



## Thought for the Week: Monday, August 1st, 2011

### A Cautionary Tale

#### How it all Began

Once upon a time, not so very long ago, a hard working family had the great good fortune to find and settle on abundant fertile land.

The patriarch of the house established numerous ventures from the resources available: material, physical and intellectual resources. Meanwhile the matriarch nurtured a growing family of progeny with strong family and work ethics. As time progressed, so too did their wealth and influence in their community. Life was hard but the sense of achievement and spiritual satisfaction was ample reward.

The bulk of their income was reinvested in expansion, research, education and other advances. Sometimes this funded incremental growth and sometimes it created new sources of revenue. Moreover, health and recreation became an increasing priority.

Using this solid foundation as a springboard, a number of offspring branched out of the family industries and found similar success in a variety of disciplines. Their artistic and sporting endeavors became recognized outside of the immediate neighborhood and the extended family pioneered many new fields including the legal system, flourishing entertainment and recreational businesses.

Everything ran like a well-oiled machine with many of these diverse interests meshing with the success of others. Their productivity, collaboration, standards of living and level of education became the envy of all who knew or heard of our, by now, extensively extended family. A dynasty had been created and those within and around this hive of activity became enriched in some way.

#### A more Balanced Life

Now, as all caring parents know, each successive generation wished to improve the lifestyle of their children. Accumulated and growing affluence had reached a point that it could be directed to support a more comfortable level of existence for all. Although many children still worked, they didn't have to work 'as hard' to receive a degree of entitlement above that of other children in their community.

Exciting new developments improved all areas of life. Resources became easier and cheaper to obtain and productivity advances allowed less and less time to be devoted to their business interests. Increasingly, the family lived off their achievements and paid others to do their hard or less attractive work. Spending disposable income and leisure took more and more of the family's time and focus.

Before too long, it also became obvious that greater profits could be made from the ancillary businesses that had propagated and prospered from the more traditional business interests. The family tree had now spread into a number of branches; those who still worked at the primary interests, those who developed ancillary interests and those who pursued other interests.

For some time, this balance greatly enriched the family and the surrounding civic good. While the numbers of those who profitably produced commodities, products, services and intellectual capital outnumbered

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those who contributed in a more ephemeral way, life was truly rich. While income exceeded expenditure, happiness resulted.

### **The Teeter-totter Teeters**

Unfortunately, this fiscal equilibrium began to change. Although income and wealth increased, expenditure and desired expenditure grew at a much greater rate. People were rich and surrounded by aspirational goods and services that made things easier – why not enjoy life a little more?

The ratio of gainfully employed family members to others consistently fell on an annual basis. Fewer relatives were working and those that did focused less on work. The delicate balance between efforts and rewards had been lost; a feeling of entitlement, of deserving without earning had emerged.

The industrious goals and frugal principles which had kept the family so close together were no longer followed by all. The clear and consistent leadership did not govern everyone. Most family members saw this new social conscience as a good thing.

At the same time, family members discovered they could ‘leverage’ the family’s accumulated wealth, natural resources, intellectual capital and cash flow by borrowing money to fund their lifestyles. Those lending to family members made money from the loans and the massive family revenues provided them with confidence that repayment would eventually be made.

That said, the family no longer lived within their means and borrowing was needed to sustain their lifestyle. Credit was always available; who wouldn’t lend money to the richest family around? If the early lenders declined, other families who depended on the original family to buy their goods and services would create new ways to make loans. The merry-go-round continued to grow and spin at an ever increasing rate with the family at the hub.

### **Sustainable Debt Levels?**

Then one day someone had the audacity to ‘run a balance sheet’ on the family’s financial condition; they added up what they owned and what they owed. The result was intriguing. Although the family had ample and growing revenues to support the current level of borrowing, overall on an annual basis the family’s combined interests were losing money. Somehow, and no one knows quite why, the remedy agreed upon by the committee that had replaced the patriarch a number of years previously, was to borrow more money. People wanted to loan money to the people upon whom their livelihood depended. To hold a promissory note from The Family was a feather in one’s cap.

Given that the committee members running the family’s interests were individually elected and therefore wished for everyone to be happy, not only did they approve more debt, they increased its availability and reduced its cost. Although the basic fiscal rule for happiness, established by the founding fathers as stated above, was broken, only a few family members minded. In fact, the two family universities could not agree on the merits of this direction. One firmly believed that leverage and participation in debt markets was a good thing; the other thought the seeds of destruction were being sown. Strangely, the former received a higher number of endowments.

## **Recession Strikes**

Year after year the debt climbed as the ratio of workers to non-workers dropped - but that was alright as long as revenues continued to grow. Alas, this was not to be and the family suffered a period of economic reversal. Confidence in their ability to pay back debt plummeted and the leverage previously employed accelerated their financial demise.

The family had to arrange emergency sources of capital, the availability and cost of which depended on the sentiment of other smaller families. They used this money not to finance new sources of revenue and increase the employment ratio; they gave this money to those doing the lending and relied on them to distribute it to those who may need it.

While this averted an immediate disaster, it did not solve the problem – some say it exacerbated it.

The family committee agreed they had to face up to a number of harsh realities but they struggled to come to an agreement as to how they might move forward. Many outside of the family predicted the beginning of the end. They cited historical cycles as evidence that all great families rise and ultimately fall.

## **The Moral of the Story**

So how might this saga end? Come on, you don't think we'll give the ending away that quickly do you?

The moral of the story is that since Roman and Greek times, endeavor, hard work and investment risk have been the bedrock of all great families. Investment of capital into increased productivity and intellect is a worthwhile form of leverage. But there's always a limit.

The family in the story above still possesses these qualities; they still lead others in virtually all areas of endeavor. They have the brightest minds, the smartest and the most competitive companies with the experiences and resources to succeed. Unfortunately, as a social group they have lost focus on what got them to this position. Great athletes can lose focus for a while and remain dominant, but it's not long before others start snapping at their heels and they need to rededicate themselves.

## **The Opportunity...**

The world they live in is growing and changing rapidly. There are more opportunities than ever before. The challenge is: can they change with it?

Their only way out of their current plight is to implement policies that encourage growth while controlling spending. If they can gather the socio-political will to achieve this, their indebtedness will fall quicker than most expect. The hard part will be the suspension of a number of privileges which are currently taken for granted. Many may have to take a few steps back before moving forward.

Success will not be achieved by continuing to reward disproportionately to contribution to growth – this balance must be redressed. Nor will it come about by creating disparate financial penalties for those who do contribute.

There's a lot of hard work to be done, but in our opinion, it is too early to write the family off.

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