DJC

THE DAILY JOURNAL OF COMMERCE, PORTLAND, OREGON

WEDNESDAY
November 17, 2010
www.djcOregon.com

Reprinted from the Daily Journal of Commerce.
To subscribe, e-mail subscriptions@djcOregon.com.

Inflation more likely than strong growth

Investors may find relief from a depreciating dollar by pursuing emerging-market exchange-traded funds

FINANCIAL FOCUS

Robert Smith

Even after his party's crushing defeat earlier this month, an unrepentant President Obama demonstrated somber defiance in the face of the Republican tsunami.

Like it or not, the United States' present economic problems are the result of decades of mismanagement. The fiscal irresponsibility of Congress and the executive branch, combined with monetary laxity by the Fed, have resulted in mountains of debt, anemic growth and a dwindling dollar. The only solution now is either strong growth or inflation.

Unfortunately, strong growth requires a political consensus that will be hard to achieve now that a Republican posse has arrived in town. These newcomers will expect cooperation and contrition from a president who does neither well. Even after his party's crushing defeat earlier this month, an unrepentant President Obama demonstrated somber defiance in the face of the Republican tsunami. Therefore, I posit that inflation and dollar depreciation are the most likely acts to follow.

On Nov. 7, in a Bloomberg opinion piece, John Dorfman, chairman of Thunderstorm Capital in Boston, wrote that "an easier money climate may produce some inflation." I think this misses the point entirely. The middle class' financial crisis isn't over; rather, "hard times have just begun." By allowing the dollar to continue to decline (the Fed's current fix), a commodity price bubble has already emerged, and its eventual pop will be extremely dislocating to the global economy.

Since Federal Reserve Chairman Ben Bernanke announced his plans for QE2 in August, the dollar has been one of the most rapidly depreciating assets. This is good for the government because it can then pay down the mountain of Treasury debt with more, easier, cheaper dollars (or should we call them Doritos now?). It's also good for corporate America because it can then bag more windfall profits from overseas sales of cheaper American goods.

However, it's not so good for Mr. and Mrs. Middle Class, whose savings account is dollar denominated. Each day, they become a little poorer (shades of wheelbarrows full of deutsche marks to buy bread). With the powers that be benefiting from the dollar's decline, the deck is stacked against the average American.

The only solution is to get out of dollars. Because most of us can't just pick up sticks and move to Liechtenstein or the Cayman Islands, we have to move our dollars instead. Investors can do this by funneling money into any or all of the following emerging-market exchange-traded funds: iShares MSCI Chile Investible Market Index Fund (ECH), Global X InterBolsa FTSE Columbia 20 ETF (GXG), Market Vectors Indonesia Index ETF (IDX), iShares MSCI Thailand Investible Market Index Fund (THD), Market Vectors Brazil Small Cap ETF (BRF), iShares MSCI Malaysia Index Fund (EWM), etc.

All these ETFs do two things: they get money out of this economy (moribund) and into emerging markets (prosperous), and get money out of the dollar and into other currencies. This lets investors participate in markets rising faster and profiting more than ours, and also hold currencies appreciating against the dollar.

By employing this strategy in combination with the purchase of commodities (gold, silver, copper, oil, etc.), an investor will be fully armored against inflation. Remember, everything from steel to oil to gold will benefit from an inflationary environment. These assets and the companies that produce them will command higher prices.

Consumers will be able to do little except grin and bear it. Hard times have just begun. Those investors who have not yet diversified their portfolios will never have better opportunities to protect against inflation.

Robert Smith is president of Oregon 1031 Investments and has been a registered investment adviser and financial planner for 24 years. Contact him at 503-241-4949 or at robert.smith@oregon1031investments.com.