Capital Drain

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Before printing, think about the environment

Hi Readers,

I've been thinking a lot, but not writing enough. It's time to fix that.

This will be quick, but some of it is timely. I want to get this out, then follow up quickly with more.

In my opinion:

Executive Summary:

- The US Economy is doing well, while the rest of the world is weaker.
-     – Greece, especially, the biggest of the sub-prime borrowers.
- Paradox of Thrift- good for you to save, even though not best for economy.
- Save half your gas price 'savings'.
- Treasury rates & inflation.
- Sell Kraft and DuPont.
- buy Europe?
- It's Credit Report time again! This time, TransUnion.

The recovery continues, and many US companies are doing well, but the prices reflect high continued growth expectations. If you're holding shares of any of the conspicuous high-fliers, especially the "hot" new tech IPOs, you might consider selling into this enthusiasm. Better to risk a little less gain rather than a lot more loss.

As confidence in the economy spreads, investing in all-market index funds becomes more attractive. Similarly, index funds in some overseas markets are inviting. We are likely reaching the phase where a rising tide will lift (almost) all boats.

If you're inclined to pick among individual stocks, be conservative and be in the best of securities: stick to value, to safety, to short maturities (for debt), and call me to chat if you're concerned about anything you're holding.

Above all, avoid the investments that are at all-time extreme valuations: junk bonds, developing-country bonds, and headline-grabbing stocks with high P/E ratios.

The Details:

The **US economy is doing well enough**, and doing especially well considering the weakness in the rest of the world. We need more growth, and we can get it, as we continue to put more people back to work.

India is doing OK now, and may become a long-term bright spot. They seldom produce great growth, but they've been doing pretty well. China has slowed, but could be OK. Japan and Brazil are slow but could improve. Brazil has recent trouble with political and financial scandals, so probably won't be a star again for a few years.

That's all pretty indefinite, I would say. We're at a point where I don't think there's anything really wrong-- and not yet widely noticed-- in the world economy. Quicker or slower, countries are tackling their problems in ways that could work.

The standout exception is that Greece is in serious debt trouble, and Europe's (mainly Germany's) leaders are slow to recognize that Europe will not prosper while Greece is forced to slowly die of austerity.

A quick word about **Greece** (and sub-prime mortgages): the government and financial establishments are too eager to blame the debtor, and rescue the lender. Lenders helped create the problem, first with bad loans, then the implosive collapse of banks starting with the 'financial engineering' products like collateralized debt obligations of mortgage backed securities.

Specifically, many big banks bet that lending to Greece would be effectively guaranteed by the other Euro zone countries, even though there was no such policy announced. They lent to Greece freely and of their own free will, at interest rates nearly as low as they charged much more responsible European countries.

Sure enough, they were right. The stronger European governments, the European Central Bank, and the International Monetary Fund essentially bailed out the banks (which were too big to fail, of course) and now hold the loans that the banks should have had the good financial sense not to make. Greece alone, not the banks, is being held responsible for the excess debt. Greece should be, but so should the banks; they too should be forced to live with the results of their errors.

Rescuing the big banks while impoverishing the Greek working class is a travesty. Eventually the European powers will have to recognize that they can't get blood from a stone, that the Greek government can't pay that debt. Whether those powers also stiffen their spine to demand money back from the rescued but equally culpable banks remains to be seen, but I doubt it.

The **paradox of thrift**: is the observation that on a personal level, it is wise for people to save, even as the country is pulling out of recession. People need rainy day funds, need to pay down debts, need to keep investing for retirement, etc. They should save, for their own good.

By contrast, on the macroeconomic level of nations and the world, the economy needs for everyone to spend as much as they can. Especially as we come out of a financial-crash induced recession, every dollar earned becomes another dollar spent and earned and then re-spent by someone else. The missing ingredient for stronger growth is consumer demand.

You, as an individual, are not responsible for the big picture. Do what's best for you: reduce, do not increase your debt. Increase your savings.

For the moment, a relatively easy way to do that is to think of your reduced gasoline spending as if it were new income to allocate. Using SF Bay prices, gas has dropped from $4 to $3 per gallon. That's $1 per gallon of decreased expense, 25%. For most commuters that's on the order of at least $100 each month. An **easy way to increase saving** is to put (at least) half of every windfall directly into savings or investment. It's money you didn't have available to you before, so you won't miss it.

There's no need to be miserly, though: use some of the windfall to treat yourself, so that you do get to enjoy the windfall now as well.

Other examples of windfalls are tax refunds and raises.

As I said, in the US job growth is good, economic growth (despite the winter stumble) is good, and inflation is low.

Will or won't the Federal Reserve raise **interest rates**? Eventually, of course, they will. They have to. They won't be doing it because of any immediate threat of inflation, though. They'll have a more benign reason: the current levels in the US and Europe are extraordinary, utterly unprecedented. When we get back to an ordinary economy (or look like we will soon) then we'll get back to ordinary interest rates.

Conventional wisdom has it that rising interest rates will slow the growth of the economy. Ordinarily yes, but again this time isn't ordinary. The stock markets may jump and swoon a little when the Fed starts announcing changes, but that's just noise that you can and should ignore.

Years ago, I wrote that I invested in a handful of big healthy dividend-paying stocks. As time has passed, I've described when and why I was deciding to sell a few of them. It's time for two more.

Within a few days I'll **sell** my holding of Kraft (**KRFT**) for a huge gain. They've done very well, and have recently been merged/bought by Heinz and some private equity. The jump in the stock price is, in my opinion, likely to fade. I'd rather sell now, and leave the uncertainty of the merger for others to ponder.

A less cheerful story is leading me to **sell** DuPont (**DD**) for a good gain. Their business performance has been declining, and I'm no longer confident that they fit the “healthy” part of my original criterion.

Note that each of these paid years of nice dividends, too, in an era when bonds did not pay much.

Despite what I said about trouble in Greece, and to some extent paradoxically because of it, I'm mulling investing in a **European stock index fund** very soon.

My reasoning is

- Europe's economies (ex Greece) have taken their beatings and are recovering.
- Europe's stock prices followed the economies down and will follow or lead going back up.
- Meanwhile, the Euro has fallen by a lot relative to the dollar but will eventually return to normal.

This combination means that right now we dollar-holders can buy already cheap European shares for an extra discount due to exchange rates. When share prices and exchange rates return to normal, we stand to gain from each.

I'm still sifting to decide which fund to buy. I'll let you know which I choose.

This is important. It's **Credit Check** time again. I sincerely hope that my regular reminders and simplified instructions are helping you to check your credit report regularly.

With all the ID theft and fraud happening today, checking your Credit Report is a free way to assure that nothing is being done to you. Once per year per Credit Agency, you're allowed to get a free copy of your Credit Report, quickly, online. Do it now!

If you've been following along with my every-four-months (-ish) pace, you're ready to revisit TransUnion.

I've taken notes from my own recent visit, so you can follow the instructions at www.longspliceinvest.com/CapDrain/TransUnion.pdf . I had no problems whatsoever.

It's time to check the spelling and ship this to you.

If you have any questions, please write or phone. If you want to read more, the company web site has archived editions of this letter, lots of charts, and links to other interesting sites. There's also a web log where I discuss the process and progress of starting the mutual fund, along with occasional economic or investing thoughts..

Please forward this to any and all friends who are interested. Thanks! If you got this as a forwarded copy, you can get on the list to get your own future copies directly by sending me your email address.

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Take care,

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"Our doubts are traitors,
And make us lose the good that we oft might win,
By fearing to attempt."
--W. Shakespeare