

Campbell Capital Management

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Dear Money Management Client:

We're turning Japanese, I really think so. The Vapors, a British rock group, may have been on to something thirty years ago. Japan was leading the world in economic growth and productivity. But in 1989 their bubble burst and Japan began dealing with a balance sheet recession which has continued to this day. Ten year JGB (Japanese government bonds) are now yielding less than 1%, in spite of untold spending projects and QE (quantitative easing) cycles in Japan since the recession began. Debt to GDP (Gross Domestic Product) in Japan now stands at 200%, more than twice that here in the United States.

You see where I'm headed? The press is full of doomsday stories about our economic conditions, when in reality we're just turning Japanese. Our economy has excess capacity, high unemployment, low inflation and historically low interest rates. Our deficit spending and QE have helped us avoid a depression, but now we're in store for a long painful period of sub par growth while balance sheets are repaired. The responsible savers are penalized, just like in Japan, because interest rates will stay low making returns on investment meager. Everyone is going to pay for the excesses that got us into this mess: workers, retirees, savers, consumers, we're all going to do with less.

Japan's debt is financed mostly by Japanese, but U.S. debt is financed about 50/50 domestic and international. So, you may argue we're different from Japan, but does it really matter who finances your deficit? Export dependent countries fighting to keep their currencies low to the dollar will continue buying our bonds because they have no choice. It's that simple.

Of course, we're living in a dynamic period where things change quickly, so we remain open minded as to possible outcomes. But for now, the deflationary camp focused on the output gap and high unemployment makes the most sense. The Federal Reserve is keeping interest rates low to stimulate demand, but there's little motivation to borrow with so much uncertainty surrounding jobs, housing, taxes and health care. Whoever thinks too much debt (balance sheet recession) can be solved by adding more debt just need look at Japan to see our future.

We remain committed to a conservative investment philosophy, which emphasizes the preservation of capital. If you have any questions or would like to discuss your portfolio, please do not hesitate to call.

Very truly yours,

Clay Campbell