

# The Kiplinger Letter

FORECASTS FOR MANAGEMENT DECISIONMAKING

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Dear Client:

Washington, July 14, 2006

Got a great idea for a new business?  
Just need the financing to make it happen?  
Now's a good time to make your move.  
Venture capital is flowing again  
to the tune of about \$50 billion this year.  
And it will grow again in 2007 as angels,  
VC firms and big businesses eager to expand  
take a chance on promising new projects.  
Although it is still just one-fourth the level  
of 2000, it's a big leap from recent years.

## BUSINESS FINANCE

What's grabbing investors' interest?  
Technology, for sure, especially mobile  
and wireless devices designed to help consumers  
navigate the Web more quickly and efficiently,  
finding stock quotes, videos, music and more.  
Portable gadgets and software are popular,  
not only with consumers, but also with firms  
wanting to reach customers who are on the go.  
Also attractive: New search engines  
that make it easy for consumers to find  
and download a wider variety of Web offerings  
to their iPods and similar devices yet to come.  
One example: VC-backed StreamSage, recently purchased by Comcast,  
provides high-speed Internet surfers with fast access to video clips.

Health care is also a magnet for funds. Illnesses tied to aging  
are getting the lion's share of attention from investors. They're mindful  
of growing demand by aging baby boomers for treatments and cures.

Particularly alluring: Development of customized treatments  
made possible by the mapping of the human genome. NitroMed's BiDil,  
for example, aims to treat heart disease specifically in black people.

Vaccines and drugs against new disease threats, such as avian flu,  
are pulling private equity firms like Kleiner Perkins Caufield & Byers.

Three fairly new fields are expanding rapidly: Nanotechnology...  
using materials as tiny as molecules to produce everything from windows  
that clean themselves to pollution-reducing fuel additives. One firm,  
SiOnyx, is making a fine film for high-resolution cameras and sensors.

"Green" energy. As long as oil and gasoline prices stay high,  
money will pour into alternative fuels, energy-efficient buildings,  
fuel cells, wind and solar power plus ways to recycle waste into energy.  
In fact, green technologies are the fastest-growing investment sector.

And organic foods. Though only a fraction of total food sales,  
the organic food market is growing by 20% a year. Big food retailers,  
such as Wal-Mart, Kroger and Safeway, are playing an important role.

## LEGISLATIVE FORECASTS

	<b>Job-training programs</b> Negotiators will cut a deal
	<b>Immigration reform</b> Not before Nov. election
	<b>Pension funding reform</b> Conferees still at an impasse
	<b>2007 budget package</b> Not until lame-duck session
	<b>Minimum wage hike</b> Odds against Dems' push
	<b>More offshore drilling</b> Environmentalists oppose it
	<b>Defense authorization</b> More tanks, planes and ships
	<b>Stem cell research</b> Bush will veto expansion
	<b>Telecom rewrite</b> Work will spill into '07

**THE ECONOMY**

Some recent good news on the economy warrants a closer look.

Stronger 2006 corporate profits growth than expected...around 12% for S&P 500 companies compared with the 8%-9% anticipated in the spring... is a boon for shareholders. That's a fairly modest decline from 2005, with a wide array of industries racking up double-digit gains: Energy, of course. But also hotels, airlines, utilities, aerospace, defense, financial services, telecommunications, chemicals, construction materials, electrical equipment, metals, paper and a host of commodity producers. (Information technology and makers of consumer products from soft drinks to toothpaste will bring up the rear, with low-single-digit gains likely.)

But the gains are coming at the cost of long-term investment.

About a third of profits growth this year is derived from a combination of share buybacks and interest income earned by cash-flush companies.

Business spending should be growing faster than the 8.5% rate that's likely this year. The labor market is tight. Productivity gains are leveling off. And plant and equipment capacity utilization is running at a strong 81.7%, only a little bit below the peaks of the late 1990s. That plus five straight years of strong profits growth should mean firms plowing money into new equipment and facilities, building for the future.

Worries about a big slowdown are sidelining expansion plans.

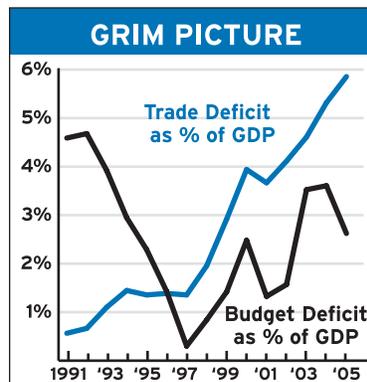
Too many managers and owners...at both big and small companies...are wary about being stuck with idle buildings and unsold merchandise on shelves.

Unfortunately, it may be a case of a self-fulfilling prophecy.

Their reluctance to commit to expansion means fewer orders, less growth.

A lower federal budget deficit also masks some not-so-good news.

Sure, it's a positive that Uncle Sam has to borrow less this year. But...



The long-term outlook remains downright dismal.

The higher tax revenues from corporate profits overshadow a 9% increase in spending, and do zilch to avert the time bomb of Medicare and Social Security payments set to soar as baby boomers retire in the coming decades.

Moreover, the trade deficit continues to mount, despite growing exports. At least in part, that's because the bill for U.S. imports is being inflated by the high cost of crude oil. With more greenbacks held in foreign hands and seeking a home, interest rates will rise, offsetting benefits from a lower budget deficit.

**HEALTH**

More federal funding of stem cell research is a matter of when...

Not if. Although President Bush is sure to veto Senate efforts to hike funding...a move that Congress won't be able to override... restrictions on federal stem cell funding will be removed by 2010 or so.

The vast majority of Americans support the medical research that holds the promise of cures for diabetes and many other illnesses.

A policy change will come after the 2008 presidential election.

Either the next president will lift current limits on stem cell research or Congress will rise to any veto challenge in light of voters' wishes.

Meanwhile, state and private monies are flowing into projects.

Calif., N.J., Conn., Ill. and Md. play a big role. A top private effort: Harvard University's stem cell institute, with \$30 million in funding.

**TAXES**

Politics will delay an estate tax deal until 2007 or later. A new flurry of negotiations won't yield fruit before Nov.

It's not hard to see where Congress is headed, but Democrats are in no hurry to give Republicans a pre-election victory on an issue that lets them argue that the GOP cares only about the very rich.

Outright repeal won't prove possible...not without big changes in both the political landscape and the budget deficit outlook.

But a deal exempting most taxpayers looks increasingly likely well before 2010, when the larger exclusions in current law expire.

Odds favor an estate plan with no tax on the first \$5 million.

And two or more brackets above that, with a top rate near 35%.

That's similar to plans circulating in the House and Senate now, but disagreement on some of the details gives each side cover for delaying. That allows them to appeal to their political bases without making the hard compromises that might offend key supporters.

**SELLING**

Marketing to stock-car-racing fans can spell huge profits.

These fans have a high degree of loyalty to firms that sponsor their favorite drivers, knowing they can't compete without backers.

There are many ways to tap the market without going broke.

Though sponsors of the top-tier Nextel Cup Series often spend millions, midsize and small firms can look to the Busch and Craftsman Truck series of races for sponsorship opportunities costing considerably less.

Many smaller deals offer some of the same benefits as big ones... use of a driver's image on advertising and even personal appearances.

Opportunities to get involved will broaden as racing expands beyond its traditional base in the South. In the next few years, new tracks will be built on Staten Island in NYC and near Seattle.

The National Football League is poised for a huge season...

a boon for scores of businesses affiliated with America's No. 1 sport.

Fans are ready to spend big bucks, not just in franchise cities, but also in many small cities...from Napa, Calif., to Davie, Fla... that host NFL training camps. Scores of local businesses will benefit.

Season ticket sales will hit a new high, topping attendance of 21.8 million last year. New TV contracts will also boost the NFL.

Back-to-school and holiday sales are sure to suffer this year as shoppers pare purchases. Gains will be about 2% and 3%, respectively. Even heavy discounting isn't likely to shake loose a lot of spending.

**AIR TRAVEL**

Despite rising airfares, people are still taking to the skies.

And that means the U.S. airline industry will break even this year. A few carriers are even expected to edge into the black.

Next year could bring an overall profit for carriers...the first since the devastating travel slump following the 9/11 terrorist attacks. But many legacy carriers still tote heavy debt, limiting expansion.

New low-cost start-ups are on the horizon. Air Gumbo has plans to begin service next year from seven Louisiana cities to nearby states. Skybus, based in Columbus, Ohio, is also gearing up to begin flying. And Virgin America, an offshoot of Virgin Atlantic, is preparing to serve several American cities from a hub in San Francisco.



**DEFENSE  
BUSINESS**

Stiffer "Buy American" rules for defense contractors won't fly. Bush and the Senate will shoot down a bid by metals producers to require that only U.S.-sourced titanium, nickel and specialty steels be used in the manufacture of equipment for the military. The Pentagon will continue to show a preference for U.S. materials and components, but it doesn't want its hands tied. Tighter restrictions on purchasing would also be sure to invite retaliation by trading partners.

**AFRICA**

A slew of new business opportunities are emerging in Africa, particularly in the development of new oil and gas fields. Besides energy technology, Nigeria, Angola and other oil-rich nations want more outside investment in roads, railways, water treatment plants and power generation. Demand for telecommunications gear is also rising. But U.S. firms face strong competition from foreign companies, especially in the push to expand oil and gas fields in West Africa.

Uncle Sam can help. The U.S. Trade and Development Agency, which helps exporters find leads, is putting a fresh emphasis on Africa, particularly South Africa. It's currently helping to arrange deals for U.S. firms interested in shoring up South Africa's electrical grid. For more information, go to the agency's Web site at [www.ustda.gov](http://www.ustda.gov).

**INDIA  
BOMBINGS**

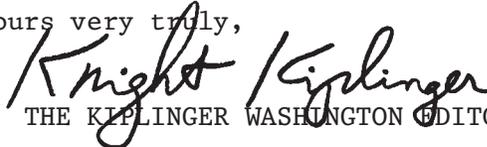
The Mumbai train bombings will draw India and the U.S. closer. The Bush administration will share active intelligence with Indian authorities and help them to apprehend the culprits. But the attacks may also worsen Washington's ties with Pakistan. If the bombers are identified as members of a Pakistan-backed group, such as Kashmiri separatists Lashkar-e-Taiba, Pakistan's reliability as an ally in the war on terrorism would have to be reevaluated.

**MIDEAST  
CRISIS**

As conflict in the Mideast threatens to spread in the region... There's little the White House can do to stop the violence. Bush's hope is to exert enough influence to at least contain the warfare. Israel won't stop short of its goal to break Hezbollah completely and remove it as a threat to northern Israel...an ambitious objective. If Israel succeeds, there's a big payoff for it and the U.S. Breaking Iran-backed Hezbollah would weaken Iran's clout in the Mideast, end Syrian influence in Lebanon and fortify Israel's hand against Hamas, also backed by Iran and Syria. All those developments would be a big help to U.S. security goals for the region, putting a big dent in terrorism.

The crisis will bring new highs for energy prices this summer. Crude oil will spike to around \$90/bbl. soon, and it could reach \$100 if Mideast strife grows much worse. With oil so high, gas pump prices will jump to a national average of \$3.50/gal...\$4 in some regions.

Yours very truly,

  
THE KIPLINGER WASHINGTON EDITORS

July 14, 2006

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