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Herb Kay on Surviving the Economic Times



An interview with Herb Kay on how to survive the current economic times. Kay is a well known business and finance expert, and author of "How to Get Filthy Stinking Rich and Still Have Time for Great Sex, an Entrepreneur's Guide to Wealth and Happiness."

Are you optimistic or pessimistic about the economic direction of this country ... both in what the federal government is doing and what's happening in the private sector?

HK: Firstly, I am a natural optimist and consider myself a self-proclaimed Pollyanna, so what I am about to say is totally out of character and should be taken with the knowledge that long term, I am bullish on the American economy for the next 10 years or so .

Okay, let's start with the initial assumption that it is very different to be wiped out as opposed to having something left. If consumers still have some money, now is the time to protect it and largely disregard return. If they don't, now is the time to build up cash as quickly as possible. Before I get into specific investment choices, let me discuss the current economic situation.

To begin, I think that the vast majority of the press and public ... not to mention the leadership on Wall Street and Washington from both major political parties ... are missing what is really going on. The conventional wisdom is that the banking and financial crisis brought on this recession and once that problem is solved, we will be on the road to recovery. I think that this is a very mistaken assumption.

I believe the financial crisis is a symptom as opposed to a cause of the problem. The real problem is that since the creation of the modern welfare state in the 1930s, the government has been spending enormous sums of money and has financed this by taxation, borrowing and printing fiat (paper with no gold behind it) currency.

In order to cope with both the tax and regulatory burden, large and small businesses have tried to maintain and grow profits with what is left over through the use of leverage. On top of all of this, consumers acquired vast amounts of debt in order to improve their lifestyles with most of that supported by inflating home prices. Now that the party is over, we have reached essentially the point of no return. I don't believe that this is a recession but rather a global reset that has a very

long way to go and will profoundly affect all of us.

Now, all of this said and I want to make clear that this is not a political statement and just a financial one; we are essentially in the second inning of a nine-inning game. This is not the end or even the beginning of the end. I say this because there is still a lot of deleveraging to go. I know that lots of talking heads say otherwise, but as a natural skeptic, I see no logic to assume we are out of the woods, unless they are basing their analysis on "hope."

For example, home prices are now nationally at 2003 levels but that year was the height of the real estate bubble. Prices must unwind to pre-bubble levels to be at a bottom and that would mean a further decline of about 30 percent from where they are today. As home equity represents the majority of what most Americans would view as their wealth, the continuing decline of values will necessarily have the effect of retarding spending and increasing savings.

This is a rational response already taking place by average Americans as the personal saving rate is zooming, but the government's plan relies upon spending enormous amounts of money to loosen credit and create activity to stimulate new consumer spending. I think this is just a stupid assumption as it relies on people acting against their own self-interest and spending irrationally. It is just not going to happen.

Further, there are four things that determine whether we have growth or stagnation that the government controls: taxes, regulation, foreign trade and the strength of the dollar. If we reduce taxes, reduce regulation, promote free trade and enforce a strong dollar, things will turn out well.

We are doing exactly the opposite as we increase taxes and tremendously increase regulation. Additionally, we are undertaking massive intervention in private business; case in point ... GM and Chrysler. We have already violated NAFTA and started a trade war with Mexico, our second largest trading partner, and are debasing the dollar by literally printing trillions of dollars that have only nominal value to pay for enormous increases in government programs.

The upturn in the economy is, I fear, years away.

Are there any suggestions you'd like to make about surviving financially during these tough times? Considering various avenues for investment, which ones should people pursue and which should they avoid?

HK: Here are my suggestions regarding investment asset classes:

Gold and Precious Metals -- Absolutely with at least 10 percent and I would recommend as much as 30 percent of the total portfolio placed in this class either by direct ownership of the metal, ETFs or mutual funds. Adjusted for inflation, the price of gold would need to reach \$2,300 per ounce to be at an all-time high and I expect that it will during the next year or two.

Bonds -- Absolutely none whatsoever. The profligate printing of money by the government will result in inflation and destroy the bond market. Stay away.

Treasury Notes and/or Money Market funds -- This is where I would place the balance of any portfolio. A combination of TIPS and Money Market funds is fine.

Real Estate -- My grandfather used to say that in a disaster, it is always the third guy who makes a profit buying a failed asset. Right now, the people buying real estate are just the second round of suckers looking to make easy money. Don't be fooled. Wait until values hit their 2000 levels to start looking and then real estate will be a good buy. One note: If inflation heats up before we hit 2000 pricing levels, then I may modify my recommendation at that time.

Collectibles -- Well, in all honesty, this is not my expertise. I suppose it depends on what you are collecting. Antique Ferraris might be good, but really, I have no idea.

Insurance and Annuities -- A pet peeve of mine is when an insurance agent or so-called financial planner sells one of these as an investment. They always suck for lots of reasons, but now with the health of the finance sector in doubt, they are really lousy.

Stocks -- Traditionally I love the stock market. However, for now I am out. The current rally is to my mind a sucker rally based upon nothing more than hope. Since essentially all ships rise and fall with the tide, being out is the safer position. That said, if you are a short seller or a VERY disciplined short term trader, it may still be for you but for the average person, again, no.

Commodities/Futures -- I myself have substantial assets in a managed futures fund and it does quite well on volatility and does not correlate with the stock market. That said, futures are a zero sum game meaning that each day there is a loser for every winner ... unlike the stock market where everyone can win and wealth, in good times, is quite literally created. So, this is a game for the wealthy or highly risk tolerant. For the average Joe, I would advise against it.

Money Under Your Pillow -- Nope. Inflation will kill you!

Mr. Kay is president of [HK Turnaround](#), a business consulting firm in Tucson, Ariz. Kay has made frequent appearances on CNBC, Fox and Bloomberg TV. He has been the in-house financial guru on the Family Channel's "Home and Family" show, hosted 150 episodes of the syndicated weekly TV show "Get Rich Smart" and wrote a business and finance column for the Gannett chain. He has served in the Navy, been with the National Security Agency as a Russian linguist, been an agent with Northwestern Mutual Life and worked for independent investment broker Integrated Resources among his various business ventures