Reallocation of Wealth in America

– or –

"How to Survive so your Net Worth can Thrive!"

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Important Note: As you read this article, realize that there is an incredible opportunity developing in the next few years for those who follow this advice to greatly increase their net worth. This is not about making a personal decision where you simply weigh the probability of this scenario developing in the US and then consider whether or not to act. These outcomes present overwhelming consequences regarding your entire net worth. Aside from the opportunity that is developing, the other great news is that the solution prescribed in this article will serve you well should this scenario develop in the next year or be delayed for a decade or more. We will provide a clear formula to enable you to answer "Yes" to the following questions, "Am I protected – is my family protected?" – *and* – "Will we be in a position to capitalize on opportunities in the future?"

In this article we will describe scenarios that are currently developing in our economy and the consequences of those scenarios as they apply to us and our financial security. We will also describe the solution regarding how to protect yourself and your family from potential negative outcomes and also be in a position to capitalize on the incredible opportunity that we see developing in the next few years. Most readers are well aware of the economic challenges we face and yet few have a solution in place that provides them the peace and comfort to live their lives with the security and protection from whatever may develop down the road. We have a solution or prescription that is a "Strategy for All Seasons".

For those who have studied long-term generational cycles, there is no question that we are in the fourth phase of the current long-term cycle. While some do not like to consider it, we are currently in the same phase as the 30's to '40's period of the last long term cycle. 3,000 years ago, King Solomon said history does repeat itself and that everything is cyclical. History has repeatedly proven that ever since. Lessons from history and long-term cycles provide a firm foundation on which we can build sound plans for the future. While the present does not repeat history exactly and the timing can and does vary, we can and we should expect the future to unfold in similar cycles or patterns we have seen in history. Let's first look back at the same phase of the last cycle - it is interesting and important to compare that period with the present.

Let's begin in the late 20's, following a period of tremendous growth of the US economy and the usual build-up of debt and greed that always accompanies the "good times". At that time, US total debt had grown to seriously high levels. During the initial years of that period, a serious deflationary period ensued as the stock market fell, real estate prices fell, banks were in trouble, America's output fell and unemployment rose – these were tough times for many families. Does this sound familiar? Recently we have begun to see many of the same problems that occurred at that time including excessive amounts of debt, rising unemployment, falling real estate prices, deflation - much like what was experienced then. It is not only interesting to note but also meaningful to realize that only the initial years of that period were deflationary - later the balance of that period was mostly inflationary. What was the major cause of that change from a deflationary to an inflationary period? The answer lies in the understanding of what took place with the $US dollar in 1933. We have all heard of the people who survived or even thrived during that period because they "put money in their mattress" and later were able to invest that money and buy assets at "pennies on the dollar". Until 1933, the US dollar was directly backed by gold. The government couldn't simply issue more and more currency whenever they chose. It wasn't until President Roosevelt stopped the connection between gold and the $US dollar and started printing money to support programs like the Works Progress Administration (WPA) & the Civilian Conservation Corps (CCC) that inflation replaced deflation during that period. It is amazing to realize that up until that time, those who "put money in their mattresses" were actually "putting gold in their mattresses" because the dollar had been backed by gold.

Today, gold is still totally separate from the US dollar – in fact, no country has a currency that is directly backed by gold. During the period preceding 1933, the gold-to-dollar linkage presented limitations which prevented a massive expansion in the money supply. That was totally different from what we have witnessed in the past few years with the U.S. and also European governments actions referred to as "Quantitative Easing"- efforts designed to stimulate the economy and bail-out the financial institutions following the collapse in the real estate, mortgage markets, the Euro, etc. over the past several years. On two recent occasions, we saw the Federal Reserve create roughly $3 Trillion dollars and later the European authorities created roughly $1 Trillion Euros. Since very little of that "created money" was ever loaned out to the general public or corporations, we have not witnessed significant inflation. Rather most analysts and economists are focused on concerns about deepening levels of deflation in the coming years. The real catalyst for the crisis in both the US and also in Europe was the downturn in the residential real estate market and later the downturn in overall economic activity – that remains the most likely catalyst for the next crisis as well.

With over 20 million vacant homes currently in the US and bank foreclosure efforts almost 2 years behind, there is a very high probability we are going to experience another significant downturn in real estate in the very near future – this time in both residential and commercial real estate markets. This would begin a simple and familiar "domino effect". The response from the Fed and the US Government to another downturn in real estate would naturally be another "Quantitative Easing" effort. Even though throughout history stimulus efforts have never truly worked (as in solving the problems of an economy), we know that this is the only response governments have. This response has been seen in the US and Great Britain as well as the most recent Eurozone efforts to support the Euro. Japan's government has launched stimulus efforts seven times in the last 21 years yet they are still mired down in an economy with sluggish performance and too much debt. Real estate values in Japan are now roughly 15 to 20 % of the levels seen 21 years ago.

The effects of "Stimulus Efforts" are very predictable as they result in one of two outcomes – either:

- The effort "buys time" and people are convinced that the worst is over causing consumers to regain confidence and continue or resume their spending; – or –
- The effort "fails to instill confidence" and people lose faith in the recovery of their economy and subsequently their currency and its value.

The latter outcome can instantly lead to extremely high levels of inflation – actually referred to as "hyperinflation" since the only thing "backing the US dollar nowadays is confidence" (remember the gold linkage or "backing" was severed back in the early '30's…)

It is much more acceptable to consider mild projections of deflation or inflation – we all can relate to those environments and those ideas don't threaten our feelings of security. Another very concerning aspect to the potential "hyperinflation" outcome is that we also learn from history that hyperinflation is the worst thing that can happen to a country financially. Effectively this means the currency would lose its integrity and purchasing power. We've seen instances of hyperinflation throughout history although nothing like this has ever happened in the US. For many reasons, people do not want to even consider that we could witness hyperinflation. There is an "it can't happen here" mentality.

Obviously, the banking industry, Wall Street and our government will continue to promote the belief that our system and our currency are stable and fully worthy of our trust and confidence. The fact is that the only thing backing the $US dollar is confidence. Also, the only thing backing any bank in the United States is confidence. So what should we learn from this realization? History tells us that we should expect and anticipate and plan for outcomes similar to what were experienced in the past.

In the late 20's when the stock market crashed, the next year there was a recovery and everyone was told the crisis was over. "Everything is fine and the worst is over" was the message from Washington and Wall Street. Then there was another, even greater downturn. (*Sound familiar? Today it is called a "V-shaped" recovery!*) Another important lesson, even with the 2nd downturn in the stock market that occurred between 1931 & 1933, although stocks lost almost 90% of their value, for the most part bonds still didn't fail. Bonds didn't fail until 1934. That was five years after the stock market crash. (*Now the question occurs – what if history <u>actually</u> does repeat?*)

It is also important to mention "timing". Will the timing be the same? Absolutely not! We absolutely know that things can happen that either accelerate or delay the onset of the conditions indicated by history. While timing and severity are definitely in question, conditions that we should expect are inevitable. When you study history and see the repeating patterns, you wonder why people always predict it will not be the same – it is obviously more comfortable to believe "It will be different this time". In the case of Vista specifically, everything else we have said based on history has been accurate. Why wouldn't this be accurate as well? Why would history not repeat? Those are more valid questions.

Interesting that while King Solomon noted that history does repeat itself, he also noted that we will never know the exact timing. History should be our primary source of expectation for the future. Winston Churchill once said, "The farther backward you look, the farther forward you are likely to see." It is baffling to many that history is such a great teacher and yet Wall Street seldom looks back more than 10 to 15 years when making their predictions – virtually never over 80 years. The answer as to why people (and Wall Street) seldom actually consult and weigh history is explained in the term, "Generational Conceit". People have, throughout the ages; always believed that because of their technological advances, they are more sophisticated than past generations. This leads them to dismiss history as they consider themselves to be immune from the mistakes and cycles of the past. Oddly, that in itself is history repeating itself – people dismiss history for the same reasons throughout history. Every generation, every civilization has always said they are so much more advanced and therefore history doesn't apply to them. Even that is cyclical!

Vista's history and long term generational cycle research concludes that, we are now facing a major crossroad in the US economy. We also firmly believe that conditions are many times worse than they would have been had Fed actions taken in 2003 and again in 2008 not occurred. Remember that we saw a significant downturn in the US economy and markets in 2000 through 2002 – our Debt to GNP ratio was approaching historic levels at that time. That was our first "bail-out" – when Alan Greenspan convinced Japan and China to fund a period of low interest free credit to virtually anyone in the US that desired to borrow. Wall Street quickly capitalized on that stimulus effort with mortgage products, etc. and the real estate bubble resulted. We now know the first chapter in this story. What should we expect from here?

Based on our research, we expect the next 12 to 15 years to be a very challenging and mostly negative economic period. More specifically, let's examine what we anticipate will be the next "domino effect" in our economy. We expect, as mentioned earlier, that we will soon see a combined downturn in residential and commercial real estate prices which will lead to another stimulus plan which will either lead to "buying more time" for the current administration (*not as likely this time around*) or that this effort will badly damage the US dollar and the value of "cash equivalent investments". Put simply, we expect that Bonds will fail, CD's will fail and Treasuries will fail – all as a result of the loss of confidence and purchasing power of the US dollar. It should be mentioned that *<u>IF</u>* the Fed efforts do "buy more time", the same outcome will occur later and in an even more powerful and rapid manner. **This is simply because the core problem of our economy is too much debt and that problem cannot be solved by**

adding more debt! Every stimulus effort (or "Quantitative Easing") compounds the core problem we face.

Now we begin to see the great opportunity develop – read on…

So does that mean the dollar will become a currency that no one will take? Not likely. People and businesses will just demand many more dollars for any real property such as cars, houses or food. This is even more likely for the near future because the US dollar is still the world reserve currency. Even though this is the case, the world is losing respect for the dollar as well as losing their tolerance for our government and their constant use of the printing press. A rating agency in China even recently downgraded the US dollar and Treasuries. At some point, we will not be able to "print our way out of the next crisis".

Taking a closer look at a very likely scenario, what would happen if we see another significant real estate decline? This would have far reaching effects since much of our economy and employment is directly or indirectly related to the real estate business – plus the vast majority of the collateral behind the loans made by US banks is real estate related. That is why the last real estate crisis (*which we predicted accurately back in 2005 based on history & cycle research*) led to a major banking crisis. So, with the 20 million vacant homes, 11 million homeowners owing more on their mortgages than their houses are worth, banks behind on foreclosures and record & rising vacancy rates for commercial real estate properties, it seems that another downturn is inevitable. Most are not aware that the FDIC has even instituted a policy called "Extend and Pretend" allowing banks to ignore their non-performing commercial real estate loans – specifically allowing banks to avoid placing certain types of loans on the non-performing side of the ledger. So, what would happen if we get another downturn in Real Estate? Initially, another bank bail-out. What else – what if that did not work or instill confidence? Could we possibly see a period where banks are closed like we saw during the early days of the FDR administration? The concern at that time was freezing the money that was held in those banks. Remember the key difference? That money was backed by gold. What is your money in your bank currently backed by? Answer: "Confidence". Can a family of four survive on confidence? Can you run your business; buy your necessary supplies; pay your employees with confidence? Obviously not… How quickly can confidence change or be lost? That is how rapidly we could experience the onset of hyperinflation.

"Opportunities are greatest when the blood is running in the streets." Warren Buffett While this scenario may not be appealing to envision, if your investment strategy includes investments that maintain your "real purchasing power", you too could experience the tremendous opportunity to buy prime assets at "pennies on the dollar". The same opportunity people experienced in the mid '30's in America…

So you have to weigh all of this when considering the current and potential future value of a dollar bill? This also directly applies to the potential future value of your CD's, Bonds and Treasury holdings. Bear in mind that a bond is a promissory note indicating that you are owed a certain number of dollars – which themselves are also promissory notes. So, what could reasonably happen if real estate goes down again? Short answer: You will lose the majority of value in your bank deposits, CD's, and bonds. Why? Again, because another bail-out would be required which means printing trillions and trillions of dollars again. Fed Chairman Ben Bernanke is a full advocate of printing money to address the risk of deflation – this is based on his analysis of the history of The Great Depression.

If we could possibly experience hyperinflation, then we had best have a survival plan. **As is always the case with crisis events, once they begin, there will be no time to prepare.** It could happen instantly and there would be an immediate loss of value to the $US. The initial loss of value may only be 20% or 30% but there is no doubt that the government and Wall Street as well as the media will be telling you this is only temporary and they now have a plan and that everything is under control. Realize full well that if the general public loses confidence in the value of the US dollar, hyperinflation is a self-fulfilling prophecy!

So what does this mean? Cash, Bonds and CD's will most likely be the worst possible investments you can have some time in the next 1 to 3 years based on history and cycles. What are we telling you and why did we publish this article? Our intent is to clearly offer a solution and protection from this likely scenario. **Your portfolio must contain investments that will perform well in this potential scenario – investments including Foreign Currencies, Foreign Bonds, Precious Metals, Natural Resources and ironically, Real Estate**. These are the only investments other than basic necessities like food which will preserve your "real purchasing power" during this period of economic crisis. Do you currently own these asset categories in sufficient quantity?

How do you maintain your purchasing power? The answer is very straightforward. *Before we go any further on this subject, it is important to state that we are not talking about a restructuring of any Vista clients' current portfolio – those investments are already positioned in all Vista portfolios.* We already witnessed how our diversification model performed in crisis periods like 2000 thru 2002 or during the market crash of 2008 – we outperformed all other major strategies. Current Vista clients ask how our Catalyst Groups would fair in a hyperinflation scenario – our overall expectation is this:

- Foreign Currencies and Foreign Bonds will be mixed
  - Asian currencies will fair much better than the Euro because Europe and the US are on the same long term cycle (*that is why we underweight Europe*)
- Fixed Income will be decimated as will the value of Money Market Funds and CD's;
- International Equities will be mixed
  - As with currencies, we expect the growth areas such as Asia to generally outperform
- US Equities will suffer significant losses initially
  - then certain strong corporations will slowly recover as investors realize the tangible values in those companies
- Natural Resources will initially decline in value due to decreased demand but will maintain net worth as they are real assets
  - Production of natural resources such as oil, natural gas, coal, timber, etc. will be purchased at prices that are "inflation-adjusted"
    - As currency loses value, it will take increasing numbers of dollars to purchase a barrel of oil, a ton of coal or a truckload of timber
    - This will be an incredibly important feature of natural resources production that few people will realize in advance
- **Precious Metals will be critical and irreplaceable during that period and most likely outperform all other asset classes**
- Real Estate is a real asset and would most likely go up in value
  - This, too, happened during the 30's
    - Real Estate values went down for 3 years during the deflationary period and then went back up in value during the inflationary period.
    - Unfortunately there is no comparison to the kind of inflation we are anticipating when we look at the brief history of the US.

This is true hyperinflation that we are speaking of – if you are not diversified <u>before</u> it happens, hyperinflation that could eliminate your net worth in the blink of an eye. If you truly diversify, however, you will maintain your purchasing power and you will witness the best buying opportunities of your lifetime!

Considering this potential scenario – one that is quite likely – it eliminates conventional investment approaches as wise choices. In the massive market decline of late 2007 through early 2009 when the S&P 500 lost over 54%, where did everyone stash their money when they sold their investments? Investors "went to cash" in some form or fashion. People still today consider CD's to be completely safe investments and the US dollar to be totally safe as well. Why? Because they always have been safe – at least as far as people can remember. This is what is referred to as "*Linear Thinking*" – believing things will continue as they have been. History teaches us the opposite – everything is cyclical. The US dollar and CD's will not always be safe – they are also cyclical. Trillions of net worth are currently in bank deposits, money market funds and bonds – what would happen if that value was suddenly lost? What would your relative net worth be if you maintained your net worth when that happened?

People believe that the future will continue just like the past. It is difficult for people to grasp that Linear Thinking is wrong and that everything is cyclical. They naturally think the US dollar will continue to be strong because in their mind, it always has been. History proves this will not continue indefinitely. It is amazing to realize that virtually all financial decisions people make are based on Linear Thinking. The entire net worth of almost all investors is exposed to this faulty reasoning. Those who have based their decisions and portfolios on recent research and Linear Thinking will likely lose all of their net worth in the next 1-3 years. Investors must understand that because we are in the fourth phase of the long-term cycle, the last 50 years in no way resembles what will occur in the next 10-15 years. Oddly, in the near future, experience will be your worst teacher – not your best. The only experience that would matter will be the last few years since the fourth phase began.

Even though the last few years have been completely different than we have seen in the previous 50 years, people are still holding on to their Linear Thinking. Seasons of history are very much like seasons of nature. It gets very cold in the winter. If you prepared for Winter just as you had for Summer and Fall, you would freeze (or wish you had frozen). Seasons are different and demand different preparation and approaches. We fully understand seasonal cycles because we have lived through many. Unfortunately, the cycles of history are 80 to 100 years in length – we recently entered the first "Winter" of our lifetimes. We aren't anticipating the next "seasonal change" to occur for another 10-15 years.

If you look at human nature and the history of the market, it is similar to the life cycle. You begin with a planting period, continue with the growing period and move to the harvesting period. Right now there is an illusion that we are in a harvesting period and that period is going to continue. This is not the time for searching for growth opportunities in the market. Greed is our worst enemy right now - the harvesting period is over. As we have told people in the past, in the fourth phase or "Winter", you increase your net worth by others losing theirs. Net worth is – and always has been - relative. The ultimate objective is to maintain your "real net worth" – in other words, own investments that will survive any form and level of inflation. During the early deflationary period of the 30's, one of the Vanderbilt families built an oceanfront mansion for $10 Million dollars – a few years later it was sold for $100,000. In the inflationary period that followed, the value rose significantly again. In a hyperinflationary environment that may develop in the current US environment, a million dollars that could buy a huge home today may only be able to buy a week's worth of groceries. With proper and wise diversification, this risk is totally avoidable.

You must prepare for this now. You must create an action plan for yourself and your loved ones to survive for the next 10-15 years under the scenarios we are anticipating. There are ways to be protected.

We can prescribe the wise action and investment plan - you must be willing to listen and you must be open-minded enough to accept that this could actually happen. This is not a hurricane that you will be able to follow the course and prepare for at the last minute. You should not procrastinate. This will be the equivalent of a category 10 earthquake. There will be no warning. Very few will be prepared - but you can be.

We realize this is a lot to absorb and a lot to face. We look forward to discussing this further with you in the very near future. Creating your unique action plan will be the most important step you could possibly take to preserve your net worth and that of your loved ones. The reallocation of wealth in America is going to take place. Which side of that reallocation will you be on? Will you be the one to “survive and thrive”?

Our future will likely take one of the two paths described in this article. Regardless of which path we ultimately take, the broad diversification we design into all client portfolios will serve you well. As stated earlier in this article, our strategy is truly a “Strategy for all Seasons”. Our real mission at Vista Financial Advisors – and it is actually a “mission” – is to design and manage a portfolio for client families that will protect them from any economic scenario they may face. In this case, with the expected scenario as we have described it, the additional goal is to prepare them to be able to capitalize on the opportunity we clearly see and expect within the next few years. These are exciting times – they will be great times for those who are prepared and can capitalize.

If the contents of this article concern you enough to take action now, please feel free to call (904) 880-8010 to discuss the necessary steps that you can take to diversify your wealth and create your own personal “Strategy for All Seasons”. Do not delay.

If you have any additional questions or thoughts relating to this article, do not hesitate to contact us at any time.

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