LAWSON KROEKER
INVESTMENT MANAGEMENT

As We See It

"The crowd can remain irrational longer than you can remain solvent."
— John Maynard Keynes

We were again fortunate to attend the *Contrary Opinion Forum* near Burlington, Vermont last month. The major themes that pervaded the conference were related to the global economic boom and China's ever-growing role in commerce, increasing global energy demand, the deteriorating U.S. housing sector, and the continuing rise in the price of gold.

The majority of speakers believed the U.S. stock market to be over valued given the risk factors present today. The biggest risk of all was perceived to be the enormous level of debt in the system. As of June 30th, total credit market debt was 338% of GDP, a record high. Not included in this number is the additional $130 trillion in derivatives which have never been stress-tested in a weak economy.

The productive use of debt has been declining over the last fifty years. It is taking more and more debt to generate an additional dollar of GDP. In the 1950s, it took $1.35 of added debt to produce an additional $1.00 of GDP, but today that same $1.00 of GDP requires an extra $5.33 of debt.

The speakers unanimously agreed that the U.S. is only in the beginning of the housing sector's decline, believing that the potential for losses in subprime mortgages is in the range of $200-$250 billion. Central bankers likely kept rates too low for too long and failed to recognize the speculation in derivatives from this easy money policy.

Being in the midst of an economic slowdown, the U.S. is the exception to the rest of the world. On a global basis, the world has never—in history—had growth like we have now. At the present time there are only four countries on the globe experiencing negative growth. Foreign firms have turned China into a global exporting powerhouse with their investment in Chinese businesses. China will soon (for the first time in its history) become a major factor in global asset investing. Evolving from the past practice of holding their foreign exchange reserves in U.S. Treasuries, China recently put $200 billion in an investment company in order to diversify their portfolio.

The abundance of global excess liquidity has found a home (at least temporarily) in the stock markets of the world. This is one of the factors that has kept valuations at fully valued levels and may keep them there for a while.

Energy demand will be insatiable over the next ten years. Oil reserves are becoming harder to find and more expensive to produce. A likely outcome will be additional consolidation of the energy sector where companies like Exxon buy small companies with reserves already in place.

The increase of energy prices bodes well for the coal industry. Currently, natural gas is too expensive for utility companies to get an acceptable return on large electric generating plants, so any new construction is likely to be geared towards coal. Coal-to-liquids and coal-to-gas technologies are providing ways to utilize coal efficiently with substantially reduced pollutants.

Most of the speakers believed that the price of gold will trend higher over the next five years. Gold has been rising due to inflationary expectations, weakness in the U.S. dollar, and assorted geopolitical risks which include protectionism and a possible war with Iran.

In summary, we heard nothing to suggest a change in our emphasis on the energy, materials (including gold), and industrial sectors of the market anytime soon.

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