Capital Drain

Rick's investment opinion newsletter September/October, 2005 v.1 no.8

Hi Readers,

My intent was to send these out monthly, but that seems to be eluding me. I'll make this one short and sweet, to get it out.

Have you given any thought to a new name? One friend has, and I've had an idea or two that I had to discard because they were taken, but no clear candidate has jumped up.

OK, here we go. In my opinion:

Executive Summary:

Inflation, which I first mentioned back in May, was widely dismissed by the popular financial experts at the time. Well, it's here now, and it will be for a while.

What's in your credit report? It matters a lot, for several very different reasons. You can find out now, free.

"What should I invest in?" You've all heard it from someone, and you may also have asked someone else. The "first things first" of this is boring and thus often ignored.

As before, I think everyone is best off with a broad diversification that includes at least 3/4 overseas assets, reflecting the distribution of world economic activity.

These are not the best of times, so investors need to 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 such as Google, Google, (did I mention Google?) or Taser.

Sure, Google is doing great. So was Pets.com once upon a time. Google's a pretty good company, but at the current price you could only buy based on the Greater Fool Theory: "Sure, I paid too much, but I'll find a Greater Fool to whom I can sell it for even more!"

The Details:

"The inescapable dramatic situation for us all is that we have no idea what our situation is."

-Christopher Fry, English playwright

Inflation is back; no one denies it anymore. What to do? In general, accept it and plan on it continuing.

Specifically, if you hold or want to hold medium or long-term US bonds, you should quickly look into shifting into inflation-protected Treasuries. The tax consequences of the mechanism of the inflation protection are a bit cumbersome, but if the bonds are in an IRA or 401(k) or similar, that won't matter.

Also, if you haven't yet, convert any floating-rate debt you have to fixed rate. Those floating rates are going up.

By the way, are you wondering what the difference is between the core and broad inflation measures that get quoted? Lots of people will tell you that food and other volatile prices-- and lately especially energy-- are snipped out of the core rate because they're volatile. That's technically true. It's also missing an important point: energy prices lately haven't been volatile so much as they have been steadily high. Leaving those out of your consideration of rising cost of living is risible. They're not going down any time soon, and that realization is causing them to percolate into all your other prices increasingly quickly. Thus what once was excluded from the calculations will soon be visible in the core inflation rate, too. Also, you know perfectly well that you're paying more for heating oil, natural gas, and gasoline, and I'm sure you're not under any illusion that if you wait a week or a month you'll be able to get those cheaper.

Two quick thoughts about hurricanes Katrina and Rita: Some folks have said that the rebuilding will be good for the economy: lots of extra construction spending, etc. That's Panglossian fantasy. The rebuilding is having to be paid for; that money isn't buying something else; at best that's net zero. Meanwhile a lot a lot of people aren't able to earn money as effectively as they formerly could; that's a net loss. Obviously many people are unemployed, and big chunks of commerce and industry in the Gulf coast won't be contributing to GDP for a while.

Second, if you don't already have your "earthquake kits" made and ready, please get busy. I call them earthquake kits because here in California that's our main threat, but everyone has a reason to be careful. This kit should have food and water-- and shelter appropriate to your climate!-- for your household for at least three days. You should have one in your home and one in each car. When the Loma Prieta quake hit here in '89, I was 25 miles from home, almost no gas in the car, and no electricity in the neighborhood to pump gas. Oooh, bummer. Fortunately, I was far enough from the epicenter to find a nearby neighborhood where the gas pumps worked. Whew! But I haven't forgotten.

As you saw in the news, the old assumption that the relief effort will sweep in to rescue you within three days has been weighed and found wanting. You may want to bump up your stockpile to a week or more. Also, keep it simple but complete: cans of food won't help without a working can opener and a stove, unless you fancy eating the stuff cold after bludgeoning it open with a screwdriver. Don't forget water: a pint per person per day just to stay alive; twice that to enjoy the experience.

There are three good reasons to check your credit report regularly:

1) You can see if someone has made a mistake and get it corrected.
2) You can spot any suspicious activity that may warn you of identity theft (i.e. an account opened with your data that's not really yours).
3) **It's free.**

A program that started here in the west a year ago has now phased in nationwide. Once per year, you can request a free credit report from each of the three big agencies. I rotate among the three and get one every 4 months. Go to
https://www.annualcreditreport.com
to get yours. In my experience Equifax and Experian were quick and easy to deal with, but Trans Union has been a pain. Start with the good guys, and do it soon. (Maybe right after you finish your earthquake kits!) Put the thrice-annual reminders into your calendar.

I'm sure you've been asked, "What do you think I should invest in?" The questioner is probably hoping to hear "plastics" or "biotech" or some such. The right answer is, "first make sure you've got your basics covered." The basics, in order, are:

- Pay off all the credit card debt and keep it that way.
- Insurance, if you don't have it. Health, for sure. Disability, if you depend on being able to earn an income. Life, if anyone depends on you earning an income.
- Three to six months' worth of expenses in a savings account, for the proverbial rainy day.

I hope that this is redundant filler for all my readers, but it may help you respond authoritatively the next time you're asked.

Since I bash mainstream and especially cable financial "news" media so often, in fairness I should recognize that (I've heard that) someone named Suze Ormann has been bringing this message to the masses. Good for her.

It's time to wrap it and ship it.

If you have any questions, please please write or phone. If you want to read more, I've got a web site with old editions of this letter and some links to other interesting sites.

Please feel free to forward this to any friends or associates who may be interested.

For those of you getting this sample gratis, I charge $120/year for this newsletter. If you're not sure you like it, you could subscribe for 3 months for $40. Your checks, mailed to the address below, are always welcome, will be appreciated, and can be claimed as a tax deduction as an investment expense.

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
