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Special Report for Advisory Clients

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An Economic Tsunami Lies Ahead- *Revisited*

- Critical Economic and Market Update
- Portfolio Repair and Recovery

In my original Economic Tsunami special report (Published February 2008): **An Economic Tsunami Lies Ahead...How to Prepare for this perfect storm - your way of life depends on it**, I accurately rang the alarm well before the “Economic Tsunami” ravaged our economy. The report warned that the dramatic demographic changes that are underway in our nation would severely affect our economy and send the stock market plunging, which it most certainly did. Be sure to go back and read the report again. It discusses in-depth the massive economic challenges that we are facing as well as how to prepare, and is still as pertinent today.

Critical Economic and Market Update – Beginning of the end (of recession) or end of the beginning?

With the economic data the worst in a generation, many analysts and investors alike are “hoping” that the end of the recession is close simply because stocks have dropped so much already and that things couldn’t possibly get worse. Unfortunately, “hope” is not a successful investment strategy.

The economy will continue to face two huge obstacles: **Deleveraging** and **Demographics**. As I discuss in-depth within the original **Economic Tsunami Special Report**, changing demographics will continue to severely hamper consumer spending which is the driving force of our economy. Every day Americans are passing their peak spending years in record numbers. The massive Baby Boom generation is naturally shifting from an era of higher earnings, spending, and taxes to less spending and higher savings for retirement. With consumer spending accounting for almost 70% of GDP, this will have a profound effect on the economy. Add in the current process of deleveraging, which removes capital out of the economy, and the Perfect Storm continues.

Major booms typically bring extreme speculation, leverage and bad lending. Recessions and depressions follow as the bubbles burst and credit deleverages. So the current meltdown of our banking system from extreme and unsustainable leverage, which has led us to the deleveraging and deflation process, is very hard to stop. When coupled with the generational demographic cycle, it’s hard for the government to stimulate effectively, as aging people save or pay down debt rather than spend. That is why the massive injections into the banks may have kept them from melting down near term, but have not stimulated substantial new lending again - because we have begun a deflationary process that ultimately is too large for the government to counteract, even with \$4 trillion. The situation will only get worse once commercial real estate begins to crumble. So you see, the banking crisis is merely a very large symptom. The real dilemma is a demographic crisis of aging. In other words, this is not an ordinary recession or correction.

Can the solution to a system with too much debt and leverage possibly be massive amounts of more debt and leverage? You know the answer. It’s easier to stimulate the economy through public works projects after the banking system has deleveraged and deflated. FDR came in and brought “The New Deal” after the banks had failed, stocks had bottomed and unemployment was just peaking. That is clearly not the case today!

As my longtime clients will attest, I am not a perpetual bear, a doom and gloom pessimist, or a non-believer in the American way. To the contrary: I have been bullish for most of my 25 years in the industry. However, the facts cannot be ignored. **I must warn once again, this is not the beginning of the end of the recession, but rather just the end of the beginning!** This is a long-term crisis, so prepare and protect accordingly.

Portfolio Repair and Recovery

We are in a long-term secular Bear Market, and an investment strategy that ignores this fact will continue to be challenged. One of the great sucker plays since the late '90s has been the "buy and hold" for the long term strategy. Just look at the returns: from 1/31/99 to 1/31/09, if you invested in an S&P 500 index and held for "the long term," your total return during this time would have been -23.5%. After adjustments for inflation, your return drops to -40.4% or -5.15 annually, and that's with reinvesting dividends making the stock market about where it was in 1996. If you did not reinvest dividends, you are about where the index was in 1973! Clearly investors must be nimble and willing to desert old fashioned buy and hold asset allocation models and employ tactical strategies to be successful.

People often make a lot of mistakes when they invest, apart from just not opening their statements. They do so as a result of their biases of judgment or mistake their perceptions as reality. There are 3 basic mistakes:

1. Over-Optimism: Most investors tend to exaggerate their own abilities
2. Over-Confidence: Investors overstate their knowledge, understate the risks
3. Self-Denial: Investors ignore statistics, employing HOPE as their investment strategy

Simply "Hoping" that stocks somehow rebound to new highs and that the economy is going to go back to what we saw in 1982-1999 or even 2003-2006 is not a strategy. **You need to be proactive and take charge of your portfolio.** Simply using a traditional 60-40 or 50-50 split of stocks and bonds, is not going to get you blissfully to retirement. Waiting for a rebound will cause heart aches while trying to time the market will cause heart attacks.

As an investor, there are three steps you can take to improve your ability to handle the current market:

1. Actively manage your assets: **Employ Tactical Investment Strategies**
2. Develop Reasonable Expectations: Hope may win the Whitehouse, but not as an investment strategy
3. Be the expert or hire one: Many portfolios are performing well. If yours is not, get a free second opinion

This is the most difficult investment climate in several generations, but there are very attractive opportunities. I would focus on absolute return types of investments. Many quality corporate and municipal bonds are currently VERY attractive, some in the 7-8+% range, as well as high yielding stocks and preferred stocks, many yielding even higher. However, it is critical to have someone who knows what they are doing in this arena. Just buying based on yield or ratings could be disastrous. These are tough times and they will likely get tougher. In the ensuing bear market, millions will lose their life savings. Don't be one of them. **Be the expert or hire one.**

To receive a free second opinion on your portfolio or to learn how our Portfolio Repair and Recovery strategy and holistic wealth management approach can help guide you through the current economic tsunami, simply contact me today at (916) 925-8900 or Keith@KeithSpringer.com.

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