

HEADWATER INVESTMENT CONSULTING, INC.

Registered Investment Advisor

Review of 8th Annual Strategic Investment Conference

*La Jolla, California
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By Scott Chambers, Ph.D.

I recently attended the 8th Annual Strategic Investment Conference organized by John Mauldin, a frequent media commentator and financial author. The two day event focused on the current investment environment and included presentations by several well-known economic commentators as well as several hedge fund managers. Overall, the speakers acknowledged that both the U.S. and world economies face many headwinds. Their individual outlooks ranged from extremely bearish to modestly optimistic. Below are a few key thoughts and insights I gained from the event.

Bear Market Outlook

Of the speakers with a bear market outlook, Gary Shilling, the author of *The Age of Deleveraging: Investment Strategies for a Decade of Slow Growth and Deflation¹*, had the most negative perspective of market recovery. His basic thesis declares that the process of households, governments, and firms reducing debt will create a drag on economic activity for as long as a decade. Throughout this process, Shilling predicts that unemployment will remain high and interest rates will remain at their current low rates.

David Rosenberg, Chief Economist and Strategist at Gluskin Sheff, was slightly less bearish, but his presentation also argued for a slow-growth, non-inflationary environment. He asserted that the recent rise in commodity prices was a phenomenon mostly related to world political tension, particularly in the Middle East, and not the start of a broad inflationary trend.

Both Shilling and Rosenberg argued that the U.S. will avoid broad-based inflation because labor costs are the primary driver of long-term price increases and unemployment is still the major problem. Specifically, the domestic economy is in its second year of recovery and unemployment has only marginally improved. At the same time, real wages have shown no significant gains for the past several years.

Inflationary Market Outlook

Marc Faber, a frequent member of the Barron's Roundtable, provided an opposite outlook. He postulated that in the near future the current inflationary environment in the emerging economies will spill over to the developed markets and result in a long period of worldwide inflation. His pessimistic outlook included the

speculation of continued currency debasement and several sovereign debt defaults. He stressed investment in real assets and emerging economies.

John Paulson, a well known hedge fund manager, agreed with Faber. Paulson predicted increasing interest rates, which will push several European governments to undertake debt restructuring.

Cautiously Optimistic Market Outlook

The most positive view was provided by Martin Barnes, Managing Editor of The Bank Credit Analyst. Barnes explained that the switch from government stimulus to private business growth seems to be succeeding. He asserted that the risk of a double-dip recession was very low, and that interest rates and inflation will rise at a measured, modest pace. Although worldwide GDP growth will be somewhat muted going forward, Barnes expressed optimism that a stable recovery will continue.

John Mauldin, the conference organizer and co-author of the recent bestseller *Endgame: The End of the Debt Supercycle and How It Changes Everything* (Mauldin and Tepper. Hoboken, NJ: John Wiley, 2011), agreed that a self-sustaining recovery was underway in the U.S. economy. He reasoned this recovery was subdued because of large and continuing U.S. government deficits and U.S. total debt. Mauldin was optimistic that the economy will

continue to improve as long as Congress puts forward a credible plan to deal with the government's on-going overspending. However, he warned of dire consequences if the U.S. does not deal with its increasing deficits. Further, Mauldin emphasized that the lack of resolve to reduce these deficits could lead to worldwide financial disorder and cause another worldwide recession.

Summary

Overall, the event included a variety of thoughtful commentators, even though their messages were completely mixed. The views were particularly inconsistent as to the likelihood of either continued deflation or a renewed inflationary period. While I was hoping to get a clearer outlook, I did take comfort in the fact that Headwater Investments portfolios contain assets positioned to generate returns in either extended cycles of inflation or deflation.

Endnotes

¹ Shilling, A. Gary. *The Age of Deleveraging: Investment Strategies for a Decade of Slow Growth and Deflation*. Hoboken, NJ: John Wiley, 2011.

² Mauldin, John, and Jonathan Tepper. *Endgame: The End of the Debt Supercycle and How It Changes Everything*. Hoboken, NJ: John Wiley, 2011.

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