

Weekly Commentary March 9, 2009

The Markets

The Shock Markets continue doing their thing. As it relates to the financial markets, essentially the only positive thing that can be said about last week is that the week is over.

The relentless decline in the stock market continued as investors focused on declining earnings, declining jobs, and lingering unhappiness with some of the administration's proposed economic plans. Talk of limiting some deductions for wealthy taxpayers and a cap-and-trade system on greenhouse gas emissions, in particular, seemed to spook investors. Of course, this year's projected \$1.75 trillion deficit doesn't help matters, either.

The Dow has now dropped more than 50 % since its all-time high of 14,164 in October 2007, according to Bloomberg. Clearly, this is not your typical bear market.

I spend a significant amount of time studying the ideas and strategies of leading economic and financial thinkers, including Jim Rogers, Warren Buffet, Lee Bellinger, Harry Schultz, and many others. Among them there are several competing basic assessments of what is truly happening in this unfolding financial crisis. Whichever model best describes where the economy is right now (i.e., the one history vindicates as correct - will determine which people are positioned to get rich and which ones could end up spending much of their lives as paupers.

So correctly diagnosing the "Big Picture" described below in three basic scenarios isn't mere a mental exercise. Having it right is an essential step to calmly and successfully navigating the financial/political mess before us (not to mention protecting what you already have).

The three most-mentioned scenarios on exactly what is happening in the financial crisis today:

Scenario1 – This is a conventional recession: Not even Wall Street cheerleaders are acknowledging we are in a recession. Yet even the severe 1982 recession did not result in the implosion and partial nationalization of the US Financial sector – nor did it trigger the simultaneous collapse of all three union dominated automakers.

Scenario #2 – This is going to be a repeat of Japan's deflationary "Lost Decade": In the 1990s, Japan's corporate-government model of economic growth (the so-called Japan, Inc.) began to collapse. As with ALL state-driven, centrally-directed economies,

corporate growth, global competition and financial pressures (i.e. reality) eventually caught up with them.

Japan withdrew into isolation and fully surrendered to uncompetitive unions/industries and bureaucrats (sound familiar?). In short, Japan entered the sclerotic dynamic of politics and blame games in their national decision making. Credit dried up and government-backed corporate interests became less and less competitive on the world stage. The government embarked on no less than nine major “stimulus” money handout programs according to the Wall Street Journal. The Japanese also refused to allow banks and other major businesses to fail – turning them into taxpayer-funded make-work warehouses known as “zombie corporations”.

Eighteen years ago, the Japanese government intervened to rescue these zombie corporations and their stock market tanked more than 75% below what it was then – and has stayed in the dumps to this day.

Scenario #3 – We are at the beginning of a great inflation: the broad price collapse of leveraged financial assets since July has convinced many experts the economy is in a major deflation. There are significant deflation symptoms. The drop in most asset values, however, was/is sparked by massive sell-off by leveraged giant investment institutions to “cover” a 40-1 debt ratio – in short a global margin call.

In recent months, the Federal Reserve has responded with high-inflationary emergency actions by dropping interest rates to zero (giving banks essentially free money to loan at a profit) and a process of forced credit feeds to banking institutions and the purchase of bad assets known as “quantitative easing”.

In addition, the current Administration is taking steps to pass a trillion-dollar + “stimulus” package.

So which is it: Scenario 1, 2, or 3?

So which is closest to reality? First it is important to take into account the magnitude of what is happening. For a decade, almost 70% of the U.S. gross domestic product has been powered by debt-financed consumer spending. This has led to the rise of millions of businesses which are entirely dependent on a continuation of easy Fed-created money, cheap energy, and rich foreign producers willing to lend U.S. consumers money to buy their products.

Making matters far worse, as consumption-driven financial growth increasingly dominated the U.S. economy in a credit-driven prosperity, regulatory paper pushing bureaucrats, mounting legal liabilities from trial lawyers, and uncompetitive high corporate taxes drove millions of great product-oriented jobs overseas. This took a great deal of time and would -- if we had the political will – take a great deal of time to reverse.

Consumers were so enjoying their credit card prosperity, not enough people noticed the United States was steadily morphing into an entitlement-oriented, legalistic, and business-unfriendly country – especially when it came to production and energy development.

In addition to the long standing capital and production flight, one of America's traditional strengths – innovation itself – has steadily been crushed by bureaucratic and political meddling. According to the National Venture Capital Association, only six U.S. companies went public in 2008. In 1999, there were 269 Initial Public Offerings (IPOs) in which innovative companies went public. IPOs are the stuff of new industries and jobs.

So can debt-driven consumption return? Given the trillions of dollars lost so far in the notional value of American's real estate and private retirement accounts, it is difficult to see how the government's policy will encourage people to spend more money that they don't have. This is why the government is currently revving up the inflation monster big time.

Americans are starting to wake up to the fact we have the worst of all worlds; an economy in which production has been shunned and hollowed out and a consumption-based GDP which has run out of credit fuel.

I think we can rule out Scenario #1, a conventional recession, although many still believe this is the scenario. So what we have left is Scenario #2, a repeat of Japan's "Lost Decade" and/or Scenario #3, the beginning of a great inflation.

I don't know for sure yet if we are in Scenario #2 or Scenario #3 (perhaps with overlapping elements). But with either Scenario, it is important (and not too late) to adopt "preservation" strategies and strategies that can grow and preserve your wealth during these historic times. People should be extremely careful of any assets that are exposed to the volatility of the stock market. Consider alternative strategies that will be better positioned to preserve and grow your wealth.

Weekly Focus – Daylight Saving Time

While it's debatable how much energy is saved by implementing daylight saving time (DST), it's not debatable that DST has an effect on health. A Finnish study last year concluded that DST can disturb people's sleeping patterns and make them more restless at night. Another study published last year found a spike in heart attacks during the first week of DST. The study also concluded that there's a brief, slight dip in heart attacks when DST ends in the fall.

Apparently, the human body does not like a disruption in its sleep pattern.

Best regards,

Tony Hartman

Securities and advisory services offered through Madison Avenue Securities, Inc. (MAS) a registered investment advisor, member FINRA & SIPC. MAS and Denver Financial Group are not affiliated companies.

* The Standard & Poor's 500 (S&P 500) is an unmanaged group of securities considered to be representative of the stock market in general.

* The Dow Jones Industrial Average is a price-weighted index of 30 actively traded blue-chip stocks.

* The NASDAQ Composite Index is an unmanaged, market-weighted index of all over-the-counter common stocks traded on the National Association of Securities Dealers Automated Quotation System.

* Yahoo! Finance is the source for any reference to the performance of an index between two specific periods.

* Opinions expressed are subject to change without notice and are not intended as investment advice or to predict future performance.

* Consult your financial professional before making any investment decision.

* You cannot invest directly in an index.

* Past performance does not guarantee future results.

* Annual stock market returns are calculated using the Standard & Poor's 500 Index from 1926 through 1970, the Dow Jones Wilshire 5000 Index from 1971 through April 22, 2005, and the MSCI US Broad Market Index thereafter.

* Annual bond market returns are calculated using the Standard & Poor's High Grade Corporate Index from 1926 through 1968, the Citigroup High Grade Index from 1969 through 1972, the Lehman Brothers U.S. Long Credit AA Index from 1973 through 1975, and the Barclays Capital U.S. Aggregate Bond Index thereafter.

* To unsubscribe from the Weekly Market Commentary please email us at team@denverfinancialgroup.com with "Unsubscribe" in the subject line