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DouglasBradley's MONEYWISE

Financial News and Insight from an Independent Advisor

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Personal Notes

Doug -

In college I enjoyed backpacking and spent a lot of time criss-crossing Shenandoah National Park and the surrounding areas. Once we started having kids that pretty much went by the wayside other than short hikes locally. But the kids are getting older and so over Labor Day weekend I took my oldest son (age 10) on his first real overnight backpacking trip. We headed off to western Maryland for an easy one nighter and covered several miles of the Appalachian Trail from the Mason Dixon line south. The weather was perfect, the views breathtaking and plenty of rocky ridges for my son to scramble over. We had a great time and it looks like I've found myself a new hiking companion.

Brad -

August is always a slow month at the office. The email slows to a crawl and the phones don't ring as everyone is off on vacation or pursuing summer activities. I know to expect it each year, as I do the period between Thanksgiving and New Year's Day, but it is still disconcerting for someone

This Time IS Different

Why the Current Recession Will Force Us All to Adjust Our Expectations and Will Usher in a "New Normal"

The "Summer of Recovery" has passed with no signs of recovery in important economic indicators such as employment or Gross Domestic Product (GDP is the sum of economic output). How can this be? The Government has bailed out the banks (\$700 billion) and spent hundreds of billions of borrowed dollars (\$787 billion) in an effort to turn around and stimulate the economy. Didn't the President promise this would meaningfully reduce unemployment and we would be seeing the "green shoots" of economic recovery by now?

With unemployment stubbornly stuck at a reported 9.6% (actually closer to 16% if you count those who have given up and/or are underemployed) and another downward revision to GDP imminent, it is clear that our political and economic leaders have misjudged the nature and severity of the recession that started in 2008. Maybe it was optimistic thinking on their part? Maybe they lacked the political will to do what was necessary at the time? Maybe they have squandered the tools in their economic tool bag over the past decade? The answer has elements of each of these, but at its core this recession IS different than any we've experienced since The Great Depression.

The recessions of 1981-1982 (oil shock), 1990-1991 (savings and loan crisis), and 2001 (tech wreck) were relatively short in duration, shallow, and attributable to a manageable slice of the American economy. A recession is never pleasant, but political and economic measures were available and saved the day.

But the problem we face today is structural. By this we mean it affects everyone - governments, large and small businesses, banking, individuals, etc. What we are experiencing has been termed a "Balance Sheet Recession" by economist Richard Koo. In corporate finance, a balance sheet is where the company lists its assets and liabilities - what it owns and what it owes. And a Balance Sheet Recession is one in which income is predominately used to pay down debt (to repair the balance sheet) versus spent on goods and services or invested.

Most politicians and economists have been content to follow the status quo - spend, spend, spend. But as Koo learned from studying Japan after their economic bubble burst, spending only sustains the economy in a Balance Sheet Recession - it doesn't stimulate it. One only has to look around and apply some common sense to see why:

who likes to keep busy and engaged with our clients (and prospective clients) on their financial matters. But, like always, reality sets in after Labor Day and activity soon returns. Our clients know that by planning today they will enjoy a perpetual summer in retirement.

Mahesh -

My family and I are back into the swing of things with the onset of the new school year.

Nobody likes a "regular routine" more than I do, which probably comes from my engineering background. I am also back into the Fall sports season coaching both my kids' teams. The first games of the season are this weekend and I am hoping for a repeat of last year's undefeated record!

- The US government, in the span of a decade and regardless of the party in power, has gone from a budget surplus to a record deficit. Any increase in spending only serves to increase the cost to service that debt. The spending did not spur the expected growth. It's like using credit cards to pay your mortgage.
- State and local government are essentially broke and face huge pension liabilities. They can't afford to take on new debt by issuing municipal bonds. They have to cut back on spending or raise taxes.
- Banks of all sizes are sitting on huge piles of toxic debt - mortgages for homes and buildings that are worth only a fraction of the original loan amount. They're hoarding cash in order to shore up their balance sheets - they're not lending it to businesses who want to grow.
- The American consumer has lost assets that they were counting on for retirement and other purposes. The decline in home values, retirement plans and personal savings will need to be made up by diverting income to savings and/or by paying down debt (namely mortgages).

As we've discussed in the past, when faced with budget shortfalls politicians' first reaction is to creatively come up with new "fees" to increase revenue. Don't be fooled - higher taxes are higher taxes. But what few appreciate is that higher taxes only make the situation worse because now there's even less money available for spending and investment. It is tough not to raise taxes, however, because of the challenges it creates. Teachers claim the children's educations will suffer, policemen and firemen warn we won't be safe, etc.... It's unpleasant - but everyone has to do their share and bear some of the burden.

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As one can imagine, solving the problems we face doesn't happen overnight. But the quicker we recognize the problem and that the "same old, same old" won't solve it, the quicker we can start recovering. But even so, this will take years to unwind.

In the meantime, the US economy and workforce has to focus on retooling. The predominance of finance, construction and manufacturing jobs is a thing of the past. All of those workers who lost their jobs in those areas have to face the reality that the jobs aren't coming back and they need to find employment in other industries. Small businesses are the lifeblood of our economy and can provide the jobs we need - as long as they aren't stifled by higher payroll and income taxes and health insurance premiums.

Hopefully, by now, we haven't depressed our readers too much - if anyone's even gotten this far. But we believe in calling a spade a spade - denial doesn't serve anyone. Despite the challenges we all face, we continue to find reasons to be optimistic. Since necessity is the mother of invention, these challenges are forcing people to be creative. That's a good thing and we read positive stories of triumph every day.

From an investing standpoint, our reading and research has only served to reinforce our belief in our three core investing themes:

- Gold has become (and will continue to be) a safe haven for nervous investors around the world. In the future it will continue to do well as inflation kicks in.
- Emerging economies like Brazil, India, China, etc. will do well thanks to their stores of natural resources and burgeoning internal economies. Another important factor is that these economies aren't saddled with the mountains of debt and entitlements that developed nations have.
- At some point, interest rates will go up and bond prices will come down. There are any number of reasons why this might happen - the US Treasury stops buying their debt back (decreasing bond demand), China starts aggressively selling their US debt (increasing bond supply), the US Treasury issues new debt as a result of the budget deficit (increasing bond supply), interest rates begin to rise as the economy recovers (bond prices fall), the stock

market begins to recover and investors shift from bonds back to stocks (decreasing bond demand).

Aside from correctly identifying the best investment opportunities out there, the number one requirement for investment success is patience. It will take years - not months - for these opportunities to develop and mature. Those with the discipline and patience to let them ripen in due time will be rewarded.



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