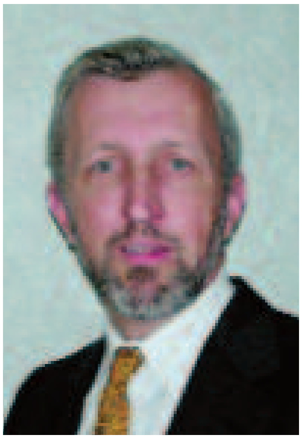
EDITORIAL

The Seeds Of A Recovery Are Present

"We anticipate moderating economic growth in the fourth quarter of 1.1%, with unemployment levels remaining steady at 5%."
The Federal Reserve "Beige Book"
January 13, 2008

"My forecast calls conservatively for the Dow Jones Industrial Index to close the year out at 13,900."
Abby Joseph Cohen
Chief Investment Strategist
Goldman Sachs
January 15, 2008



We reference the quotations above not so much to gloat over the forecasting foul-ups of some otherwise very smart people, although we admit it can be fun to watch big-time talent strike out. Rather, we offer them up as consolation to all those in the industry who were taken unawares by the economic turmoil of the fourth quarter. Whatever you want to call it, this economic mess completely ambushed the country's most celebrated economists and financiers. If the best brains in the Federal Reserve and the Treasury Department, not to mention all the professional talkers on television, were caught figuratively with their pants down, then the relatively lowly music industry has nothing to be ashamed of. These aren't called unpredictable events for nothing.

Right now, there's a lot of jawboning going on about whether we're at the beginning, middle, or end of the recession; whether it will get worse, better, or stay the same; and whether unemployment has peaked, will continue to rise, or will hang at 7.2%. To anyone who thinks they have the answer, we would refer them to the quotes above, and to Yogi Berra's famous admonition: "predicting is hard, especially when it's about the future."

Rather than waste a lot of time worrying about things beyond your control, we would offer up some rather elementary advice. Control costs with all the energy you can muster. There are probably no single 10% cost reducing ideas, but chances are there are ten things you can do to cut costs by 1%. And the task is made somewhat easier by the fact that every one of your vendors is probably more willing to negotiate than they were a year ago. Focus on taking care of your customers. Call people you haven't seen for a while, bend over backward to accommodate anyone who walks in to your store. Finally, explore alternative financing options. Both retail inventory and consumer financing will be harder to come by in the near term: Your challenge is to find out how to do more with less.

Without venturing too far afield with a prediction that begs to be overtaken by events, we would suggest that the current slowdown contains the seeds for a robust recovery. For close to a decade, there has been broad-based consensus that the American economy has had four primary weaknesses: a meager consumer savings rate that had dropped to the lowest level on record; personal debt that had increased as a percentage of income; rising housing costs that were placing a squeeze on discretionary income; and a swelling trade deficit.

In the past three months, each one of these problems has been addressed head on by the economic slowdown. Cautious consumers have gone from spending to saving, and the savings rate is currently at a near post-war high of 8%. Consumers are also rapidly de-leveraging. For three months running now, outstanding credit card balances have decreased. Housing prices are off anywhere between 17% and 45% depending on the market—bad news for mortgage holders but a bonanza for people entering the market. Finally, the trade deficit has also contracted in each of the past three months. Painful medicine to be sure. But, we have to believe that each of these factors will contribute to a strong rebound before too long.

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