Portola Group Investment Commentary

Too Much, Too Late

March 19, 2009

The Fed and Chairman Bernanke spoke loudly yesterday. With one announcement, the Fed has declared that they will print whatever money is required to reflate the economy and fund the spending mandated by an out –of-control government. Trillions of new dollars will be printed in this pursuit. This is what they should have done 1 ½ years ago when the cost was far less. They did not.

The reaction was immediate. Gold soared, the dollar plunged and Treasury notes and bonds rallied. Treasuries rallied as the government will become the buyer of first and last resort. What likely has occurred is that the Chinese either did not have the money to fund our outrageous spending or they refused. Europe also pushed back, saying that they did not favor more spending. There was only one choice left…the printing press.

The tip off was Bernanke's appearance on 60 Minutes on Sunday. Since it was the first appearance by a sitting Fed Chairman for an interview of this nature, he was asked, "Why?". We received the real answer yesterday. He was preparing the public and the financial markets for what he knew was coming shortly, the decision to print.

We have always told people that it was much more likely that we would experience hyper-inflation before another Depression as the people will demand it. After-all, spending funded by tax dollars comes from "other people", "rich people", so the bulk of the population will be for it. People throughout history have always "voted" for inflation over Depression. It does not change the outcome, a Depression ultimately ensues, but it feels good in the meantime.

It is sad, but our allocations are proving to be "spot on" as they say. Our most likely scenario was that the global stimulus would work, and that the world would experience a powerful economic recovery. It also implies that the equity markets will have an equally powerful recovery. Coming out of the early '30s, as GDP and unemployment bottomed, the U.S. stock market went virtually straight up until tax rates were raised by Roosevelt in 1936 to 79% and the threshold for the tax was dramatically lowered to tax more citizens. We expect a similar scenario.

Therefore, we should enjoy the party for the next couple of years. The price for our continued self-indulgence will be severe. As stocks climb, bonds will most assuredly move in the opposite direction. Inflation will wipe out the value of fixed income as it did in the mid-'70s to the early '80s. This time, however, it will be more severe as the dollar has been the reserve currency of choice. Real assets will also soar…gold, silver, oil, industrial materials will see all-time highs before this is over. Prime, unlevered real estate should also provide shelter in the storm.

The unhappy ending does not have to happen. If we, as a nation, change our reckless behavior, we could very well enjoy prosperity as far as the eye can see. Time is running out, however. We need to act responsibility to get past this current mess, and then get ready for the real storm ahead, Social Security and Medicare. Let's hope we have the courage.