Business

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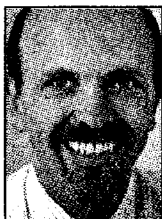
# Watch your investments with care

With military events fading from the daily news, many Americans are shifting their focus back toward the economy and the investment markets. Stocks have experienced a rally, fueled by significantly lower oil prices and relief that the world has made it through the latest round of international conflict without huge fallout, at least so far.

ROB RIKOON



Real Money

Investors who had moved to cash need to determine if the positive sentiment and advancing stock prices are just a release of the pent-up anxiety generated by the United States successfully taking international law into its own hands. If the strong upswing is a vote that the war on terrorism is over, then the rally will likely fade and reverse itself at the first sign of renewed systemic violence.

There is a chance that we have seen and weathered the worst point in the market cycle already. The crisis of public confidence in the future efficacy of the markets engendered by corporate scandals, plummeting technology prices and veiled nuclear threats by countries such as India, Pakistan, North Korea and the United States could be behind us. The markets need a general sense of confidence that the future will be bright, or at least better than the recent past, in order for investors, who have fled to cash and government bonds in the hope of finding a safe haven, to return to investing in stocks for the long term.

The desire to retreat to safety, to hunker down in a "wait-and-see" mode, is understandable but ill timed and if improperly executed, can be dangerous to one's long-term financial health. Uncertainties about whom one can trust and how one's basic income needs can be met have led investors to take some bizarre actions. Annuities are a hot item in the media, with promises of 4 percent guaranteed returns garnering billions of dollars in assets. Banks are awash with money deposited in CDs as investors look for assurance that their accounts will not lose any more in value.

The problem with this approach is that we, as a nation and as a world economy, are facing severe long-term inflationary pressures. Any investment that promises a fixed rate of return, especially over an extended period of time, must by definition be placing at risk one's ability to adjust to higher prices in the future. Beware of these kinds of promises of safety. In an uncertain world, the only sensible refuge is diversification and in order to properly diversify, investors need an understanding of the different kinds of risk found within every type of investment. Government-insured accounts might sound safe, but they in no way are certain to lead to a secure financial future.

For example, if interest rates rise, investors who have locked in low rates are sure to experience regret at buying long-term investments at the very worst time, i.e., when rates are at or near their low points. Equally dangerous is trying to reach, without adequate safeguards, for higher yields or returns. There are many products that promise investors a high level of current income, including real-estate investment trusts, corporate bond funds, and preferred stock, but each

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vehicle has its own drawbacks.

These types of securities can be useful, short-term alternatives to money-market funds, as they do pay considerably higher dividends. The danger is that if one does not follow their price changes daily, when interest rates go up, all of these seemingly secure investments could plummet in value.

It is possible to protect this kind of a portfolio's value by using "stop losses." These are standing instructions to automatically sell the stock or fund if its price goes below a certain level. Investors striving for higher income need to continuously monitor the targeted level at which their holdings should be sold, and renew the stop losses on a regular basis, as regulators require stop orders to automatically expire every 60 days.

It is possible and often highly desirable to earn more money than available in a money market, savings account or CD, but understand the risks before you take a leap. Using several different types of these alternate income investments simultaneously will help minimize the amount of hurt you will experience if the economy takes an unexpected turn that adversely effects income-producing investments.

When the economy starts to exhibit signs of strength, short-term interest rates will likely rise. There are other factors that could upset the apple cart of cautious individuals who have sought refuge in "safe" investments. For example, the U.S. dollar, in which most people in our country have all their savings, could continue its decline versus the European monetary unit called the euro. This is not an esoteric matter, as it directly affects our domestic standard of living. Many of our consumer products come from overseas. Foreign investors own much of our government's debt.

Our nation has a huge and growing need for money from outside the country. This is the only way we can finance the government deficits on which our economy depends. If the U.S. dollar falls appreciably versus other currencies, the effect it has is that it takes more dollars to service the same amount of debt. This is not unlike a reduction in one's credit rating, as for governments, businesses and individuals alike, the worse one's credit rating, the more one has to pay to gain access to money.

Some people believe that one reason the United States decided to go into Iraq was not so much the physical threat posed by that military dictatorship to the outside world or the human suffering endured by its civilian population, but because in 1999, Iraq started trading its oil in euros, abandoning the U.S. dollar as its international trading currency. Shortly after that event, Russia threatened to do exactly the same thing, and several other Mid-eastern and Asian countries considered following suit. After all, diversification in our personal portfolios makes sense, why shouldn't sovereign countries diversify their finances in case something bad happened to the dollar?

Over the last year, the European currency has appreciated more than 25 percent versus the U.S. dollar. The countries (and individuals) that did partially change their dependence on the U.S. dollar have therefore experienced a tremendous economic benefit. The U.S. conversely experienced a decline in purchasing power and an increase in costs. If this movement were to continue and accelerate, the control of important parts of our economy, such as the setting of interest rates and formulation of policies of strategic growth could pass out of the hands of our political and business leaders and into the domain of international traders. It would be akin to the fate of many debtor nations who, over the last 20 years, have fallen prey to notorious bandits called currency traders — people who have no allegiance to anything or anyone other than their own (diversified) bank accounts.

It is possible that these concerns may be unfounded. Iraqi oil could now grease the wheels of market commerce with U.S. dollars for some time to come. This would help to offset the U.S. Treasury's present dilemma of shrinking receipts from taxpayers because of investor losses and the widespread global business slowdown that has produced massive layoffs. Our nation's government deficits, along with those of Europe, will likely balloon because of the continued economic downturn, increased spending on the military and domestic security, along with the proposed tax cuts. The great hope is that commerce, industry and investors would return to their pre-Sept. 11 mentalities, because perhaps now, after a U.S. victory in the Middle East and assertion of dominance on the economic front, the world is again a relatively safe place and investor confidence is warranted.

Economic statistics are notoriously inaccurate, untimely and often contradictory. Unemployment continues to rise while factory utilization (otherwise know as the level of industrial activity) continues to be at its lowest level since the early 1980s. Home foreclosures are rising at the same time as record amounts of debt have been taken on by consumers in the rush to refinance at lower rates.

On the other hand, gold, a harbinger of tumultuous times has been falling while the consumer savings rate is starting to go up for the first time in many years. Overall, investor anxiety seems to be waning.

Market volatility is a fact of life that is here to stay and so the short-term ups and downs should not be cause for concern. The hard issue at hand for investors is deciding if we are in a bear market rally, a temporary rise inside a flat or down long-term trend. The best advice I can offer at times like these is to diversify "outside the box," dare to be non-traditional. Don't be afraid of looking at non-U.S. dollar vehicles, especially short-term government bonds denominated in New Zealand, Australian or Canadian dollars; don't reach for high current income without adequate safeguards such as stop losses; and temper your expectations for a quick recovery in stock prices back to the levels of the late 1990s.

*Rob Rikoon is president of Rikoon-Carret Investment Advisors, 510 Don Gaspar.*

*He can be reached at 989-3581 or via email at rrikoon@aol.com.*