

DOUGLASBRADLEY LLC

Personal Financial Advisors

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DOUGLASBRADLEY'S MONEYWISE

Financial News and Insight from an Independent Advisor

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The BIG Question

The success (or failure) of your investments over the coming few years may very well depend on correctly answering one really big question: Are we going to experience Inflation or Deflation?

In other words, will the prices of goods and services rise year-to-year as they have for most of the last century or will we see prices, wages, interest rates, etc. continue their recent declines.

On the surface you might be inclined to prefer deflation. That way you pay less for the items we use every day as well as big ticket items like cars, homes, appliances, and so forth. But the cumulative effect of these declines results in negative growth for the companies that comprise our economy. This is because when prices drop the companies providing the goods and services earn less.

If these companies are experiencing "negative" growth they are not hiring, they are freezing (or lowering) wages, they are not investing in new equipment and R&D, their stock prices are going down, etc. Combined, all of these factors spread throughout the economy as employees and suppliers have less money to spend. At the end of the day, negative growth for companies equals negative growth for individual households and the country. This is why deflation is bad for everyone and worse than inflation.

The problems we are facing today stem largely from the excesses of the last 30 years - namely excessive borrowing and credit. Unfortunately, since the world has never seen the bursting of a bubble this large before, there isn't much historical precedent to guide us. The closest example is the bursting of the stock market bubble in Japan in the early 1990s and the very painful 20 years that followed. Literally everything they tried to do to counteract the subsequent deflation failed.

Once we get into a deflationary environment, it feeds on itself and the cycle is very hard to break. The following graphic drives home the point; namely, there is no place for a business or investor to hide once deflation has taken hold.

Chart 5: The Deflationary Spiral

Source: zerohedge.com

Has the US had better luck? So far, the answer has to be no. All the money directed to the stimulus packages (\$2 trillion when added together) has not had the intended effect of turning the economy around. There are several reasons for this, but chief among them is the decision by the major banks to keep the stimulus money for themselves to shore up their own balance sheets instead of lending the money to companies and individuals who will put it to work. The result has been additional weakening of the economy, unemployment rising to 9.5% (with the consensus that it's going higher), no let up in foreclosures, ...

Look at it this way: it is estimated that in the current crisis \$14 TRILLION dollars in wealth has been destroyed via foreclosures, bankruptcies, defaults, investment losses, etc. The result is \$14 trillion less to be spent, saved, and/or invested. So far, the government, through the Fed and Treasury, has put only \$2 trillion back into the economy via the various stimulus programs. That leaves the economy with a gap of \$12 trillion - and filling the gap would require a further increase in our ballooning Federal budget deficit. We already addressed how little of that initial \$2 trillion has made it to where it is needed most due to politics.

History makes it clear that while we may not like inflation, inflation is a far more understood, manageable, and desirable economic condition than deflation. After experiencing our recent "Goldilocks" economy where inflation and interest rates were "just right," the coming period is full of peril. An investor's success or failure will hinge first-and-foremost on judging whether inflation or deflation will prevail. Answer correctly and the rest should be a piece of cake.

We're Here to Help

DouglasBradley's truly independent analysis correctly anticipated the stock market decline more than a year ago and we positioned our clients' investment assets accordingly. As a result their accounts have been protected during this downturn. In that same spirit, we've found plenty of attractive investment opportunities despite the challenging scenarios outlined.

We keep reading about people who are frustrated by their financial advisors lack of communication and the firm's inability to provide any advice other than to "stay the course". At DouglasBradley, we always have a "plan of attack" and keep our clients in the loop. If you're ready to try something that doesn't involve a wing and a prayer then give us a call to chat. We are happy to share our ideas and proud to share our performance over the past year.