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JOHN MAULDIN'S THOUGHTS FROM THE FRONTLINE CONVERSATION WITH JOHN

In this week's *Thoughts from the Frontline* John Mauldin publishes a recent interview he conducted with Damien Huffman of Wall Street Cheat Sheet. In the interview he answers questions on his views of the future and in particular how technology will bring about quicker changes. Another important issue is unemployment and the question is asked whether enough jobs can be created to fill the unemployment void left by the recession.

Enjoy the read.

This week I am in New York, and have a whirlwind of meetings (and I admit, a lot of fun on the side) and not much time to write. I have been saving today's letter for a month or so, for a time such as this. Damien Hoffman of the *Wall Street Cheat Sheet* interviewed me and posted the transcript on his web site. I thought it was one of the better interviews I have done recently, and so it is this week's *Thoughts from the Frontline*. In addition to the wide-ranging economic questions, he asks for my thoughts on how one becomes an investment writer. I often demur when asked that question (what do I know?), but did my best to answer this time. I think you will enjoy the letter. (By the way, he does a lot of interesting interviews, which he posts for free on his web site at www.wallstcheatsheet.com.)

But first, a quick commercial. Are you reconsidering your investing strategies for the year ahead?

I am pleased to invite you to join me, together with my US investment partner, Jon Sundt, President and CEO of Altegris Investments, for a special live webinar on Thursday, December 17th, at 11:00 am Dallas time (that's 9:00 am on the West Coast and 12:00 noon on the East Coast).

In this special webinar, we will discuss the forces that are shaping today's economy and their influence on financial markets, as well as the potential impact on your investing decisions. This is an excellent opportunity to learn about alternative investment strategies designed to provide non correlated diversification for your portfolio, as Jon and his team are experts on alternatives. We'll set aside time to answer your questions.

Due to regulatory issues, this event is limited to US investors who qualify as "accredited investors" (generally, net worth of \$1.5 million or more). It's easy to sign up; just allow yourself a few minutes to complete the steps. First, register online on my Accredited Investor website. From there, if you are a US investor, you'll be directed to register for the webinar.

[Click here to register](#)

If you have already registered on my Accredited Investor site, please contact your Altegris Account Executive for a streamlined registration process. Space is limited. So even if you can't make it at this specific time, I urge you to register so you can listen to the replay at your convenience after the event. (In this regard I am president and a registered representative of Millennium Wave Securities, LLC, member FINRA.)

And for those of you who are not quite accredited investors but are on your way, I suggest you go to www.cmgfunds.net/public/mauldin_questionnaire.asp and register there, then talk with my friends at CMG about alternative managers and strategies available to you. As I mentioned above, there is no better time than now to think about your investment strategy for 2010.

Unemployment Positives

This morning's unemployment number, though still down by 11,000, is the best we have seen in a very long time. The birth/death ratio only added 30,000 jobs, and previous months were revised upwards. Given that the ADP employment number on Wednesday was so high, and the service ISM was not good, this comes as a very pleasant and positive surprise. Is this a trend, or something seasonal because the main driver was temporary jobs? We will see in a few months. Let's hope we see a real turnaround soon.

A Conversation with John

With Damien Hoffman

John Mauldin coined the incredibly popular phrase, "Muddle Through Economy." If the next few years continue to drag along as we rebuild from the greatest credit bubble in history, then John's term may become the catch phrase used by every financial journalist and economist in the land.

John is a passionate traveler with business partners all over the world. He also puts out a free newsletter to over one million people worldwide. This reach of friends and travels give John an excellent macro view of the world economy. Further, his multidisciplinary interests offer some unique insights into economics and human behavior.

I had a chance to catch up with John and talk about his experiences as an economist, his perspective on which countries will grow the fastest in the coming decades, how he sees demographics affecting the world, and a bonus question from one of our 1400 Twitter followers ...

Damien Hoffman: John, was economics part of your schooling or a passion of yours right from the start?

John: I had a triple major in college, one of them being economics and history. So I've always been fascinated by history, economics, and finance. The markets are a big puzzle to me and I'm a puzzle addict. So it feeds my addiction. I started reading the Austrian economists first, in the early '80s as I entered the investment world. That was my real introduction to economics. Over time, if you stay around long enough and read enough, you can pick up all the other schools of thought, like I did.

Damien: Based on some of your newsletters, I can see you are also interested in anthropology via the studies of the generations. These are major themes for investors to trade, because they're based on slow-moving macro phenomena. Can you share what interests you about this particular framework?

John: That's a good question and a difficult one. This topic covers a book I'm trying to write. I don't know if I'm ever going to get it done, but it's called *The Millennium Wave*. It's about what the world is going to look like in twenty years. My basic thesis is, we're going to see a pace of change that far exceeds anything human beings have experienced since the dawn of man. Furthermore, in terms of technology, that change is going to accelerate. We're going to have multiple waves of technological change. It would be as if electricity, the steam engine, and the automobile all showed up at the same time. Boom!

We're going to see massive technological revolutions. However, as human beings, our psychology was developed on African savannas, dodging lions and chasing antelopes. So we have a much slower rhythm

to us. We're not paced for change. Therefore, we're going to have a backdrop of slow-moving generational changes.

Demographic changes are predictable: we know how many people are going to be here in forty years because they're already born. We know how many forty-year-olds we'll have in forty years because they're already born. So, we can see these changes coming at us.

If you're Japan, you're walking into a demographic nightmare. Russia is a demographic train wreck. And it's not going to be but a few decades, in the grand scheme of things, until Iran will have more people than Russia. That's got to be fit into your equations. You've got to look at these large, broad changes that are happening.

In the US, we're going to be running into the freight train of Medicare and Social Security. There's just not any way to get around it. We're going to have to make tough generational decisions about how to handle that. And how we handle it is going to have enormous implications for our economy. If we handle it the way it's likely to be handled - which is by raising taxes - then we have said we're making a decision, conscious or not, that we're going to become Europe. That means high residual unemployment and difficult, slower growth of individual opportunities.

There are other large changes when you talk about the demographic issues. Europe would have to take massive numbers of immigrants in order to support their system. They're just not prepared for that. Neither is Japan. The US is blessed with a world population that wants to come here and are not very culturally different from us - especially the Hispanic populations. We're going to need those immigrants. I think that one of the most economically suicidal things we're doing today is trying to figure out how to close the borders. We need to be doing the opposite. We need to figure out how to open the borders. It needs to be a more rational policy than we have now. Again, you have to put those things into the financial equations.

We also have the fast-moving things such as the growth of biotech and the complete retooling of our telecommunications network over the next ten years. The way we communicate with each other and the way we receive information is also going to be significantly different in the next ten years. There will still be human beings talking, but how we sort through and assess information is going to be different. There are going to be winners and losers in that competition.

I do a lot of biotech research to determine where it's going. For instance, you could construct an investment play where you are long life insurance companies and short annuity insurance companies, because we're going to live much longer than any of the actuaries would tell us. That means life insurance companies aren't going to have to pay, while annuity companies are going to have to pay longer. That trade is probably not ready to happen yet. But when the perception kicks in, that's going to be a very good trade.

The new medical devices and therapies that are coming along are going to be transformational. I think about what kind of impact that will have on societies and generations - what John Howe and Richard Strauss call "the Fourth Turning," which we're in the middle of. All of these things have an impact on the way I think.

Damien: Keeping on a similar topic but shifting over into a different part of the logic tree, let's talk about one of your passions: traveling. You kind of touched on which markets have a lot of trouble, but which markets will out-perform in the next decade?

John: If I'm picking regions, I would be an emerging market fan over the developed world, simply because the developed world, especially old Europe, is going to be running into such major underfunding problems in their pensions and healthcare. That's going to put constraints on them and on their growth. Developing countries don't have that problem. I'm not as much a China fan as an India fan. I like Brazil. I like Canada, Australia, and New Zealand. I know that Australia wouldn't be an emerging market, but they sell the

resources and the tools to the emerging markets.

Damien: Is there a specific reason why you prefer India over China? If you were going to have a conversation with Jim Rogers, who favors China, what would you say to him?

John: We've had a lot of conversations over time, but not that one. I think India is eventually going to get its act together. I think there's more upside there. I think China is still trying to absorb 24 million new people into their markets annually. They've got major demographic issues. I'm talking about the next two decades. China may still be better than India in ten years, but I think India is the favorite over time, because they have natural resources, smart people, and better technology. But who knows. Governments can always alter the course by doing stupid things.

Damien: That's inevitable.

John: Exactly. Government is the wild card. For example, Japan just elected a very left-of-center government. One that's far more left of center than Obama. If interest rates were to rise by 1%, it would cut into their budgets by at least 25% or 30%. I think Japan is going to be a basket case ten years from now.

Damien: That's interesting, because one of your letters sparked a conversation with my friend Andy Glatstein about the life cycle of empires. Thinking about the Roman Empire, the Iberian Peninsula, the British Empire, and the US after WWII, it seems our predecessors in the Western line of empires have a life-cycle. It started with entrepreneurship and ambition, exploring and conquering, then reached some sort of stability point that included a decent standard of living for the masses. However, ultimately the economy sort tripped over itself and all these former empires had major issues. If today you look at Italy, Spain, Portugal, and Britain, they've all moved in a similar direction. Is this the fate of the US?

John: We're in the process of having that debate as we speak. It's not clear how we're going to answer that. We're going to have to raise taxes when we hit the Medicare crisis in the next decade. No question about it. If we use that tax increase now, it will be hard to cut later. If we save the tax increases and hold our spending down, then we'll be able to handle the Medicare crisis. It's not clear which of two directions we're going to take right now. We're probably going to raise taxes and kick the ball down the road. It will have some very serious consequences in the middle of the next decade. We will probably be forced to implement a VAT tax, which is one more way to slow things down.

Damien: Switching topics, can you explain why Wall Street economists tend to be permabulls or permabears?

John: Mostly because their job descriptions create agendas. There are very few like David Rosenberg who feel they have the independence they need. Also, a lot of them are traditionally trained. So, they're trained to create tools, and they think economics is a science. It's not. It's an art. And quite frankly, when you treat it as an art form you have a better chance of getting the numbers right.

Damien: Can you explain what you mean by that?

John: All of the economic models are created on past performance. For instance, right now the economic idea du jour is what the recovery will look like. So, economists go back and average the eight post-war recessions and say, "Look, this is what the average was and this is how it responded." Well, making a prediction based on that only works as well as the



underlying fundamentals of the recession.

This is a deleveraging, deflationary, asset-bubble-bursting recession. We're going to lose 8-10 million jobs. We're back to where we were in early 2000 in terms of jobs. Over the next five years, just to keep up with population growth, we must create another nine million jobs. Plus, we've got another almost five million people who are underemployed. And the Census Bureau took 450,000 people off this year because they said, "They're no longer looking for jobs, and since they're not looking for jobs they're not unemployed." That is a fascinating way of looking at it! Last month you were looking for a job and now you're so discouraged you're not looking for a job, so we're not going to count you as unemployed. That's a patently silly idea!

Damien: That's absurd.

John: Right, it is absurd. Over the next five years we're going to have to create something like 17-20 million jobs to get back to 4-5% unemployment. That's a staggering number of jobs. That's something like a 15% growth in the number of jobs over five years. You'd need real GDP growth of 15% to make that happen. What is the likelihood of total real GDP growth of 15% for the next five years?

Damien: Less than 0%. [Laughing]

John: I think we're going to be lucky to have GDP growth of 8-10%. So there's going to be a real shortfall with jobs. Unemployment is going to stay stubbornly high for the next five years unless something comes out of the clear blue - which is always possible. Somebody could invent a new energy source or we could start retooling our telecom systems - something like that.

Damien: Are those the technological catalysts that will bring us the next economic expansion?

John: Yes. Remember, in the late 1970s we were in an economic malaise. The Japanese were kicking our butts, inflation was high, and the market was in the doldrums. It was not a fun time. Yet the correct answer to the question "Where are the new jobs going to come from" was: I don't know, but they will. Because that's what happens in free-market societies. That's why I'm an optimist. Even looking at all the data and all the problems, I'm saying that 130 million families will figure out what to do to make their lives better. Some of them will sit around and wait for the government to do it, but a lot of people will do it themselves. It's like the two vultures sitting on the cactus, and one of them looks at the other and says, "Patience? Hell, let's go kill something."

Damien: As my regular readers know, that relates to one of my favorite quotes: "Desperation is the mother of ingenuity."

John: Precisely. Most people will go out and try to figure out something to do. That's just what we do as a country. It's part of our particular genius. We're going to be helped along by some major technological and scientific breakthroughs. I'm an optimist in that regard.

Damien: John, sometimes there are so many variables to think about and so much information it can lead to paralysis by analysis or even worse. Where do you draw the line while informing your investment decisions, when markets diverge from economic reality?

John: You've gotta look at why markets are diverging from economic reality. You have to ask yourself, "Do I need to reassess?" You must constantly question yourself and sift through the data.

Right now we're at a place I call the Statistical Recovery. We're going to see a recovery in the math, but it's not going to feel like one in the real world. It's probably going to be the middle of next year before we see job growth and reduced unemployment. If we're not seeing job growth, if we're not seeing income growth, if

we're not seeing a drop-off in foreclosures, if we're not seeing a rise in consumer credit and consumer confidence, if we're not seeing a lot of things of that nature, it won't feel like a recovery.

Economists can say, "Look at these numbers! The numbers are good!" But in the real world you may say, "I'm still not getting the hours I want. I haven't seen a revival of people coming into my store. Sales are still down 10%." If that's the case, then it doesn't feel like a recovery.

That's where I think we're going to be. But that's part of the process of going to the New Normal. We're having to rationalize our entire economy, our world economy, which was built around ever-increasing amounts of leverage. And that leverage bubble has burst. The genie is not going back into the bottle. The psyche of the American consumer has been permanently scarred. And we're going to get to a new level of economic activity that's going to assume 7%, 8%, or 9% savings. We will see less credit. We're watching unprecedented amounts of credit-card debt being paid off. That's never happened in America. That's positively un-American. Yet, we are. Because what happens? People are saying, "Maybe this leverage and debt thing is not so good. Let's get more conservative." It's the new frugal.

All we did with this "Cash for Clunkers" thing was move cars forward that would have been bought later. You're not increasing sales down the road. Yeah, you're taking cars off the road and spare parts and stuff, but I think it's kind of a silly investment in dollars. But, what's \$3 billion when we're wasting a trillion here and a trillion there? Still, it's disappointing.

Damien: Speaking of disappointment, I'm in my early thirties, and when I think about these trillions of dollars being thrown around I say, "I've been out of college a decade. We've had two bubbles and two collapses. It's been a completely volatile employment and investment market. A completely volatile social environment. And, to top it all off, we're kicked in the butt with all of this debt." My peers look ahead and see our parents getting older and the cost to society. What do you say to our generation? Will we be the forgotten generation which toils our way through it and pays for the problems created before us, to repave the road for those behind us?

John: I tell you, I'm sorry. That's what you're going to have to do. You're going to have to move the ball forward with an extra twenty pounds on your back. That's just the way life is. I don't think it's only your generation in your thirties. I think it's my kids in their twenties who are going to be dealing with it as well.

We've made some generationally bad choices, with unintended consequences. And now we're going to have to deal with them. It just makes moving forward in the economic environment tougher. You play the hand that's dealt to you.

You can't wish, "I would have been better with 35% taxes." I know that my tax bracket is going to go into the mid-40s at a minimum. Would I be happier and have more money to invest if I had a tax bracket in the mid-30s? Yeah. But that's just not the hand that was dealt. So, I have to figure out how to move forward with my taxes. When they add the VAT tax in the middle of the next decade, my effective taxes will run into the 55%-60% range. That's just the way it is. I can either crawl into some hole or go to another country, or just move on and make the best of the hand I've been dealt. I choose the latter.

Damien: John, we chose a question from one of our 1400 Twitter followers: Can you be very successful and still live a fulfilling family life without being obsessed with work?

John: I'm partly obsessed with work. But you have to take time for family. You can't ignore it. It's easier for me now; I've only got one left at home.

The most fulfilling part of my life is my seven kids. We adopted five, so it's a colorful family. We all get along. It's the one great pleasure of my life -- the best pleasure of my life: my kids, and now grandkids.

Damien: What advice do you have for your grandkids if one day they read this and aspire to follow in your footsteps?

John: That's a tough question, because I took the Yogi Berra path of career guidance: you come to the fork in the road and you take it. I am as surprised to be where I am today as anybody. I have partners around the world that take the leads we get and do sales and research on funds. Besides writing and trying to figure out the world of economics, my real job is to make sure I have the best partners, who are in the right spot to help readers find the appropriate investment ideas for them. That is not as easy as it sounds, because the majority of potential partners are either traditional money managers (which I am not) or have constraints because of their situation.

People ask me what I'd do if I retired. I'd read, write, travel, speak, and enjoy myself - that's what I'm doing now! So, I don't know if retirement is in my path. But for a young person starting now, looking at what I do, I'd say the first thing you have to do is start writing. It's a craft. I didn't start out writing top-quality work. When I look back on letters I wrote early on, I think, "My goodness that's sloppy." I've improved over time, over the decades.

One of the people who helped me learn how to write was my first publisher. I tried to copy his writing style. He had a particularly friendly, easy-to-understand writing style. I've long since developed my own style, but I am still grounded in that foundation. I tell people, "If you want to be a writer, find a writer you like and try to imitate him." I have a certain style, a certain voice when I write. It's not better than anybody else's. Sometimes I go back and think, "I don't particularly like that." But it's my voice and I'm comfortable with it.

Second, don't be too hung up on knowing everything or thinking that you've got to have it all figured out. You won't. You'll never figure it all out. Economics is an art form. The goal is to kind of be in the middle of the lane and not end up in the ditch somewhere. Don't think you're going to be there by the time you're 30 or 35. It takes time to reason, read, and mature.

Third, early in your career you should be reading more books and analyzing less data. Information is less important than theory and a grasp of the basics. You need to understand what the difference is between John Maynard Keynes and Irving Fisher and von Mises. If you don't understand what they're writing, if you can't get your head around their concepts, data isn't going to help you.

So, you've got to have a handle on how the big stuff works and what the theories are. But none of the theories have independently proven to be particularly adept at describing the problems we have. So, you've got to figure out how to blend them and weave them.

If you cling to one perspective, you are going to run into a wall. And you're going to run into a wall at one of the most embarrassing times. It can be a career-ending event. I've been wrong. It's easy to go back through my letters and say, "John, what were you thinking?" But on average, I've been more right than wrong. I often joke that I am often wrong, but seldom in doubt. But I never get married to a position. I constantly test my views. Constantly. It's important to get the big things right and understand the big picture while not focusing too much on the little details.

Damien: John, thanks for that advice and thanks for indulging my curiosities this afternoon.

John: My pleasure. You asked some very interesting questions.

New York, London, Monaco, and Zurich

Today was a great (and going to be a long) day. I started off with a couple of interviews on *Yahoo Tech Ticker* with Henry Blodgett, had a few meetings, and then went to Henry Blodgett's office at *Business Insider*, where we did three more quick (and different) interviews. He is doing something quite intriguing. I

walked in, and there were a dozen 20- and 30-something kids working intently at screens, crammed into a room not as big as my bedroom. In less than two years, he is getting two million unique visitors to come to his web site each month.

It made me feel like such an old lion. Tiffani and I have been giving a lot of thought as to how we should manage the business over the next two years. How do we adapt to a world that is changing so fast?

Zip to two million in two years? Interestingly, as we talked business at a long lunch, I wondered if I should write more, as there are so many blogs that hit us each day, and the number seems to be growing. He disagreed. He emphasized that I should not change my model. "You are the one guy I read each week who is above the fray. You see through the day-to-day noise. You come and tell me what was important and make me think. For you, less is more. Don't change." Maybe the old lion still has some teeth.

And speaking of old lions, I later visited with Art Cashin and the Friday evening gathering of the Friends of Fermentation, at Bobby Vann's across from the exchange, at the close of the trading day. What a pleasure. Art is one of the world's great market savants, full of wisdom and the greatest stories, and a true friend. There is never enough time to spend with him.

And when I hit the send button, I will go to Festivus with Todd Harrison and the crowd from Minyanville. That is always a great party and a worthy cause. Tomorrow night we see *Gods of Carnage* with Barry and Toni Habib, and then back on Sunday. And then home until the middle of January, when I go to London, Monaco, and Zurich.

But the most important news is that yesterday the doctor told Tiffani she may be getting ready to have my new granddaughter a little early. It is going to be a great Christmas.

Have a great week, and remember to make sure you have some fun on the way. And spend more times with friends. That is the best dividends you will ever get.

Your having fun in New York analyst,

John Mauldin

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