

# Down the Cycle We Go

September 25, 2003

Just when we thought there was really nothing more to write about, the press became alive with comments concerning the weakness in the dollar. The primary concerns by most writers are that (1) this would create inflation in the US & (2) foreign owners of US securities would no longer want to hold an asset that is depreciating in value due to exchange rate dollar weakness. To counter this problem interest rates would have to move higher to offset the weak dollar. All of this could be true, but there is always another side of the story concerning this or any other matter. In our minds the “rest of the story” conceals the true consequences of these two negative possibilities.

First, let us say we do believe our government’s unofficial position is calling for a weak dollar to make our goods competitive with other countries. We believe this is a short-sighted policy and is another nail in the economic coffin of the “cycle of deflation.” By the way, we have decided to include this chart in our Web Buzz each week until we believe it is burned into everyone’s psyche. It is the answer to most all the misinformation one gets from Wall Street and the financial press concerning inflation. Secondly, if Japan and China want to sell us goods they will of necessity have to own U.S. dollar denominated assets regardless of the level of interest rates. Also, they will probably not allow the dollar to depreciate versus their currencies. We are the markets for goods of all kinds and they are not at all interested in having their price advantage disappear. But let’s say they do go along and allow their currencies to float, will that really create inflation? We don’t think so, because high consumer debt will limit demand and price wars will cancel price increases. The day-to-day debt leveraging of all sections of the economy cannot go on forever. The consumer’s spending habits will have to change.

On the matter of higher interest rates, we can see that happen as it pertains to corporate, consumer and mortgage debt but not government. Why? As we continue to move down the cycle of deflation, the economy gets weaker and weaker, debt becomes more of a burden, and common stock become a source of funds. What is left over for investment from their sale will, in our opinion, go to government bonds as a safe haven. In other words, what the foreigners won’t buy in the way of government bonds will be more than made up through domestic purchasers.

As the saying goes – “That’s our story and we’re sticking with it.” Oh yes we will be on the road this week so look for only the cycle of deflation next week, which if we haven’t mentioned before was developed by Comstock partners in New York, one of the few on Wall Street that gets it.

# The Cycle of Deflation

