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Policies enacted since the Vietnam War era have promoted extraordinary levels of Federal deficit spending, loose mortgage financing and consumer credit, shallow supervision and regulation of financial institutions and a pervasive entitlement and bailout mentality. Today, we can see where these policies have brought us.

Even though a "hope" spigot has been turned on by the recent stock market rally, favorable earnings reports from bailed out banks and visions of a second-half economic recovery, it is likely to be an illusion. Thus far, the stock market rally has carried approximately 25% from the lows recorded in early March. This rally could carry further depending on factors that are heavily influenced or controlled by the Federal government. However, we should not confuse a stock market rally with an economic rebound. There can be no economic recovery without the creation of millions of jobs that are centered on reducing the US import bill. Whatever stimulus has been deployed to date has been earmarked for a myriad of "bailouts." We have to assume that "job growth" stimulus is somewhere off in the distance. Job income will be the engine of economic recovery just as it was during the Depression era of the 1930s.

SEQUESTER THE INVESTOR

During the past 18 months, we have been dragged into a game of chance called "Sequester the Investor." The game's agenda is to corner investors by giving them as few good choices as possible. The rules of the game are convoluted at best and unscripted at worst. The stakes are much greater than "Monopoly" since we are forced to play with our own money. This makes the game very stressful.

At *DocOnomics*, the first thing we observe about "Sequester the Investor" is that there are negative rewards in abundance. The most obvious is in risk-averse investing. With interest rates on the lowest-risk investments ranging from 0-3%, our real return could be negative should our overall cost of living rise by a greater rate. If we are in this situation for a sustained period of time, our wealth will erode, perhaps appreciably.

The next thing we notice is that the rules for "Sequester the Investor" are very opaque. Consider how any or all of the following could impact the outcome of the game:

- Knowing which specific companies will be bailed out by taxpayer funds and at what cost to shareholders and bondholders
- Sudden changes in accounting protocols, e.g., arbitrary tightening or relaxing of mark-to-market standards that determine the degree and magnitude of reported losses
- Sudden changes in market rules and/or their enforcement, e.g., arbitrary tightening or relaxing of margin requirements and short selling disciplines
- Knowing which specific industries and companies will receive large amounts of Federal stimulus
- The degree of excess money creation and the methods of dispersal, which will have a profound impact on interest rates and the purchasing power of the US Dollar

In light of the above, *DocOnomics* thinks this new-fangled investment game is best left to those who live to outguess the government policymakers or design clever trading programs to beat the system. As we have witnessed in the hedge fund and investment banking community, many of these types of players no longer collect paychecks. They failed. The lesson learned is that this may not be a game worth playing until the rules have been clarified. Until then, we must dwell on being

conservative and protecting our wealth to the best of our ability. Despite negative real rates of return on risk-averse investments, lifeboats with small leaks are better than no lifeboats at all.

For years, *DocOnomics* has opined that our national debt addiction was the root of all financial evil. Now, excessive debt has given rise to powerful cycles of inflation and deflation. Investment portfolios must be structured to preserve the purchasing power of assets during an inflation cycle and to protect the nominal value of assets during a deflation cycle. The timing of these cycles cannot be pinpointed because the success or failure of government policies will influence the timing. It is a feedback loop. Suffice it to say that an inflation protection strategy will under-perform during a deflation cycle while a deflation protection strategy will under-perform during an inflation cycle. Therefore, one must pay attention to the catalysts behind the cycles and shift assets when the timing appears to be right.

Since our national currency--the US Dollar-- is underpinned by massive debts and no longer represents a reliable and stable store of value, it is important that we view the investment markets through the lenses of inflation and deflation. We should not fall into the trap of evaluating investments through traditional criteria, e.g., growth vs. value, developed markets vs. emerging markets, large cap vs. small cap, cyclical vs. non-cyclical. Our national currency--the US Dollar-- will not come to represent a reliable and stable store of value until the national debt problem has been resolved. Depending on how our government goes about the task and how other world governments react, this could take a very long time.

Today we are in a cycle of deflation, the telltale signs of which are widespread job income declines, debt defaults, debt contraction and falling asset values. We must be alert for an ensuing cycle of inflation. This will rear its ugly head as the excessive money creation policies designed to revive the slumping economy meet with some success. As we enter the inflation cycle, prices of goods and services that are relatively fixed or in tight supply will surge, just as they did during the first half of 2008.

At *DocOnomics*, our primary investment themes designed to safeguard wealth during each of these cycles are as follows:

Deflation

1. Cash equivalents
2. Indexed annuities (offering a guaranteed return with complete protection of principal)

Inflation

1. Diversified commodities and natural resources, including countries that export these items
2. Foreign currencies (i.e., likely to benefit from a devalued US Dollar)
3. Infrastructure and clean technology (i.e., sectors likely to benefit from government stimulus)
4. Precious metals

There always will be some ancillary investment themes intended to capitalize on discernable trends within key economic sectors, e.g., defense, healthcare, retail and telecommunications.

In conclusion, we must remain open to the possibility that emergency systemic reforms will be enacted by the Federal government in response to the current crisis. These could be game changers. At present, we know that every major central bank in the world has begun to follow the lead of Federal Reserve in creating vast amounts of money to halt the destructive forces of deflation. We are left to wonder how this will affect people's perception of government-issued money. There is a scenario in which government money no longer will be trusted because it is based on government's ability to borrow and tax. If governments no longer can borrow because traditional lenders no longer will accept the credit risk and if governments cannot raise taxes because constituents will rebel and demand change, then the government-issued money will lose significant value. People will want to hold alternatives. Historically, those alternatives have been precious metals and other assets that are relatively fixed or scarce in supply.