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Happy days are here again

Of course, a future tweak in interest rates could chill hot times in O'town

By Pat Beall
Editor

If you can wield a hammer or sell a home, the local economic recovery is anything but jobless.

If you own Florida microcap stocks, the market is anything but bleak.

In fact, there is an abundance of blue-sky news about the Central Florida economy — “the best since 1999,” says David F. Scott, chair of the Phillips Institute at the University of Central Florida's College of Business Administration.

Yes, the interest rate hikes are coming, but, says Michael W. Poole, a principal of Orlando-based PCE Investment Bankers Inc., “worrying about that is somewhat like worrying about getting wet before the rain comes.”

And while waiting for Greenspan & Co. to take the logical next step, there are plenty of economic positives in Central Florida.

Help wanted

To begin with, there is work.

“We have added a significant number of construction jobs,” says Scott.

From March 2003 through March 2004, Central Florida construction payrolls swelled by 4,500 — a 7.8 percent increase.

By contrast, payroll growth in the broader local job market has grown by only about 2.1 percent.

“This is not like 1997 through 2000 where we added 30,000 to

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35,000 new jobs” a year, says Scott, but, combined with the lowest interest rates since 1958, Central Florida's economic outlook is “a pretty darned nice picture.”

Rooftops are driving much of the construction job growth. In a three-year period ending in 2003 — a period that included the worst of the economic downturn — residential construction for single-family homes grew by 61.5 percent in Orange County and by 53.4 percent in Osceola County. In Orange, the value of all residential permits pulled hit \$1.63 billion in 2003 alone.

“We continue to lead among the six largest metropolitan statistical areas in single-family home construction, and that is not slowing,” says Scott.

“All you have to do is look at plans for all the condominiums in downtown Orlando. That's a pretty good index. UCF is booming, too, with our own construction projects.”

The impetus is clear: “This is one of those unusual periods of time when we have some of the lowest interest rates in a generation,” says Scott.

The boomlet in jobs is not confined to residential construction. Resort tax receipts in Orange County are on the rise — an indicator of an uptick in the hospitality industry. Because retail typically follows rooftops, it comes as no surprise that, according to state figures, Orlando-area accommodations and food service concerns hired 3,000 new workers in the 12 months ending last February.

Some of the industry growth in housing, retail and restaurants also reflect the region's behind-the-scenes industry — one that is not directly reflected in job numbers: the retirement industry.

“But retirees are not necessarily coming here to find a job,” says Scott. “They've given up their job and are ready to spend their retirement checks.”

To be sure, not every local industry has enjoyed a robust need for new employees.

One of the hardest-hit local industry niches remains air transportation, which lost 1,000 jobs between February 2003 and February 2004 — 18.2 percent of the local jobs available — as major airlines and related industries continued to trim payrolls.

Then there's manufacturing, an industry that has been losing ground steadily in Central Florida. Between April 2002

and April 2003, 3,600 manufacturing jobs disappeared from the local landscape. Further, there is evidence that the region is losing manufacturing jobs at a much faster clip than the state as a whole. (See "Manufacturing lower wages?" in the June 17, 2003, edition of *Orlando Business Journal*.)

That trend continued in the 12 months ending in February 2004, when the Orlando area lost 4.4 percent of its already dwindling manufacturing positions.

Public success, private indicators

Few of these traditional economic indicators have generated surprises.

Not so the PCE Florida Index.

The product of PCE Indexes LLC — an affiliate of PCE Investment Banking — the index tracks smaller, Florida-headquartered public companies. Market values range between \$1 million and \$250 million.

Such microcap stocks are not generally where investment money heads during a downturn.

More often, dollars flow out of the market into other investment instruments such as real estate, or, if they remain in the public markets, there is the much touted "flight to quality" — the shift of money into blue chip stocks.

However, the small Florida firms put in a stellar showing in 2003, outperforming the blue chip-heavy Dow Jones Industrial Average and the S&P 500.

"This past year there was a huge shift in the valuation of these companies," says Poole of the index stocks.

Huge is not an understatement: "The

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small public companies in the state of Florida in 2003 grew by 82.5 percent," says Poole.

Even the Russell 2000, which also tracks small cap stocks, rose by only 45.4 percent.

More surprising still are the industry breakouts of the PCE Index. Those Florida companies dealing in information technology — a niche all but given up for dead a year or so ago — grew by 174 percent.

Nor does growth appear to be slacking. In the first quarter, the PCE Index has risen by 11 percent, with the financial, consumer discretionary and information technology sectors leading the gainers.

Poole speculates that the flight to quality is reversing as broader market performance has improved, leading investors to rethink microcap opportunities.

"The big question is, does this portend a good valuation for the private businesses in Florida?" asks the investment banker.

Poole says there is no way to know for certain whether there will be a trickle-down effect to private companies.

However, he points out, "In the private sector, if a small retailer is seeing improvement in the public market, it could lead one to believe they will start seeing the same improvements."

Who's afraid of the Big Bad Fed?

That's not to say there are no dark clouds in all these silver linings.

The Federal Reserve is poised to raise interest rates, possibly in August, possibly sooner.

"They have to rise," says Poole. "The Fed can't sit back." That's because of what UCF's Scott describes as an inviolate law of economics: "Rising inflation rates get built into interest rates."

And while inflation remains well below 5 percent, it is inching upward.

Besides, says Scott, low interest rates are not a boon for everyone. "Just ask retirees," he says. As interest on certain investment accounts has dwindled, so has the buying power of this fast-growing segment of the Central Florida population.

Other investors are being stung as well.

"You would typically expect that, if you buy corporate bonds you would get a return of more than 8 percent," says Scott. "Right now, you get only a little more than 6 percent, and maybe not even that."

Yet both Poole and Scott acknowledge that tweaking interest rates upward may spook the markets temporarily.

"When it comes to interest rates, there are some who definitely have a mentality of short-term responses," says Poole.

However, he notes, "Most business investments are not based on a quarter-point or a half-point rise in interest rates.

"For most, a half-point is not going to make or break a business decision."

As to those industries that are unusually sensitive to interest rate hikes, "You don't want to panic builders and brokers," says Scott. But that may involve simply learning to expect the expected, he adds: "We just need to face it and brace for it."

— Pat Beall