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The Inflation Threat What You Need to Know About Inflation and the U.S. Dollar

Economic Projections and Actionable Advice from Economist Alan Beaulieu

By Paul Diamond, Web Editor, Vistage International

(October, 2009) Despite high unemployment and low consumer spending that both get worse in the next six months, we are at the beginning of an economic up-cycle, says Vistage Speaker and economist Alan Beaulieu of Institute for Trend Research.

Business in the U.S. is now initiating a slow-turn around. "We have to think differently about how we run our business," said Beaulieu at an October presentation he gave to Vistage members in Los Angeles.

The information Beaulieu conveyed is geared to help executives make the right business decisions based on a clear view of the future. According to his projections, 2011 will be a strong year. He offers three top pieces of advice for U.S. businesses:

- Begin selling/exporting your products and services to foreign markets. The global economy will be strong in 2010 and stronger in 2011, while the dollar will be weak. Foreign sales will be more profitable than domestic sales.
- Get ready for growth in 2011. Work now to improve your customer service, plan to spend more on marketing and expansion, and prepare your workforce with training and motivation to take on an increased workload.
- Be ready to raise prices and pay your employees more as we will see a steady rise in inflation through 2012.

Though business picks up in the next two years, the recovery won't create a significant number of new jobs or great prosperity as previous recoveries have.

Inflation

Inflation, says Beaulieu, will likely rise to 6 percent by the end of 2011 and to 7.5 percent by mid-2012. Companies can protect themselves from inflation by:

- Purchasing goods before inflation takes hold
- Locking future expenses into contracts and leases
- Not locking in the price of future goods and services to customers

- Planning budgets with inflation in mind

"We have to take action and think differently when inflation reaches these levels," says Beaulieu. "The purchasing power of your business and your employees will diminish. You'll need to raise wages by six percent a year so your employees don't fall behind, and you'll need to raise your prices as well. Plan these figures into your budget well in advance."

Investors can protect themselves against inflation by buying fixed assets, with fixed debt. Assets such as commercial and residential property usually go up along with inflation.

In the past year, the U.S. government has created vast amounts of money. The Federal Reserve maintains its actions won't lead to excessive inflation because it can "pull the right amount of money out of the market at the right time" to paraphrase Fed Chairman Ben Bernanke. Beaulieu cautions that the Fed's strategy, based on market timing, probably won't work out as planned.

Inflation is likely to help banks by raising the value of homes and the value of mortgage-back securities, thereby restoring the value of their "toxic" assets. Inflation will force the government to borrow money at high interest rates, going deeper into debt while managing cash flow problems either by raising taxes or cutting services.

Collapse of the U.S. Dollar

Vistage members attending Beaulieu's Los Angeles presentation asked repeatedly about the possibility of a U.S. dollar collapse. Beaulieu asserted that a dollar collapse is highly unlikely in the next couple of years.

In a dollar-collapse scenario, China, Japan and other countries sell off treasury notes rapidly on the secondary market driving down the value of the

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dollar relative to other currencies, and this leads to panic selling of both the dollar currency and assets denominated in it. A collapsed dollar would bring about high interest rates, commodity inflation, expensive imports domestically and unprecedented global economic turmoil. Investors would rapidly shift money previously held in dollars to other currencies, real estate and commodities such as gold.

Beaulieu says a dollar collapse is unlikely because it's in both China and Japan's best interest to hold their U.S. treasury notes and keep their largest market healthy. Until China has a market to sell goods into that is larger than the U.S. (such as India or a maturing internal market), they're unlikely to stop buying treasuries.

Shape of the Recovery

Beaulieu anticipates that the graph shape of this recovery will be a broad "U." "For the next 12 months we will be bouncing along the flat bottom of the U," he says.

Based on the leading indicators, he sees no evidence of either a "V" (a quick recovery) or a "W" (short-lived recovery followed by a second leg of decline.) However, he cautions, a second decline could be triggered by a trade war or some other unforeseen calamity.

Economic Projections

Based on the movement of leading economic indicators:

- 2010 should bring a tepid recovery as banks begin lending again, but the next 12 months won't bring job creation or marked prosperity. The recovery picks up dramatically in 2011 and levels off in 2012.
- U.S. housing markets have reached their lows and home values will soon stabilize and perhaps begin rising again later in 2010.
- The value of the dollar is likely to decrease in 2010 and 2011.
- Unemployment will peak in early 2010 above 10 percent nationally and the figure will begin to dip in the latter half of 2010. Currently, our national unemployment rate is 9.8 percent.
- Bank lending will increase in 2010, but with higher standards and tighter conditions.
- Commodity prices will go up in late 2010 and into 2011 when industrial production increases.
- Deflation is over and inflation will steadily ramp up to 6 percent 2011 and 7.5 percent in 2012.

Actionable Advice to Business Owners

Beaulieu recommends that business owners take the following actions:

- The beginning of 2010 is a golden time to expand your operation. Equipment, real estate and advertising will be inexpensive while interest rates will be low. Plan to

borrow and spend money on expansion.

- Borrow as much money as possible in 2010, as conditions may be less favorable in the years to follow.
- If you lease business space, renegotiate your contract as vacancy rates go up. Lock-in those rates in for as long as possible to counter the effects of inflation.
- Hire some exceptional talent before 2011.
- Invest now to improve your customer service.
- Ramp up your marketing and advertising.
- Prepare your workforce, with training and motivation to handle larger workloads.
- Find clients in these resilient sectors: energy, "green," water, healthcare, funeral services, alcohol, security, legal services, food distribution, water purification/distribution, electricity, natural gas distribution, distance learning, pet products, and leisure.
- Sell products and services into foreign markets. As the value of the dollar goes down, the value of these clients will go up.
- Position your business towards "green" and sustainability as money will gush in this direction.
- Lead with optimism.
- Communicate your company's future clearly.
- Take risks and be courageous.
- Learn to compute your company's "12/12 rate of change" so you can project where your revenues are going.

Actionable Investment Advice

When making investments now, consider how inflation may diminish your return.

- To protect against inflation, buy a home or a second home with a fixed mortgage. Housing prices are at or near their bottom. Rarely do low interest rates align with low prices and the promise of a modest recovery two years off. There won't be a better time to buy real estate in our lives.
- Commercial real estate should bottom out in June of 2010, representing a good investment for those with cash.
- Select stocks in companies involved in "green," energy, commodities, food, technology, security, and those that will benefit from infrastructure spending.
- In the post-2010 world, avoid bond funds as they will be under long-term negative pressure.
- 2012 will be a good time to sell your business as multiples will be up, though capital gains taxes are likely to rise in 2011.

As a final thought Beaulieu reminds us, "Don't give up hope, and don't give in to whining or complaining. America is still the land of opportunity where you can become what you dream to be."