DocOnomics
Financial and Investment Insights for the Physician

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A year ago, we wrote a commentary entitled March Madness. We made numerous references to the NCAA Basketball Championships in trying to comprehend what might be blowing in the financial winds. We shuddered as a $200 billion bank rescue package was announced and $30 billion in financial assistance was showered on JPMorgan Chase for its takeover of the failed Bear Stearns. We wondered what arguments and accusations would swirl amongst the Presidential candidates and what blustery promises would be made of returning the gloomy financial and job markets to sunnier days.

THE RETURN OF MARCH MADNESS

As we look back, we now recognize that events of a year ago were the harbinger of much worse things to come. Many had hoped for a gradual if not sudden end to the economic ills and a return to the status quo. However, it appears that the status quo may be long gone. Take, for instance, the latest manifestation of March Madness. The Federal Reserve just announced that it will buy $300 billion in bonds from the US Treasury. This is nothing short of an open admission of counterfeiting at the highest level of our government. It should be judged as nothing less than a desperate act to halt the waterfall declines in asset values and employment income. Whenever a government presses the panic button, we can surmise that the eventual results cannot be forecast with any degree of confidence and that returns to the status quo cannot be assumed. The quicker that we detach ourselves emotionally from “hype and hope”, the better we can prepare ourselves for what is likelier to occur.

There are some recognized social theories that portray present-day America as an “acquisitor” society. This means that our present culture has become predisposed to acquiring material possessions and garnering wealth in disingenuous ways including the heavy use of debt, the perpetration of fraud and influence peddling at the highest levels of government. This process of acquisition has been expedited by the willful destruction of checks and balances, e.g., the gutting of supervisory agencies and regulatory authorities. It is the triumph of greed.

What succeeds an age of acquisitors is subject to different interpretations but the prognosis is not a good one. The aftermath generally is characterized by increasing public outrage, breakdowns in law and order, the assumption of quasi-dictatorial powers by threatened political leadership and/or military rule. The common thread running between these outcomes is a loss of trust among and between governments, businesses and taxpayer constituents. It is precisely this pervasive loss of trust that seems to have leeched into industrialized societies during the past 10-15 years and represents a compelling reason why a return to the status quo anytime soon is a long shot. Logically, we have to be preparing for different outcomes, some of which can strain the imagination. However, sitting idle and hoping that desperate governments around the world will “get it right” is not our idea of a preparation strategy.

From a practical standpoint, we at ***DocOnomics*** believe that wealth and income protection are of paramount importance. As the golden age of debt-enabled income and consumption is being written into history, aging Baby Boomers may never have a chance to generate income and accumulate wealth as they have in the past. Higher taxes, government controls over the economy and investment markets and cycles of inflation and deflation are sure to produce some very stiff headwinds. As realists, we should be focused on creating and preserving income, saving more for retirement (which means learning to be content with fewer creature comforts) and preserving our wealth from the ravages of inflation and deflation, both of which stem from the twin evils of excessive debt and government counterfeiting.

During the past year, we have experienced pronounced bouts of inflation and deflation. The more astute investment strategies during an inflationary period will strive to preserve the purchasing power of assets. The more reasoned investment strategies during a deflationary period (such as the present) will seek to preserve the nominal value of assets. Here is some basic income and wealth protection advice that can help you cope with what ***DocOnomics*** terms as the "unraveling status quo":

Indexed annuities. This type of investment vehicle provides guaranteed returns with upside potential based on the performance of a market index. Principal and future gains are completely locked in and protected against loss. The investment is creditor and judgment proof. In addition, it offers some penalty-free early withdrawal features. Future value can be converted into guaranteed monthly payments for life. An indexed annuity provides both protection from deflation and offers some inflation protection. It also can be converted to a lifetime source of income which is important to those that place a premium on predictability.

Commodities, precious metals and foreign currencies. These investment sectors provide a base level of inflation protection. Commodities generally are in fixed or scarce supply. Unlike paper assets, they cannot be created in infinite quantities so they tend to protect purchasing power as money supply and credit are greatly expanded. In particular, precious metals and well-managed foreign currencies can provide protection against a devaluing US Dollar, which is a form of inflation. The oversupply of Dollars relative to gold and other currencies detracts from the Dollar's unit of exchange value in foreign trade.

Cash and fixed income. These investment sectors represent the ultimate protection in a deflation when asset values are falling due to lack of credit availability and/or declining incomes. However, default risk on cash and fixed-income securities is now a very real concern. For cash, you need to be cognizant of where and how you hold your cash. There have been well-advertised problems with banks, investment firms and investment vehicles such as money market funds. For fixed-income, there is an ample selection of government bonds, municipal bonds and corporate bonds but these carry certain levels of default risk. As we know, ratings agencies have been compromised and the derivatives markets can create and obscure significant risk (e.g., counterparty failure on credit default insurance.) We are learning these lessons daily.

To receive a copy of our original **March Madness** commentary dated April 11, 2008, please e-mail chris@doconomics.com.