# Market Perspectives

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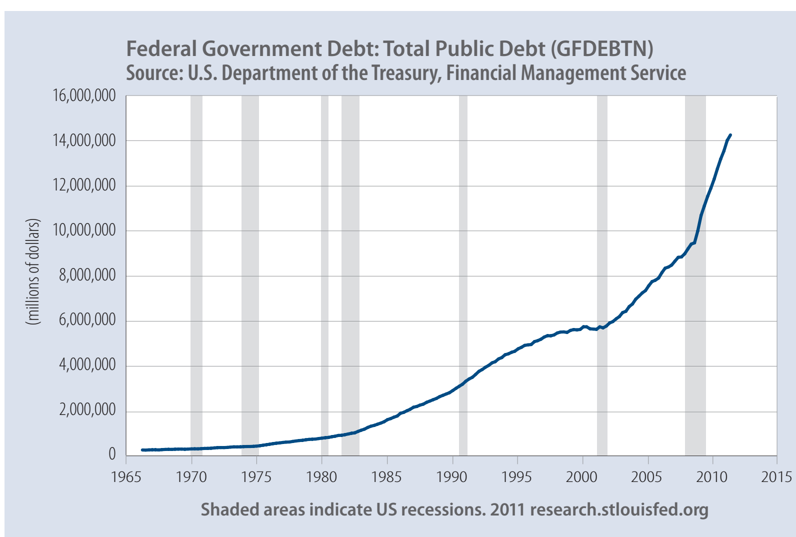
## Investing in a Deleveraging World

Debt is the new four-letter word. After being the economy's best friend for the past half century, debt leverage has now become cursed as governments, corporations and individuals come to grips with ridding themselves of its' heavy burden. While the issues regarding the world's debt situation are simply too many to repeat here, our intent with this edition of *Market Perspectives* is to assess how we believe portfolios should be constructed to weather the leverage storm.

The chart below shows the accumulation of debt by the US government, which is now above $14 trillion and growing faster than the economy as a whole. We're not just singling out the US; the chart looks similar for most developed countries, particularly in Europe. What has spooked markets of late is the simple fact that investors in debt securities are asking themselves "how do we get our money back?" The presumed safety and security of owning a government-issued bond (the assumption is that a government can always raise taxes to meet interest and principle repayments) is being put to a severe test, especially in Europe, as countries like Greece grapple with how to bring budgets into balance.




Getting one's money back is the most important thing to a debt investor. Today, debt buyers are willing to live with paltry returns, knowing at the end of the loan period, the monies forwarded will be returned. At the heart of the Euro crisis today is a growing disbelief that when debt comes due in places like Greece, Portugal, Ireland and Spain, there will not be monies available to pay. To put things in perspective, consider investors in US Treasury securities are accepting yields of less than 0.25% for periods of up to two years. **With inflation at 2% or so, today's buyer of 2-year US debt appears willing to sacrifice buying power of 1.75% (2% inflation less 0.25% yield) per year for the supposed comfort of knowing they might get their original investment back when the security matures.**

We find it interesting the debt crisis has changed the way investors think about safety. Increasingly, corporations are now being perceived as "safer" places to put money than governments. Governments interested in job creation are realizing more and more each day that taxing corporations is not a solution if the result is further layoffs. Despite the fiscal pain, governments around the world continue to advocate lower corporate tax rates. Corporate balance sheets today are in excellent shape. As governments and consumers levered their balance sheets, corporations went the other way, reducing debt and piling on cash. This is a very good thing, especially for equity investors.

At the core of our investment philosophy is a belief the best way to preserve and grow savings is to invest in quality equities that currently pay and have the potential to grow their dividends. With dividend growth, the opportunity for higher dividend income down the road has historically resulted in capital appreciation.

In today's low-yield environment, many of the quality companies in our portfolio have dividend yields higher than their cost of borrowing. This unusual situation has not been seen for decades. For well-financed companies, there may be an opportunity to prudently increase debt to pay additional dividends.

Recent market volatility has shaken confidence. In an environment where large liquidity pools are dancing in and out of markets on the drop of an economic number, market uncertainty is escalated. In this uncertain world, however, we remain true to our belief that good companies can manage through any economic turbulence. As earners and compounders of dividends, we believe the investment adage "*time-in the market is better than timing the market.*" We continue our long-standing bias towards large-cap dividend-paying stocks, believing they offer the best opportunity for not only income, but inflation-protecting growth. ■

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