Low returns… high risk: The world turned upside down

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Anyone looking to find a safe haven for their cash quickly finds that money placed with your friendly banker yields almost no interest. You even feel that it costs more to go to the bank and sign the forms than you will receive in interest. Obviously, that is not the case. However, there is a constant drumbeat to create an expectation of low or no interest. The whole financial world bases its rates for return on the U.S. treasury bond. Everyone is supposed to believe that lower rates equal safe investment. In fact, now it is just the opposite. Investors are slowly realizing that they have to pay more, a lot more, for goods and services and there is a real-world inflation clicking along at between 4 and 5%. With bonds being discounted at crazy rates, not only is the interest pennies on the dollar, but there is a real risk of loss of principal.

So why the negative interest rates? Some say governments cannot afford to pay the real rate plus interest. Some say the sovereign debt is the highest in world history. In fact, in a recent family office conference, an expert calculated that investors in U.S. treasury bonds alone have lost over $2.4 trillion since 2008 due to the difference between the artificial low rate and the real rate, including inflation. No wonder the economy there has been so sluggish. Call it a tax, a loss, whatever. It is a major dampening effect on the economy. Investors feel poor and do not spend. The same goes for Europe, China and other parts of the world, where the governments use the low interest rate to cover their debt load each month.

If you look at the real economy, outside of the financial world, business is paying 8% on short-term commercial paper. That is the real rate, including inflation and a risk premium. Look at the balance sheet of those companies and compare it with sovereigns and see which one you prefer. Many family offices have gone totally out of the market and are no longer having sleepless nights wondering if the Dow does a dip or banks and bonds are going to blow up. There are effectively two economies. One is political, the other economic. You need to decide which one you want to invest in for the future. The world has really turned upside down, because low interest for a prolonged period is not safe. Inflation will wipe out all income and part of the principal if left to run its way. Just ask Swiss pension funds.

Today, business news is totally blocked out by the latest attempts of governments to deal with their economic challenges. A daily dose of government meetings solves very little. Governments cannot create jobs in a vacuum. Governments can only create an environment of stability in which private enterprise can grow and add jobs. Interventions only lead to the need for more intervention. Quantitative Easing led to QE2 and beyond with only minor results to show for it.

The more the governments act, the less the private sector responds. Call it the "East German syndrome". When the wall fell, no one knew who should do what, so nothing was done. The government was so involved in every aspect, that everyone waited for their action to react. That is what is happening today. Everyone waits for governments to act, but there is really little they can do. Let's give them a break and create realistic expectations for our leaders.

Europe's sovereign debt crisis in particular is structural in nature. Call it the last vestige of communism. Social programs had to be created in the last century to avoid elements of society from "going over" to the Communist mode and pushing for a total change of government. The sovereign debt from those policies and the huge government cost created as a result are sinking major countries in the Eurozone.

While the streets are unrealistically demanding more, it is time to expect less. Governments should take a break and give some stability for business to do its part. The politicians are doing their best, but it simply is not their job or that of the government. A CEO of a public company would have been gone by the second quarter of bad results.

If one has doubt about how regulation often hurts more than it helps, one need only look to the banks and their efforts to create liquidity to comply with Basel III. Shutting off lending to profitable family businesses with decades of track record in paying their bills only pushes the real economy down the drain. It happened in the U.S. and you can see how business responded. The same is going on right now in Germany and other parts of Europe. It is better business to borrow cash at the Fed window and arbitrage than to lend it to businesses and individuals. That is the real role of banks, but government has unintentionally forced a different, unforeseen consequence. A very negative one for all.

So it might be very wise to look at those "risky" investments off the markets and in private business or investments once thought of as "alternative". It may be the safest bet you can make in the new year.

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