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Confusing investment time to continue

Real Money

By Rob Rikoon | For The New Mexican

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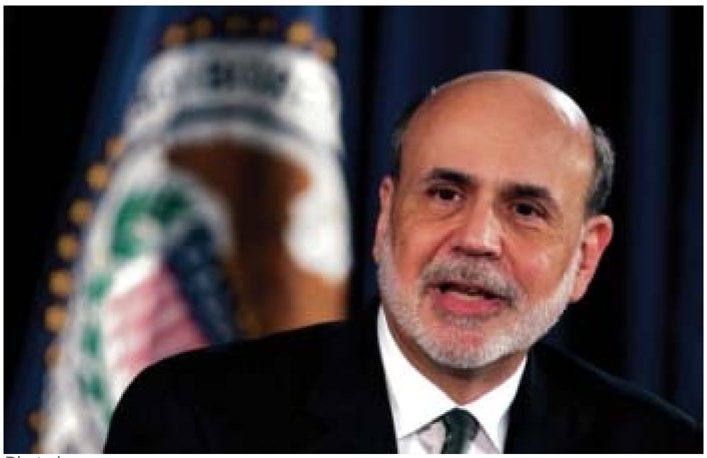
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I feel like we have a bad case of déjà vu. It seems as if we are back in 2005 and there is a party going on in the markets. You know the story of the boy and the wolf, where the crier of danger gets ignored because he has too often repeated his plea for caution. As we enter October, traditionally a month of great volatility in stocks, many cautious investors remain on the sidelines with substantial cash reserves. No wonder, with CD and money market rates close to zero!

Given recent announcements that the intent of the central banks in the United States, Europe and Japan are hellbent on promoting higher domestic employment levels at the risk of runaway money creation and eventual inflation, it is appropriate for individuals to consider how to cope with a global environment of ultra-slow growth and the potential that the next meltdown will be in government finance, which means there will be no bailouts. Every public market will be affected — bonds (especially mutual funds), stock indexes and packaged products such as real estate investment trusts, master limited partnerships, everything that relies on low interest rates.

To put this challenge in context, the European Central Bank has said it will do whatever is necessary to bailout southern European nations who are on fiscal life support. America's Fed is determined, at all costs, to bolster employment and Japan's finance minister stated that they will print money endlessly to promote an end to their 20 years of stagnation. Due to these concerted actions, the world's stock and bond markets have bounded ahead.

Investors do not tolerate earning less than the rate of inflation. We now may be entering a "liquidity trap," which means that people keep large amounts of cash out of fear. Money stops circulating, no matter how much is printed, and government policies meant to stimulate the economy actually end up having little effect on job creation. The velocity of money, a standard measure of circulation, has been falling rapidly throughout the past few years, despite multiple rounds of qualitative and quantitative easing.

This topsy-turvy investment environment is unlikely to change soon because the Fed has promised to keep rates low until 2015. Mortgage rates may continue to decline but this will not convince entrepreneurs to take risk and hire more employees. No matter who is elected in November, imbalances in the U.S. such as the mismatch between the skill level of most people coming into the workforce and the technical demands of 21st-century manufacturing jobs will remain. If this analysis is correct, it points to chronically high unemployment levels, muted consumer spending, plus a continued need for high government expenditures. As we see in Europe, this is a recipe for meltdown.

The markets have not been bogged down by these concerns because risk assets continue to benefit from artificially low interest rates. Investors who are willing to take risk and participate in the market, but who want to maintain some defensiveness, should find and hold only the highest quality global companies that pay substantial dividends. Telecommunications, pharmacuticals, diversified manufacturing and energy related companies are our preferred industries because we believe they will continue to produce enough cash to pay out dividends, no matter what happens in terms of government and bank insolvencies.

Where else can investors go? Besides high dividend paying stocks, we believe that investors can find private real estate investments, particularly rental situations, that pay high cash flows and are well collateralized.

It is important to keep in mind the real estate investments I am referring to here are ones that you (or someone you know and trust) can actually touch and feel on a regular basis. We are not currently in favor of investing in traditional bonds or bond mutual funds, as new bonds are paying in the 1 percent to 2 percent range. If the advertised earning rate is higher, watch out!

One final suggestion is to look at precious metal stocks that pay dividends. As governments and banks debase the value of local currencies by maintaining an unsustainable status quo, investors need to protect themselves.

Here are some Pollyanna solutions to the problems noted above. If the world's governments did what they say they believe in and co-operated on banning all nonpeaceful nuclear work and materials, we could fund a global system of free education and health that would train and put people to work all over the planet. If the world's underground energy resources were considered to be common heritage assets of everyone, we could fund a multifaceted approach to the environmental problems facing the world's population as a whole, with some mixture of materials and technologies, which would also be a great propeller of economic growth.

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