, even apologize. We were right.

Even so, I slipped the first mate a few bucks on the way off, because it really wasn’t his fault, and he was a likeable enough guy. From what I could tell, most people didn’t, and I heard more than a few of them complain something along the lines of: “Man, that is the last time I take that boat. The captain didn’t even move although it was obvious the fish weren’t biting where he took us. At least act like you are trying. Good grief.”

No argument, however...

This particular boat captain has about as captive an audience as you can have for such things. His is the only party fishing boat in the South Beach Marina within the Sea Pines Resort on Hilton Island. Yes, there are charters available, but nothing else like his, and the foot traffic in the area is awesome. Basically, if you are staying in Sea Pines, and you want to go on a party fishing boat, you have 2 options: 1) use this guy, or; 2) drive 15-20 minutes to another marina out of the resort and take your chances. Your choice.

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**America would be a better place if leaders
would do more long-term thinking.**

**Wilma Mankiller
(Chief of the Cherokee Nation)**

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Further, his business doesn't necessarily rely on 'repeat business.' After all, not everyone on the boat with me will be back in Sea Pines or even Hilton Head next summer. Some might not ever want to go out on a boat again, or where doing it as part of a larger group, as evidenced by the family reunion next to me. In short, of the 30 people on the boat, I would guess no more than 50% were potential repeat customers, with the actual number probably closer to a quarter or a third.

So, 7-10 people? Let's call it 10. If he had given us \$10 back to everyone on the boat, that would have been about \$300 out of his pocket in order to save 10. Of those 10, probably another half would use his boat again, regardless, because of the convenience. So, he would really be shelling over \$300 to save 5 customers, which would be \$60 per, about the price of the trip per person.

By the time you factor in the cost of operating the boat, giving back a rebate of \$10 would have been, at best, a break even over 12 months, at best. No wonder he didn't do this, but what should he have done.

If we assume the same numbers of people, what might a 10% discount for the next trip do? Frankly, it would have made me, and probably everyone else, feel better. Further, it wouldn't have meant a single dime out of his pocket! At most, it might have 'cost' him \$60 dollars next summer, but if he 'saved' those 5, he would have gained \$270. Besides, what is the likelihood someone is going to keep a 10% coupon for 12 months, and then remember to bring it with them on vacation? Maybe 50%? At best? Probably 25%? So, maybe anywhere from 2-4 people would have presented that coupon in the future? At a cost of \$12-24 to the captain? To me, that is a no brainer.

I think you get the picture. There are many businesses which think too short-term for their own good. "What did they expect for \$60? A great white? A hammerhead?" However, it isn't just the off business owner, this mindset is basic human nature, and pervades throughout society. After all, it is very difficult to look into the future, so we focus on the immediate.

Such is the case with the so-called "Fiscal Cliff" the US faces at the end of the year. This is when all the various tax cuts expire, and automatic spending cuts kick in. There is no shortage of people wringing their hands and gnashing their teeth over the potential ramifications, both political and economic.

Ask anyone who cares about such things what the biggest problem facing the fiscal health of the United States is, and I believe a majority would say the Federal budget deficit and accumulated debt. Essentially, all things US Treasury related. When you ask them the follow up question what must the government do to get the budget deficit under control, I imagine just about every one would say something along the lines of: "Well, it is obvious, the government has to increase tax receipts and it has to reduce spending." Hmm.

So, if the biggest problem facing the financial health of the US is the massive Federal budget deficit and accumulated debt, and the solution is to increase tax revenue and reduce spending, hmm, what is it about the so-called fiscal cliff which gets everyone so hot and bothered?

Clearly, the answer is short-term: an increase in taxes will decrease discretionary income which will slow consumer expenditures, and a decrease in government spending from previously announced levels will, I am not sure really, slow things more than they would have ordinarily. In any event, combined, it doesn't look good, short-term, for the US economy, and that isn't a good thing for anyone....short-term.

So, what is the solution? Well, Congress is **sort of attempting** to figure one out right now, and keeps stumbling over political differences which don't amount to much in the long run. Why do I say that? Because the tax code itself is the problem in the US, not necessarily a slight increase in marginal tax rates for a handful of people. It is also a problem close to half of US taxpayers don't pay any income tax. Basically, they aren't paying into the day to day functioning of the US government.

Further, there are loopholes upon loopholes, and deductions on top of deductions. Shoot, there are even tax credits which allow people who don't pay a dime in income tax to receive an income tax refund. Frankly, our tax code is so cobbled together and cumbersome as to inhibit business activity and, ironically, the collection of taxes. Meanwhile, individuals go to great lengths and expense to avoid paying taxes. This helps to support legions of people in a number of different

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industries, but is it the highest and best use of capital? I don't think it is, and my industry is one that benefits from the Byzantine way we collect taxes in the US.

Basically, all the political wrangling in Washington has to do with what I would consider short-term fixes to the existing tax code. As such, it seems to me the problem isn't with these fixes as much as the tax code itself. There is the problem, not whether or not 1% of the population might have to pay an additional 4.6% at the highest marginal tax break point. While no one really wants to pay higher taxes, is this the biggest problem in the country today? No.

We need a massive overhaul of the tax code. Period. It is unnecessarily complicated, and leads to the misallocation of capital in the economy. It inhibits the free flow of money, and encourages the evasion of taxes in general. Tweaking it at this juncture, with a credit here and a break there, will produce diminishing marginal results. After all, you can continue to plug your tire whenever it springs a leak, but at some point you will need a new tire. That is where we are.

The Republicans and Democrats in Washington can keep arguing about marginal tax rates, credits, breaks, and deductions all they want. However, they will not see a vast improvement in tax receipts until the US develops a transparent, permanent tax code which actually encourages the payment of, well, taxes. We don't have that know, as, again, our tax code was cobbled together by short-term thinking.

In essence, Washington needs to start thinking like a business owner: how does it maximize revenue and minimize costs? Instead, each year it seems to enact policies which do the exact opposite. It is completely counterintuitive, which is the reason why the populace has lost so much faith in our public institutions. It isn't the taxes people mind as much as the fiscal irresponsibility.

But...but...the government isn't a business, and can't think like one. Right? To this I say, why can't it? I have had this debate with others, and no one has been able to really come up with a good answer for that question. The problem is getting the government to agree to this way of thinking, because that would mean it would have to get its costs under control. It would have to get its act together, and be more efficient. But where to start?

It would take years to undo the massive redundancies and inefficiencies in many of our Federal agencies, maybe even decades. However, fixing the tax code wouldn't take time as much as will. Do we have the will to change it? Knowing that doing so might eliminate some loophole in our favor, etc.? Whew. That which is politically feasible is incredibly difficult to physically do. On the flipside, that which is easy to physically do is political anathema. Who has the guts to do the right thing?

The right thing, hmm. What would be the right thing to do if you were a boat captain who took 30 paying customers to a fishing spot where there were no fish? Not only that, but let down the anchor and didn't move a muscle for hours? Didn't even try to ensure the customers caught something, or at least make the appearance of doing so?

Would it be to not say anything to anyone, and pocket their cash? Or would it be to apologize in some manner, extend the trip by 15-30 minutes, and perhaps give a small discount on a future trip? I think you know the answer, at least the one that would produce better long-term results.

So, if we can see it in this example, why can't we all see it when it comes to the tax code and Washington?

Important Economic Releases

Release	Survey	Actual	Prior	Comments
Producer Price Index (July)	0.2%	0.3%	0.1%	<p>I would say this week's economic data was pretty good. I mean, I wouldn't take out an ad in the New York Times about it, but it was okay. It bespoke an economy growing around 2.5%, maybe a shade more.</p> <p>I guess that was enough for another good, if unspectacular week for stocks. Hey, we will take it.</p>
Advance Retail Sales (July)	0.3%	0.8%	-0.7%	
Business Inventories (June)	0.2%	0.1%	0.3%	
Consumer Price Index (July)	0.2%	0.0%	0.0%	
Total Net TIC Flows (June)		\$16.7B	\$121.3B	
Industrial Production (July)	0.5%	0.6%	0.1%	
Initial Jobless Claims	365K	366K	364K	
Housing Starts (July)	756K	746K	754K	
Philadelphia Fed (Aug)	-5.0	-7.1	-12.9	
U of Michigan Confidence (Aug)	72.2	73.6	72.3	
Leading Indicators (July)	0.2%	0.4%	0.3%	

Tables & Data Points

<u>STOCKS</u>	Dow Industrials	S&P 500	NASDAQ	Russell 2000	Nikkei 225 (¥)	DJ STOXX 50 (€) Price
12/31/10	11,577.51	1,257.64	2,652.87	783.65	10,228.92	2,792.82
12/31/11	12,217.56	1,257.60	2,605.15	740.92	8,455.35	2,216.55
7/26/12	12,887.93	1,360.02	2,893.25	777.11	8,443.10	2,251.05
8/2/12	12,878.88	1,365.00	2,909.77	768.60	8,653.18	2,263.36
8/9/12	13,165.19	1,402.80	3,018.64	802.90	8,978.60	2,437.04
8/16/12	13,250.11	1,415.51	3,062.39	813.08	9,092.76	2,456.53

<u>BONDS</u>	3-Mo UST	6-Mo UST	2-Yr. UST	5-Yr. UST	10-Yr. UST	30-Year UST
12/31/10	0.13	0.19	0.60	2.01	3.30	4.34
12/31/11	0.01	0.06	0.24	0.83	1.88	2.90
7/26/12	0.10	0.14	0.23	0.59	1.44	2.50
8/2/12	0.09	0.13	0.23	0.61	1.48	2.55
8/9/12	0.11	0.15	0.27	0.73	1.69	2.76
8/16/12	0.08	0.14	0.29	0.82	1.84	2.95

<u>OTHER</u>	Prime	Fed Funds	3-Month LIBOR	Gold/troy oz.	Oil— WIT/brl.	\$/Euro	JPY/\$	\$/GBP	CAD/\$
12/31/10	3.25	0.25	0.30	1,421.40	91.38	1.337	81.19	1.559	0.994
12/31/11	3.25	0.25	0.58	1,566.80	98.83	1.296	76.99	1.551	1.017
7/26/12	3.25	0.25	0.45	1,615.10	89.39	1.228	78.22	1.569	1.010
8/2/12	3.25	0.25	0.44	1,587.40	87.13	1.218	78.24	1.552	1.007
8/9/12	3.25	0.25	0.44	1,617.10	93.36	1.231	78.56	1.564	0.991
8/16/12	3.25	0.25	0.43	1,616.10	95.60	1.236	79.35	1.573	0.987

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