

THE DECOUPLING MYTH

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Over the last month, President Obama has worked with leaders at the G20 summit to coordinate global economic policy. Treasury Secretary Timothy Geithner has coordinated economic policy with the other countries, the International Monetary Fund, and the World Bank. Secretary of State Hillary Clinton has visited China asking (persuading? begging?) the Chinese to continue to lend to the United States. Why the global effort?

It has been said that if the United States sneezes, the world catches a cold. Essentially, this means that if the U.S. economy experiences a down turn, then the rest of the world enters a deep recession. In the past, this has been the case because the United States is the main consumer of goods from countries throughout the world. The world manufactures products, and we buy them. If we are not doing well, we stop buying their products. When the world's largest customer stops buying, it causes high unemployment in other nations and leads them into a deep recession.

"The countries of the world are more dependent on each other than ever before."

Numerous people have asked recently about the 'decoupling theory', an idea that received a great deal of attention as this crisis unfolded. The idea of 'decoupling', which was encouraged by many of the 'end of the world' crowd, can be summarized as follows:

The rest of the world used to be dependent on the United States, but that is not true any longer. Because of the new middle class developing across the world, other countries like India and China no longer need the United States. They can simply sell to their own, brand new middle class. Since these other countries do not need to sell to U.S. consumers, they will not suffer a recession along with the U.S. The United States, dependent on loans from China, Japan and other countries, will find itself without a lender. Without a lender, the United States would not have access to the money needed to fund recovery plans during recessions. The United States would then fall into a depression while the rest of the world gets along just fine.

As 2008 proved, we can put that theory to bed...at least for now.

In December 2007, the United States headed into a recession - one of the worst on record. Many proponents of the decoupling theory moved most or all of their investments overseas either prior to 2008 or in the first half of 2008. Their logic was simple: if the U.S. is in

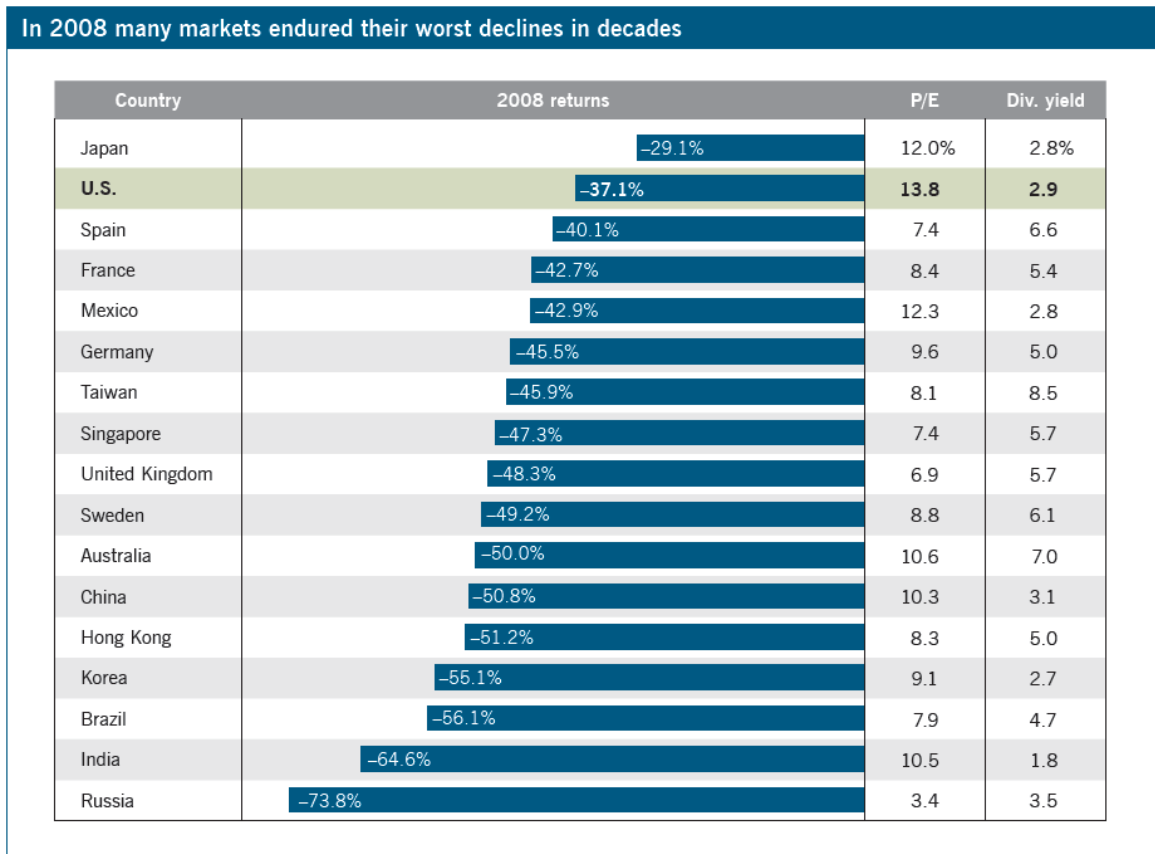
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THE DECOUPLING MYTH

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recession, and the rest of the world does not need the U.S., then why not invest all of the money overseas? They believed that the U.S. markets would tank, but the rest of the world's companies would not lose significant profits since they could sell to their own people. They assumed foreign stocks would hold up just fine during the U.S. recession.

It turns out that there is no such decoupling – at least not yet. In fact, the emerging economies of the world are more dependent on the United States than ever. Most foreign countries have fallen into a deeper recession than the United States, and most of the foreign stock markets have followed suit. One glance at the chart below sheds some light on how this recession affected international markets. If you thought it was bad here, take a look at how the rest of the world is faring.



Source: MSCI

Indexes are unmanaged, and their results assume reinvested distributions but do not reflect sales charges, commissions or expenses.

The United States is still the center of the economic universe. However, we do agree that we are headed down the 'decoupling' path. It is not here now, and it may take years or even

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THE DECOUPLING MYTH

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decades to develop. Nonetheless, it is important that we get our nation's debt under control before that day comes. Otherwise, China and Japan may not be here in the future to buy our Treasuries. If those countries develop the ability to sell to their own emerging middle class, allowing the U.S. to collapse, then the U.S. Government would not have access to the money it needs to spend our way out of the next mess. For now, China has an incentive to help us, as they need our consumers as much as we need to borrow from them. China loans us the money to save our system, and we continue to buy from them. With a real middle class, China and the rest of the world would simply sit by and let the United States defeat itself.

'We are currently witnessing the greatest, largest, most coordinated international economic recovery effort in history.'

At Creative Planning, we have consistently positioned a portion of client portfolios in international stocks, not because we believe decoupling will occur this year or next, but because some countries simply do better than others in any given year. A large portion of most portfolios is also allocated to large company U.S. stocks, which are really global in nature. Companies like McDonalds, Nike, and Wal-Mart may be listed on the U.S. stock exchanges, but they are all global companies in that they receive a significant percentage of their profits from other countries. By owning companies in various countries, we hedge against a crisis in any one country, and spread the risk across various currencies as well. A nice side benefit is that when decoupling does arrive, and it eventually will, the international stocks will be less correlated with U.S. stocks, smoothing out the volatility of a portfolio.

For now, imminent decoupling has not only been exposed as a myth, *but it has also revealed that the countries of the world are more dependent on each other than ever before.* Thus, the scope of the current crisis is both systemic (a problem with the financial system itself) and global. Because of this, we are currently witnessing the greatest, largest, most coordinated international economic recovery effort in history.

We are truly 'all in this together.'