



## Morning Bullets

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### Why We're Upbeat

**OVERVIEW:** Our friend Charlie Cook wrote recently that things outside of Washington are looking better; he focused on the growing likelihood that the U.S. will be energy self-sufficient within the decade. This prompted us to dust off our extensive list of other things that are getting better . . .

**THE BUDGET DEFICIT IS FALLING:** Data to be released later today from the Congressional Budget Office will confirm the least appreciated story in Washington -- red ink is falling significantly, especially as a percentage of GDP. We may not be in a climate of austerity, but we're in the midst of a long stretch of restraint -- *coupled with rising revenues.*

**STATES ARE IN MUCH BETTER SHAPE:** The fiscal turnaround is particularly apparent on the state level, where a cyclical improvement in the economy -- combined with spending restraint -- has put virtually every state on sound footing. We're not sure whether to believe Jerry Brown that California is headed for a surplus, but finances clearly have improved in the Golden State -- leaving Illinois as the only major state in the country that can't get its act together.

**THE U.S. MANUFACTURING SECTOR IS REBOUNDING:** Last week's Barrons cover story should be required reading for the America in Decline crowd -- manufacturing is coming back to the U.S. because it's cheaper to produce goods here than elsewhere, thanks largely to our glut of low-cost energy.

**CORPORATE BALANCE SHEETS LOOK SPECTACULAR:** Veteran financial analysts are in complete agreement: thanks to debt restructuring and productivity advances, corporate balance sheets are in the best shape of our lifetimes. It's a major reason why hiring will gradually increase.

**THE ECONOMY HAS TURNED:** The slight downtick in fourth quarter GDP was a fluke, thanks to Hurricane Sandy, inventory drawdowns, a sharp drop in federal outlays, etc. Growth in the first half will be restrained by the payroll tax hike and a possible budget sequester, but indicators ranging from durable goods to retail sales show that a recovery is underway, likely to gain momentum by the second half.

**HOUSING HAS BOTTOMED:** As we travel around the country we're amazed that in some regions people are talking about a surge in housing prices; in fact, we worry that ultra-low interest rates could produce still another bubble. In any event, the psychologically crippling fear of foreclosure has subsided considerably.

**WASHINGTON ISN'T QUITE AS OBNOXIOUS:** Despite the media hype, we didn't fall off the fiscal cliff last month, a government shut-down is unlikely, and there won't be a debt ceiling default crisis. Yes, sequester is possible and the partisan rancor is still fierce. But Washington has gone from a major negative for the markets to a neutral, largely because investors and taxpayers have clarity on tax policy. No major new revenue raising is likely for the foreseeable future.

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