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The Age of Deleveraging: Investment Strategies for a Decade of Slow Growth and Deflation

A. Gary Shilling

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"You will be a better investor having read this book. . . I cannot recommend it (the book) strongly enough."
—Dennis Gartman, from the Foreword, The Gartman Letter

". . . brilliantly exposes the delusions of the bullish consensus . . . one of the sharpest thinkers on economic issues and their market implications. This is a must-read book for all."
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"Gary Shilling is rarer than a black swan; he's an economist who foresaw deflation. Shilling has predicted the ‘ impossible' several times in his career, so his colleagues should no longer be surprised when he turns out right."
—Robert R. Prechter Jr.,Author of Conquer the Crash

"Ignore Gary at the peril of your investment portfolio. Let him show you alternatives that will work in a world of deleveraging, deflation, and slower growth."
—John Mauldin, President, Millennium Wave Advisors

"The acid test of advice: those who followed Gary's not-always-popular advice during these turbulent times made money. This man is an original-and well worth listening to."
— Steve Forbes,President, CEO, and Editor-in-Chief, Forbes magazine

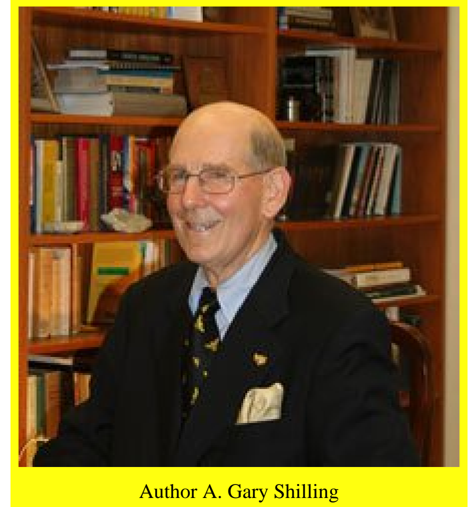
Top economist Gary Shilling shows you how to prosper in the slow-growing and deflationary times that lie ahead.

While many investors fear a rapid rise in inflation, author Gary Shilling, an award-winning economic forecaster, argues that the global economy is going through a long period of de-leveraging and weak growth, which makes deflation far more likely and a far greater threat to investors than inflation. Shilling explains in clear language and compelling logic why the U.S. and world economy will struggle for several more years and what investors can do to protect and grow their wealth in the difficult times ahead. The investment strategies that worked for last 25 years will not work in the next 10 years. Shilling advises readers to avoid broad exposure to stocks, real estate, and commodities and to focus on high-quality bonds, high-dividend stocks, and consumer staple and food stocks. .

- Written by one of today's best forecasters of economic trends-twice voted by Institutional Investor as Wall Street's top economist
- Clearly explains what to invest in, what to avoid, and how to cope with a deflationary, slow-growth economy
- Demonstrates how Shilling has been consistently right about major economic trends since he began forecasting in the early 1980s

Filled with in-depth insights and practical advice, this timely guide lays out a convincing case for why investors need to be prepared for a long period of weak growth and deflation-not inflation-and what you can do to prosper in the difficult times ahead.

Q&A with Author A. Gary Shilling


Author A. Gary Shilling

Your book is called *The Age of Deleveraging*. Could you explain what you mean by deleveraging and how it informs your long-term view of the economy?

Starting in the 1970s, financial institutions worldwide began to leverage their equity by heavy outside borrowing. U.S. consumers did the same, commencing in the early 1980s as they dropped their saving rate from 12% to 1% in 2005, slashed their down payments on houses and hyped their borrowing with credit cards, student and home equity loans. Now, embarrassment over the near-financial meltdown and newly-vigilant regulators are forcing the financial sector to delever.

Meanwhile, American consumers have no choice but to save more and repay debt. After earlier home equity withdrawals and the collapse in house prices, few have any equity left in their houses and a quarter of those with mortgages are under water. With the stock nosedives in 2000-2002 and 2007-2009, few individual investors trust their equity portfolios to finance their kids' educations and their own early retirements. The postwar babies desperately need to save for retirement, and many can. Many are in their peak earning 50s and their offspring's college tuition payments are completed. Also, continuing high unemployment is encouraging saving for contingencies.

The deleveraging of the global financial and U.S. consumer sectors as well as seven other forces detailed in my book portend slow global economic growth in the next decade.

You see deflation as more likely than inflation. What would you say to investors who are worried that so-called QE II will ignite inflation in the years ahead?

Deflation is looming because chronic slowing global economic growth will mute demand. At the same time, worldwide supply will surge due to spreading globalization and the flowering of productivity-soaked and cost-reducing technologies such as semiconductors, computers, the Internet, biotech and telecom.

Massive fiscal and monetary stimuli have done little to promote economic growth or deflect deflation. The $814 billion 2009 fiscal stimulus program didn't slash the unemployment rate to 7.0% in late 2010, as Obama's economists predicted in January 2009. Instead, it reached 9.8% in November 2010 and consumers saved over half the resulting rise in after-tax income. With QE I, the Fed created $1 trillion in excess reserves that the banks don't want to lend and creditworthy borrowers don't want to borrow. So those reserves didn't turn into money. QE II will simply add $600 billion to that excess pile. And if lenders and borrowers are energized to do business, it will take three or four years for robust global growth to use up excess capacity and threaten inflation. That will give the Fed plenty of time to extinguish surplus reserves, as Chairman Bernanke said they would in his December 5 "60 Minutes" interview.

What are the risks that the long period of deleveraging and slow growth could lead to protectionism or other counter-productive policy responses that potentially could contribute to another protracted recession?
Sadly, protectionism is the normal result of high unemployment, and politicians find it very attractive since the foreigners against whom it's directed don't vote in domestic elections. American consumers were for decades the buyers of first and last resort for the world's excess goods and services via U.S. imports. But now U.S. consumers are retrenching, and the world has turned to ultimately ineffective but destructive competitive devaluations to replace their demand.

Rising protectionism is one of nine forces leading to slow global growth in the next decade, as discussed in my book. Furthermore, protectionism and persistent financial woes threaten to turn chronic slow global growth into a worldwide depression.

What is the outlook for Europe? Will the eurozone remain intact?
The eurozone has been a noble experiment, combining the Teutonic North and the Club Med South under a common currency, but with no common fiscal authority. It held together due to robust global growth from its 1999 inception until the Great Recession, but is now flying apart. The North doesn't like bailing out the South, including Ireland, but has little choice given the heavy Southern exposure of Northern banks.

The threat to the U.S. and other non-European major countries is not so much the high probability of renewed recession on the Continent. Instead, as detailed in my book, it's the global intertwining of banks and other financial institutions that will spread unfolding European troubles worldwide.

In *The Age of Deleveraging*, you discuss 10 investment areas you favor. What do they include?
In 1981, I predicted the unwinding of then-double digit inflation. I went on to recommend 30-year Treasury bonds, then yielding 15.25%, and stated, "We're entering the bond rally of a lifetime." Since then, 25-year zero coupon Treasurys have outperformed the S&P 500 by seven times despite the strength of equities in the 1980s and 1990s. And even though the current 4.4% yield on 30-year Treasurys may seem very low, there's more appreciation in store.

I've never, never, never bought Treasury bonds for their yield, but only for appreciation, the same reason most people buy stocks. If the 30-year bond yield drops to 3% due to the slow economic growth and deflation I foresee, the gain in price will be 27% plus interest coupons, and 51% appreciation on a 30 -year zero coupon Treasury bond.

Another of my 10 buy suggestions is equities with high, consistent and increasing dividends. With slow growth in the economy, corporate profits will rise modestly in the years ahead. So dividends will likely constitute the majority of the total return on stocks.

In your new book, you also discuss 12 investment areas to sell or avoid. Which ones?
Companies involved with big-ticket consumer purchases will suffer for two reasons. Leisure airline trips, ocean cruises, new household appliances and vehicles are expenditures consumers will postpone or avoid as the ongoing saving spree persists for years. Furthermore, in deflation, falling prices for these items will encourage prospective buyers to waits for still-lower prices. Then inventories and excess capacity will pile up, forcing prices lower and encouraging buyers to wait still further in a self-feeding downward cycle.

I'd also avoid conventional homebuilders and related companies. There are at least 2.5 million excess housing units in inventory over and above normal working levels, and more to come as foreclosures proceed. That's a lot considering the long run annual construction rate of 1.5 million units. The crushing inventory burden will probably push median single-family house prices down another 20%. At that point, 40% of homeowners with mortgages will be under water, owning more than their houses are worth, up from 23%

now. That will encourage many more to abandon their abodes, resulting in many more foreclosure sales.

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