

Same Idea, Different Outlook

November 1, 2004

Bill Gross is the recognized media guru as it pertains to investing in bonds. It is with a great deal of trepidation that we mention his website (www.pimco.com), as we quite often find ourselves in a disagreement with him. We can see ourselves spending a lot of time explaining to those who read us both why he is wrong and we are right. On the other hand, it is exactly that exercise in which one needs to participate in order to make sure one's opinion "holds water."

Bill's investment outlook for November is required reading, in our opinion. In his piece, he mentions the one thing with which he is most sure. Obviously we like it, as we agree 100% and have so stated over the last five years. It is as follows:

. . . Real interest rates in the United States will have to be kept low, that the old Taylor rule is out. Too much debt in a finance-based economy precludes raising interest rates like we have in the past and while that keeps the patient/economy breathing; it leads to asset bubbles, potential inflation, and a declining currency over time.

The interesting thing is that his conclusion from the same believed idea is the opposite from ours as it pertains to the investment in Government Bonds. His idea is to buy Treasury TIPS to protect his clients from inflation, while we believe one should own longer dated non-TIPS government bonds to take advantage of a larger coupon plus the tax-free income, which will accrue from deflation.

Please note the chart below. Do the late 20's and early 30's look a little like today? Do you remember that Franklin Roosevelt did his very best to create inflation during the 30's? One of his "brightest ideas" was for farmers to destroy their pigs in order to raise prices. They also revalued gold and that also didn't work. My friends, debt is a millstone that first stops consumer spending and then has to be paid either by income or default. Income will be near non-existent and default leads to bankruptcy – NO INFLATION THERE.

