July 2012

Dear Clients and Friends:

My entire career as a financial planner, now approaching thirty years, has been nearly encompassed by one economic cycle. Known as the "long-term debt cycle," this repeating trend consists of credit expansion followed by deleveraging (reducing debt). The debt cycle usually lasts 50 to 75 years, and the last one ended four years ago.

The shorter business cycles we're familiar with, where good economic times give way to bad, then return to good, are an overlay to this underlying and more important debt cycle.

The total domestic debt of the United States is now 341% of our gross domestic product, up from 150% in 1980. During this long run of credit expansion, the value of securities and real estate has increased, which fuels the demand for more credit to purchase assets, and that leads to even higher prices.

The implosion of federally-insured real estate loans in 2008 signaled the end of the credit expansion phase. In the last few years, Americans are saving more, spending less and reducing debt. That's the best news out there, because it means the healing process has started. However, the deleveraging phase of the long-term debt cycle usually takes at least a decade. In Japan, it took 20 years. We're in for a period of relative austerity, and growth will be slow since consumer spending represents 70% of the economy.

The slowing we're seeing now is not a normal recession, but the start of the process of deleveraging. Although government debt is rising, private debt is decreasing, and we've reduced our total debt since 2008 by 14%. So take heart that we're on a healthy track.

Sincerely,

Charles M. Shackelford