

Risky Business

Many of the traditional risks associated with investing continue to morph into almost unrecognizable forms. For instance, there is a relatively new wrinkle in the current assessment of investment risk. That is, Asian countries are running huge trade surpluses with the US and indirectly subsidizing the US consumer. This occurs when countries like Japan and China recycle their outsized trade surpluses into US Treasury bonds. This surging demand for bonds helps to keep long-term US interest rates low and enables the debt-laden US consumer to continue its spending spree on competitively-priced Asian manufactured goods, which keeps more and more Asians gainfully employed mainly at the expense of the American worker.

This scenario will not hold up indefinitely. Eventually, the US consumer will reach its debt saturation point and China will have a large enough middle class to absorb a growing share of Asian manufacturing output. When this occurs, China officially will assume the position of the world's major economy and this will oust the US Dollar from its traditional role as the world's reserve currency. The likely domino effect of this shift in economic leadership will be a rapid deflation in the US Dollar and Dollar-based assets (e.g., stocks, bonds and real estate) at which time the rest of the world will be able to buy America at fire sale prices.

The question is how long it will take for this end game to play itself out. Although we can't predict the timing with any precision, we can continue to watch for clues and hedge our investments accordingly.

The key is to appreciate that investment risks are greater than ever, and we must be ever more diligent in our attempts to protect investment capital.

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