PCM
Consulting

"Put the Helmet On!"

This is the final research article in our series of four themes that will drive investment decisions and returns over the next 18-24 months. This may also be the most controversial and difficult to understand. The topic itself does not easily lend itself to extensive quantitative analysis. Nonetheless there is a growing body of actual events that serve as blueprint of things to come.

Recently I heard a comedian discussing Homeland Security's Color-coded Warning System and is it truly necessary to have so many different levels. His conclusion was to quickly whittle down the need to two levels: Get a Helmet and Put on the Helmet. We are now at "Put the Helmet on" stage. First, let's set the stage of how, globally, we are heading down a path of behavior usually seen in what is euphemistically called third world countries run by ruthless despots.

The financial crisis that consumed the global economies has caused extensive damage to banks and governments. The entire blame has been laid at the feet of "greedy" capitalists worldwide. As the fog from the initial crisis is beginning to lift, we are now seeing the housing bubble was only a symptom of the real problem. The bankers are a convenient scapegoat and they provided cover for what is increasingly seen as failed government policies. It is important to remember that the same government officials missed the coming of the financial crisis are now telling us how to cure what they didn't foresee or understand. Currently, the focus today remains Europe, in particular, Greece and Spain. The resolve of the European Union is being severely tested. As the EU comes together to try and deal with the economic crisis, the proposed structure is meeting resistance by those in need of help. The EU has demanded for pouring each country's treasury behind the bailout that austerity measures be taken to decrease the debt levels that now exceed their GDP. The help of the EU has been met with anger by the populace of Greece and other nations at risk. This has fed a political anti-incumbency movement, extreme polarization and is being played out in the streets with heated social tensions and rioting. The media outlets (including a Nobel Prize economist) are playing this out in a very oversimplified "austerity vs. growth" debate. The ignored reality is that the status quo is no longer an option for Europe. Eight Eurozone governments have been voted out of office in the past couple of years. Globally more than 50% of GDP will face defining changes in 2012.

In May, President Nicolas Sarkozy was booted from office as France elected a Socialist Francois Hollande who campaigned on more spending, higher taxes (Hollande campaigned on imposing a top rate of 75%) on the rich and pay cuts of corporate officers.

Not surprising emigration requests were up over 40% after the election as the rich are trying to beat the rush. Knight Frank, a European property agent has reported that the number of French web users searching online for prime London properties has increased 19% compared to the prior year. The equivalent figure for Europe as a whole fell 9%. Executives at UBS in London confirmed inquiries have risen in what can be done to protect the assets of the wealthy French.

This scene is being replayed in Spain, the latest Eurozone country to fall victim to excessive spending. Riots in Barcelona broke out during a nationwide general strike that closed factories, slowed transportation systems and crippled hospitals. Tens of thousands of people marched in Madrid and other cities protesting an economic plan of spending cuts and tax hikes. Despite all of the wringing of media hands over austerity, it has yet to be implemented to any significant level. In 2008, these governments enacted "stimulus" packages when the financial crisis began. In 2011, well after the real danger of the crisis had passed, 23 of the 27 EU member states have increased spending. France, Spain, Greece and Great Britain are still spending at pre-recession levels. France and the UK have not cut spending at all while the small cuts by Spain and Greece have sparked riots hoping to apply political pressure for a return to higher spending. We are witnessing first hand the meaning of Winston Churchill's famous quote on capitalism and socialism. "The main vice of capitalism is the uneven distribution of prosperity. The main vice of socialism is the even distribution of misery". The misery is spreading.

The economic woes in the Euro zone and the growing unrest are well documented. In other parts of the world, unrest is playing out in the Middle East and Africa in a slightly different way. These areas are plagued not from the failure of socialism but from pressures of the push to democracy in countries that have been under repressive regimes for decades. As the U.S. has declared the end to the conflict in Iraq and Afghanistan, Iran continues to test the patience of the west by thumbing their nose with its ongoing efforts to build nuclear weapons. Additionally, they continue efforts to consolidate and extend its regional influence. Iran is being aided by Turkey, Russia and China. This has made Saudi Arabia quite nervous who is trying desperately to quell unrest by young Arabs who have not taken a kind view of the Saudi royal family. They have attempted to head off serious protests by handing out cash.

Political instability in the Middle East is accelerating. Syria and Egypt have seen rioting and killing as Mubarak's reign has ended and Assad's regime is under global pressure to step down. Rebels in Syria are attacking security targets and infrastructure. Battles have led to mounting deaths as the world watches in horror. The inaction by the global community, unlike what occurred in Libya, will lead to a rebel opposition becoming more radicalized further increasing Middle East tensions.

Egypt is moving ahead in its post-Mubarak era with a new election being hurriedly scheduled. The struggle for control pits the military against the Muslim Brotherhood. Both will need to make concessions to avoid stopping the political transition. These concessions are by no means easy and may in the end deteriorate into another round of rioting and violence.

Although there are no significant sings of turmoil in N. Korea, Russia, Brazil, Argentina and Venezuela, they are one spark away from a full fledged forest fire. In Argentina, as a result of trade barriers implemented February 1, there are reports of consumer goods shortages ranging from furniture to pharmaceutical drugs. Argentina will not yield to international pressure and will focus on its domestic needs assuring the isolation of Argentina.

Reports out of Venezuela state that dictator-for-life Hugo Chavez is near death losing his battle with cancer. His maniacal control of Venezuela may then soon end however the result may lead to further economic chaos putting energy supplies at risk. Furthermore new labor and pricing laws will lead to higher prices, shortages of consumer goods and civil unrest.

In addition to threats to the world's energy supply in the Middle East and Venezuela, militant struggles in the sub-Saharan Africa put more of the energy supply at risk. Militants in the Niger Delta region carry out attacks against energy infrastructure. Similar militant uprisings continue to play out in Somalia, South Africa and Sudan as well. Currently it is reported that 96% of Africans earn less than $10 per day despite the wealth of natural resources. A slowing global economy will only increase tensions and renewed attacks will be played out across the globe as jobs, food sources and other goods will fail to reach a great majority of the emerging and frontier economies.

Bulgaria, the Czech Republic, Hungary, Latvia, Lithuania, Poland and Romania have already announced their intentions to revisit their obligations to adopt the euro. The UK and Denmark have explicit opt-out provisions from the common currency. Sweden, which lacks a formal opt-out provision, has simply refused to fulfill one of the requirements for membership. The euro was a noble experiment but it appears to have simply failed. They attained a common currency but not a common political philosophy.

If history is any guide – we are more likely than not to see the financial failure of Greece, and its exit from the EU, along with a one or two other unimportant members (Portugal & Spain come to mind), before the EU collapses entirely. Then there will be the re-establishment of European national currencies, followed by a round of tariffs to protect home-nation farmers and factories, followed by, stagnation of international trade – especially stuff made in the US. Higher deficits, trade restrictions, and turmoil will be the order of the day.

As we look across the globe, the collapse of the European economies is being laid at the feet of capitalism. What is being ignored or obfuscated is the crushing weight of social-insurance systems not only in Europe but in Japan and the U.S. as well. These programs were designed for different circumstances –rapid economic growth, rising populations and lower life expectancy. In order to address successful post-world War II fiscal consolidations, similar to what is faced now; OECD countries averaged $5-6 in spending cuts per dollar of tax increases. Currently there are far too many people collecting benefits while too few work and pay taxes. The tax rate required to fund social welfare programs depend on three factors: the ratio of recipients to taxpayers, the ratio of benefits to average wages and the economic growth rate (approximately productivity plus population growth). The more widespread and generous the government benefits are the higher the required tax rate that is required. As we have seen in France, there becomes a level of tax that becomes too burdensome for taxpayers. Capital then flees to areas where it is treated well.

The floundering economies in Europe have highlighted the failure and decline of socialism. Capital (human and financial) is fleeing several European countries. The view from the U.S is that it cannot happen here. That is a view that may be seriously misguided and may cause tremendous negative impact to investor capital. On many measures the U.S. is no better off than Greece, Spain or Ireland. The U.S. is saddled with an expanding level of public debt ($15.8 trillion), budget deficits, cowardly political officials and denial that the country has a population that is increasingly dependent on government benefits. The media remains in constant denial over the current administration's attack on capitalism and its inability to deal effectively with the financial crisis and the accompanying fallout. The phrase "we were handed the worst economy since the Great Depression…" has become tiresome and after 3 years of inept policies, laughable. The current economic policy amounts to: hostility to banking, revenge taxation and demands for more investment which is the current euphemism for re-allocating tax payer money to political allies. Not exactly the stuff enduring economic recoveries are made.

In 2008, the U.S., tired of war, elected an inexperienced young senator that promised to "fundamentally change" America. The electorate had no idea how true and perverse the tagline truly was. The press took the guided tour and never attempted to vet what a U.S. would look like with a president that had virtually no experience in anything but radical politics. Despite rhetoric to the contrary, President Obama has spent, regulated and froze the capitalist spirit that has driven the greatest economy in the world. Now facing an economy that remains, to be charitable, lackluster, President Obama is taking the tact to use the public coffer to buy votes while one group is targeted as a villain to the benefit of another. The Great Uniter has turned into the Great Antagonizer. Single issue regulations, laws, and policies by the current administration are pitting this country by race, gender, sexual preference, generation, citizenship and even government branches in ways never seen. Groups like Occupy Wall St backed by public unions are leading the rush to violence. The election will be dirty and furious. We are six months away and the tone has been set. President Obama's push to a government controlled economy has resulted in 49.1% of the U.S. households receiving government benefits, a persistently high unemployment rate and corporations that are unwilling to make an substantive move in the U.S. fearing what they perceive to be a government siege. Trillions in taxpayer funds has been spent and the call is for more to be spent. Free health care, free education and a bailout of the consumer, to be paid for by the wealthy all in the name of fairness, of course. Entitlements have now become synonymous with compassion and are now considered civil rights. President Obama has presented Congress with a "To Do List" which is essentially of photocopy of his failed spending plans he has floated for the last 3 years.

It may seem harsh and outlandish but anyone looking somewhat objectively at the economic performance in the U.S. as a result of current policies can rationally come to one of two conclusions: President Obama and his staff (mostly academics) are clueless on how capitalism and the economy works or they are deliberately trying to destroy the economy. In fact an argument can be made that both are correct. Before one automatically dismisses the two conclusions or begin to hurl of pejoratives let's examine some facts that weave the segments of the road map that depicts how chaos and violence may find its way to the U.S. economic shores.

First let's examine the crown jewel of the Obama administration- ObamaCare. As unemployment was screaming higher, banks' teetering on the verge of collapse and businesses closing the priority of a Democrat-controlled House, Senate and White House was a 2000+ page bill that put 16% of the U.S. economy under the auspices of yet to be created government bureaucracies. The villain of course in this instance was the greedy health care insurance companies in the private sector. Based on the promises of lower premiums, better care, lower debt and unchanged service the bill passed along party lines forcing everyone to join or pay some fee to the bureaucracy. Businesses fearing untold regulatory nightmares and higher costs resorted to dropping their current plans. Despite the protests that this was not a further step toward socialism or government-controlled industry, the constitutionality of the backbone of the bill was challenged by over 20 states who saw a tidal wave of budgetary red ink and an infringement of freedom from the this legislation. The suit has reached the Supreme Court and arguments were held earlier this spring. A decision is expected this June. The administration followed a strategy it had previously employed and attempt to bully the court by incorrectly stating that to declare the law unconstitutional was unprecedented. Remember, this is from someone who the media viewed a constitutional scholar. The other main argument pressed by those in favor of ObamaCare was more incredulous than wrong. If the court decided 5-4 against the law, it was politically motivated activist judicial action. However a 5-4 vote for the law was right and just. How does that work? In the end time, money and political capital was wasted during a time of financial distress. Businesses held cash, did not hire and many made the decision to drop their current plan in favor of paying the much smaller fee. Concurrently doctors stopped accepting new Medicare patients and insurance premiums rose sharply.

After quickly creating havoc in the health care sector, Washington put the energy industry in its crosshairs. True to his campaign pledge, President Obama through the EPA regulatory process, enacted new regulations that not only cut jobs but forced up energy prices to a consumer being crushed by higher prices with a lower income, if they were lucky enough to still have an income. It also enacted regulation that will effectively kill the coal industry. All of which was being done for "clean air" while punishing the villainous job creators in the coal, gas, oil and utility industries.

Other efforts for a "greener" economy saw the government handing out tax dollars like candy on Halloween to companies promising alternate energy schemes. One by one they are marching into bankruptcy with the taxpayer again being stiffed. As it turns out most of the dollars were handed out to contributors of President Obama's 2008 election run. The examples of the government's failure to successfully pick winners and losers are gaining legendary status. Without a hint of shame, President Obama tries to paint the presumed Republican nominee Romney as an out of touch robber baron who made millions throwing hard working folks out of jobs while he hands out dollars to failing ventures. Bain Capital vs. Solyndra is not an image that will help President Obama's cause. It does give us a solid hint of the lack of understanding of the administration as to how capitalism works and another attempt at class warfare. One only needs to compare Bain's attempt to save companies (and jobs) with investor money with Obama's attempt to buy votes using tax payer money. Romney and their investors while not saving every company had noted success with others that grew creating economic prosperity along the way. President Obama has handed out hundreds of billions of taxpayer funds to political allies on ventures that have been shut, throwing workers into the street and leaving the taxpayer further in the hole. All done with the rhetoric of its unfair, you deserve your fair share regardless of what you do.

As President Obama's campaign moves from one special interest group theme to another. At the same time the floundering economy is being ignored except for the rhetorical tirades about "fairness" and the wealthy should pay more in taxes. Of course this is usually followed with more rhetoric that this is by no means any action tore-distribute wealth. Next up were student loans. No one will argue that education is critically important to our economy and that college educated folks are top earners. Additionally, no one can argue (reasonably at least) that our educational system is in desperate need of repair. Tuition costs over the past decade has risen 29% for private schools and 72% for public universities. (No greed charges at academia though.) The result for the rising cost puts the U.S. student in the teens and twenties for achievement in science and math. The response is always more money but never accountability. Students have flocked to colleges with the ability to receive low interest loans backed by the government. We now have a populace that has degrees in areas such as: Woman Studies, Black Studies (or pick your favorite special interest group Studies), Urban Education and Leadership, Peace & Conflict Studies, or Film Studies. Not to belittle those fields of study but how many graduates of those areas do we actually need and can one reasonably expect to earn a living and pay off those mountains of student loans? The finest educational system in the world puts out at an alarming pace students with an over-inflated sense of grievance and entitlement without any useful work skills. Median income for graduating students has dropped from $30,000 per annum (2006-07) to $27,000 (2009-2011) while their average student loan burden at graduation has risen to $23,287.

The habit of handing out taxpayer dollars is now the most durable fabric of political life. We have seen for decades our political leader's inability to deal directly with any problem. It has been referred to as "kick the can" down the road. The major difference we face today is that road is a dead end now full of mines and has the ability to blow up economy. Prime examples are Social Security and Medicare systems and the U.S. Postal Service. Social Security was created to build a safety net for elderly Americans to provide the necessities of life. Today Social Security provides 53% of the income for beneficiaries ages 64-66. In California (more on that fine mess later) if you look at retirees in the middle of the income distribution, a full 70% of their income is derived from Social Security. We now have a non-means tested retirement plan where folks now collect multiples of what they have contributed. In 1950 the ratio of workers-to-recipients was 16.5:1, in 2005 it was 3.3:1 and by 2025 it is estimated to be 2.3:1. Social Security trust funds will see deficits beginning in 2021. The burden of large numbers of baby boomers retiring, longevity of recipients, a poor economy and the holiday of payroll taxes since 2011 will crush the system. Current beneficiaries do not want politicians to touch it while future recipients are beginning to realize that their tax rate will skyrocket to support the bloat and concurrently will see this system unavailable to them. It will pit one generation against another. The disability fund will run dry by 2016 and Medicare is also on life support. Despite seeing the decay caused by these expensive entitlements in Europe, the political class remains unmoved by anything but their next election.

The U.S. Post Office is the poster child for archetypical political patronage. It cannot compete with modern technology of email or with companies like FedEx and UPS and yet Congress will not let it die. The USPS is essentially insolvent. This fiscal year it will lose $12 billion on $60 billion in revenues. There are tens of thousands of unionized postal workers being paid not to work. They are paid generously with lavish fringe benefits. With political interference implementing clumsy regulation they support a half a million workers at the expense of the customers.

The propensity to meddle in business and buy votes is not limited to the federal government. Several states are approaching a fiscal cliff for the very same reasons. If one wants to get a real preview of what may happen here in the U.S. take a hard look at California. The Golden State accounts for 13% of U.S. GDP. Now due to its entitlement mentality is facing serious budget deficits and there is no real effort to cut and reform the system. The deficits are the result of 1990 laws passed (some retroactively) that gifted budget surpluses to union workers with higher wages and free health care for life. A 1999 law knocked 5 years off the retirement age. Most workers could then retire at 50 or 55 years of age with half their pay. For a comparison it was calculated that a worker in the private sector to retire with a similar monetary payment would need to start putting away half of their salary at the age of 25. Governor Brown had forecast a deficit of $9.2 billion which in reality has turned to $16 billion. The response is the patented "raise taxes on the wealthy" in a tax system that is already one of the highest. Governor Brown wants a quarter-cent increase in the state sales tax for four years and a seven hike of 1-3 percentage points on those earning more than $250,000. It ignores the reality that the pension plan has a shortfall of nearly a half a trillion dollars. Teen unemployment in California (See Table I.) is the highest at 36.2%.

Table I. State Teen Unemployment Rates

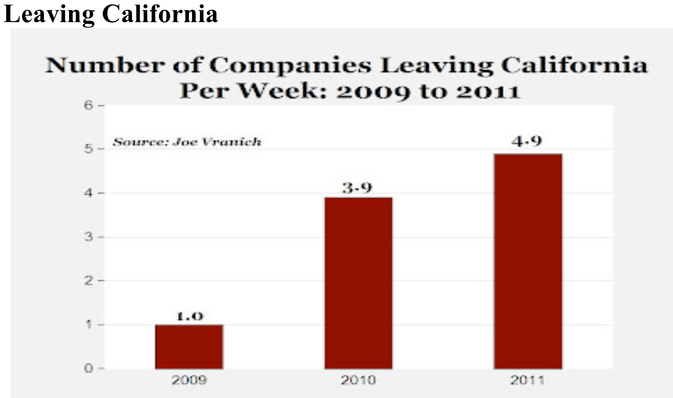
California	**36.20%**	**Nevada**	**28.85%**
S. Carolina	**31.20%**	**Idaho**	**28.40%**
Rhode Island	**29.80%**	**N. Carolina**	**28.20%**
Washington	**29.00%**	**Missouri**	**27.70%**
Arizona	**29.00%**	**Louisiana**	**27.60%**

Source: BLS

Needless to say this new tax scheme has not set well with businesses. Since 2009 the number of companies leaving California has increased (Chart I.) from one per week to nearly 5 per week in 2011. It is now estimated that figure to be closer to 10 per week. Apple is shifting substantial functions to a new facility in Texas. Another shining example of politicians ignoring the rule that capital will flow to where it is well treated. California is not alone n this budget trap. Illinois has $83 billion in unfunded pensions. To illustrate how this problem has been ignored, the level of unfunded pensions has doubled since 2003 and is up 315% since 1995. The reality is the liabilities are probably much higher but through the wonders of creative accounting the pension funds continue to use an investment return assumption of 7-8% which reduces the funding needed. It should be noted that as of the end of May the 10 year return for the Barclay Capital index was 5.72% and for the S&P 500 was 4.14%.

Budget deficits in other states are the result of primarily shortfalls in public union pensions. Once again the politicians have largely folded to the threats of public unions with the notable exceptions of Governors Christie in New Jersey and Walker in Wisconsin. Walker for his part is the victim of a punitive recall process that has been spearheaded and funded by the public unions. Wages and benefits of public union now exceed those earned in the private sector. These excesses are also prevalent at the city and local levels. Cities like San Jose and San Diego pays nearly 25% of its annual budget for retiree benefits.

Chart I. Companies Leaving California



These uncontrolled costs are passed onto a strapped consumer who is struggling to make ends meet. Politicians try to paint a sympathetic picture of those that are recipients of the government largesse. When the question of out of control spending arises the response is that it is for our police, fire and teachers. The recipients go well beyond those and ignore exactly what a proper salary, benefit and pension package should look like. Nor is the competency or achievements of teachers ever questioned or reflected in those tax dollars spent. The public is becoming increasingly annoyed that while they suffer, why that suffering is not shred by the public sector. Slowly we are seeing more voices heard on these issues and more government workers are seen as less vital and are going through a similar although still much smaller contraction than the private has seen. Rest assured, as demonstrated in Wisconsin, these public unions with the full support of the White House and Democratic Party will not go quietly.

The federal, state and local governments offer but one solution- - more spending with more taxes in what they view as a balanced approach. They site the need to spend more money on failed programs while taxing the rich. Spending has been confused with compassion. Democrats are trying the same card trick foisted on President Reagan, higher taxes now and spending cuts later. Spending cuts do not happen. There is always a need to re-distribute wealth in the minds of some. The Democrats have even sunk to a new low as training manuals have been distributed to the House Democratic Caucus on how to frame any budget cuts or reference to free-markets as an act of racism. In a nation already on the edge as unemployment for minorities is extremely high, the circus of race baiting over Trayvon Martin, rise in race based attacks across the country we have an irresponsible party helping to incite more violence for the sake of power.

As the economy remains weak and the election becomes more heated (and it will) the rhetoric of hate pitting one group against another will increase. It is becoming more apparent to voters that for 3 years President Obama's government controls of the economy have failed miserably while putting the U.S. financial structure on the verge of collapse as debt has ballooned out of control. President Obama's rhetoric will get more strident and negatively charged and he will have but one hope—buy voters.

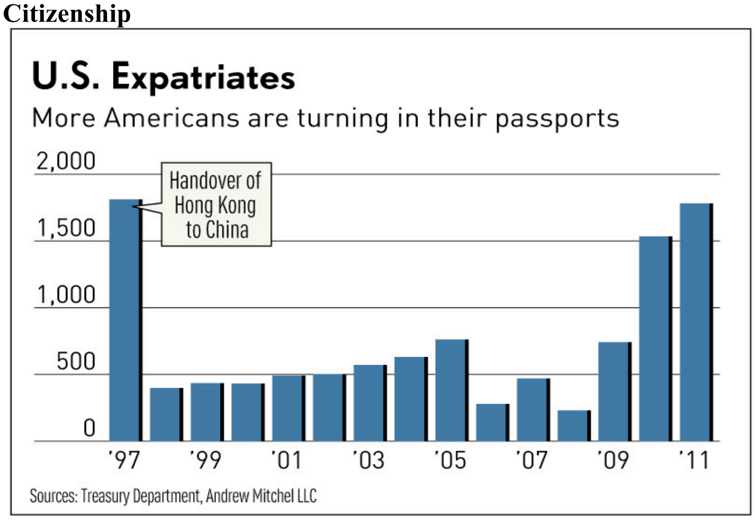
President Obama has already laid out how folks can go through life with his "The Life of Julia" sketch on his campaign website. This is a cradle to grave description on how the government will tend to every need of Julia. Remember one gets chastised for referring to the President as a socialist despite every policy points to no understanding of capitalism and only government control of lives. The most shocking part is not the free health care or having a baby without marrying that Julia experiences but the allusion that throughout Julia's life there is only one President-Obama. Freud would have a field day.

The tax the wealthy meme is a global theme. One of the usual suspects in calling for more taxes is the UN. We are not disappointed. The UN Human Rights Advocates has been urging the G8 to take up the "Robin Hood tax" on wealthy nations to offset the costs of enduring economic, financial, fuel, food and climate crises and to protect basic human rights. Or to be more precise, enact a global mechanism to re-distribute wealth. This is a tax on every financial transaction. Many of the top proponents are EU members. What better way to socialize the Euro debt? There is not a more corrupt political entity than the UN. Let us not lose sight those organizations such as the UN and the IMF (International

Monetary Fund) fight vociferously for diplomatic immunity and tax free income for its employees while volunteering others to pay more in taxes.

As we mentioned above the flow of companies and capital out of California is being executed at other levels as well. Individuals fearing punitive tax rates and loss of freedom are turning in passports and renouncing U.S. citizenship. This is being met with anger by politicians who firmly believe they have a call on everyone's capital. As seen in Chart II., a small but growing number of Americans are renouncing citizenship.

Chart II. Ending Citizenship



The Treasury Department reported 1,781 American citizens renounced in 2011, up from 1,534 in 2010 and 742 in 2009. There were 461 more in first quarter alone. By comparison, the annual average from 1998-2007 was 497. The trend globally is undeniable. The wealthy can and are leaving their country of citizenry as they fear they will be the scapegoats and suffer punitive assaults on their wealth as their fellow countryman accustomed to a life of entitlement will demand politicians continue to accommodate the life they have become accustomed. The politicians in all probability will acquiesce. Law, politics, legislation and regulatory bodies exist to seek approval, poll numbers and re-election. They create subsidies, guarantees and tax credits leading to higher costs not jobs and personal responsibility.

By now many have concluded that we have lost every ounce of sense. Others wonder how this will lead to violence while others remain in denial that it can't happen here. Circumstances and evidence to the contrary have us believing otherwise. This is not a "we hate Obama" tirade or do we favor one party over the other. The Republicans are not blameless. Both political parties have failed and the system is close to a point where investors are in serious danger of suffering real capital impingement. The blame extends to all levels of government.

What is needed is an overhaul of the tax code flattening the rates and removing many deductions. The tax code should be used to provide revenue for needed government services and not to manipulate behavior. Medicare and Social Security must be reformed and be returned to its original intent. Additionally, overreaching legislation by regulation should be stopped to renew job and economic growth. Concurrently banks should once again return to the days when they were depository and lending institutions and not leveraged profit centers with tax payer dollars. The question then can our elected officials put the interest of the citizens ahead of their own selfish power hungry interests? Eventually the focus will slip from Europe to the U.S. and the investor may realize the emperor has no clothes if these issues are not addressed.

The question is how best to protect one's investment in the event that the U.S. does deteriorate into fiscal and political chaos? It is rock solid certain that the election will pit one group against another with the ultimate villain being capitalism and the wealthy. We have seen that violence as demonstrated by unions and OWS types will escalate as the economy falters. The convention this summer will be reminiscent of the 1968 Democratic convention in Chicago (How about that for irony?). It will be expected that a pound of flesh will be taken from the wealthy. The reality that only 3% of all taxpayers earn more than $250,000 according to IRS tax filing data and it is a mathematical certainty that the profligate patterns of spending must be addressed. It will be neither pretty nor easy.

As investors you will undoubtedly receive two types of advice from your traditional wealth manager: 1) This is an excellent buying opportunity or 2) Stay the course. This may translate into poor returns ands negative hits to capital. Globally public equities will trade in tandem downward while government bonds will provide you a negative real return out through 10 years. It is wise to remember that this type of advice is based on the belief that many wealth manager's job is to grow assets—theirs not necessarily yours. A recent survey by a financial magazine listed current and historical assets for stock and bonds. There was little difference between the high, low and current allocation. The theme being repeated from the Wall St. strategist is they believe that in the long term (undefined) the market is a mean reverting system. U.S. stocks are trading at 13 times earnings and the historical average is 16 times. Corporate profit margins are near all-time highs. If the market was truly mean reverting, at the trough the markets would have hit their historically low P/E ratios and profit margins will fall. By applying all of the logic of mean reversion, U.S. and European stocks at a trough would trade at 7-8 times earnings. Russian stocks during their financial crisis in 1998 traded at 2.5 times. We hear about what investors miss on the upside if they are not in the market but the one chart that is rarely, if ever shown is the one below which shows the returns needed after a loss to regain pre-loss levels of capital. Advisors rely more on markets going up than in protecting in a down market. This can be a fatal error to one's capital.

Chart III. Returns Required to Regain Losses

Loss %	**(10)**	**(20)**	**(30)**	**(40)**	**(50)**	**(60)**	**(70)**	**(80)**	**(90)**
Return Req. %	**11**	**25**	**43**	**67**	**100**	**150**	**233**	**400**	**900**

Source: Crestmont Research

In previous research we discussed three vital investment themes food, gold and energy. They will be important investments. The final leg for a strong investment environment is an orderly market. The struggle between entitlements and capitalism is headed to an angry confrontation. Over the past month we have seen the negative affects from the struggles in Europe. By comparison the U.S. looks to be a safe haven for investors. Currently this is mostly an illusion helped by the diversion Europe has help create. It is highly probable that without bi-partisan government action here in the U.S., a similar fate for investors lies ahead. If the civil unrest develops here in the U.S. as a result of the unresolved issues we have outlined, a further 20-25% drop in equities is possible. However if we do see positive movement to address these issues, some upside will be missed. There are better risk: return options available to navigate this volatile time. Given the overall atmosphere this may be a small price for capital protection. Capital preservation is the most important factor for investors in this uncertain world. We are entering a period where an investor's level of security is flashing "Put the Hemet On!"

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