The Miami Herald

100th YEAR, No. 170
SUNDAY, MARCH 2, 2003
One Dollar
Price may vary on the Florida edition
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Top Money Manager Has Record of Being Right

By Harriet Johnson Brackey

Three years ago, when Michael O'Higgins was entirely out of stocks and into zero-coupon Treasury bonds, when he was predicting that stocks would lose half their worth, I didn't believe him.

If you listen to O'Higgins now, you won't want to believe him either: he's predicting another depression.

However, I think you should pay close attention, because it's possible he's on target. Again.

O'Higgins, for whom the term contrarian is much too mild, has a record of being right when most of us are headed in the wrong direction. And a record of making money while we're losing it.

Since our last conversation in March of 2000, zero-coupon treasuries are up 43.5 percent. The S&P 500 Index is down 41 percent. He said long-term Treasury bond yields would drop from 6.15 percent then to 4.6 percent. They are now paying about 4.7 percent.

O'Higgins manages $200 million at his boutique investment firm in Miami Beach that caters to clients with assets of at least $1 million. He's been a top money manager for more than 20 years and has written best-selling investment books, Beating the Dow and Beating the Dow with Bonds. He's best known for his Dogs of the Dow theory, which worked well for quite a while when the market was still going up.

Today, O'Higgins won't touch a Dow stock or almost any other stock at current prices.

Because he is looking for a depression to begin soon or to be already in progress. "Perhaps the greatest deflation and depression of all time," he says, ``Following the greatest speculative boom [in stocks] of all time."

It'll begin as the Baby Boomers wake up and realize that the stock market's downturn over the last three years has wiped out almost half of their nest eggs.

"When you say it can't be like 1929 through 1931 [when stocks lost 89 percent of their value], ``you're right. It could be worse," he says.

Boomers and consumers will begin to save more money when they realize that the bull market is firmly over. Stock gains in the future will not bail out an investor if he has put too little money away.

People today have higher levels of debt --for consumers, government and corporations as a percent of Gross Domestic Product --now than at any time since 1929, he notes.

The depression will not end until that debt is liquidated, he says.

ECONOMIC COLLAPSE

When consumers decide to save more, they'll stop spending. And the economy's main support will collapse.

After that, you can wait and watch for the Dow Jones Industrial Average, currently just under 7,900, to sink by another 24 percent to 6,000. And that's his best-case scenario.

It could go as low as 3,100, if the stock market goes back to its normal range throughout the last century for the dividend yield, which is the figure you get if you divide a stock's dividend by its price.

Right now, O'Higgins is only interested in gold, which he sees as undervalued and heading up because of deflation. "Because it's real money, because it has held its value for thousands of years, because it's not subject to the manipulations of government or central banks or dishonest corporate executives," he says.

What's more, gold goes up when stocks go down. In 1929-1932, he notes that gold rose 69 percent. And indeed, in the last 12 months, it is up 20 percent. Yet its price is still far below what it traded for in 1980: $850, or roughly 2 ½ times higher than today's roughly $350 an ounce. Global supplies of gold, too, are dwindling.

A gold stock, Newmont Mining, is the only stock he owns today and he's betting against the rest of the market. His strategy is risky, not diversified and, well, daring.

"He's made some great calls over the years," says Joseph McGraw, a hedge-fund manager who is president of Yankee Advisors in Waltham, Mass. ``Mike likes to be emphatic, but I'm pretty negative, too. I'm concerned about deflation coming out of China. I'm concerned about the U.S. consumer totally retrenching and freezing."

"Fundamentally I think he's correct," says money manager John N. McVeigh of Upland Capital management in Ridgefield, Conn. ``I think we're in a secular bear market. Those typically run 10 years or more. That takes us out, from the spring of 2000, to 2010."

For the record, this isn't the mainstream view. According to Bloomberg News, the average Wall Street market strategist thinks you should put 68 percent of your portfolio in stocks.

The Wall Street crowd has largely been wrong, throughout this bear market that began in March of 2000. Mostly because of O'Higgins' correct bet on the direction of interest rates and bonds, the O'Higgins Fund of Funds in 2000 soared 71.32 percent, when the Dow dropped more than 6 percent, and rose 4.76 percent in 2001, when the Dow was down more than 7 percent. Last year, as he moved out of bonds and into gold, his fund rose 19 percent, when the Dow dropped 17 percent.

Certainly, O'Higgins has not always been on target. He moved out of stocks too early and missed the great 86 percent gain on the Nasdaq in 1999, when his fund rose only 48 percent.

As he admits, "I'm only dealing with probabilities. I don't have any illusions that I have a crystal ball,'" he says. ``I just know financial history."

STILL BUBBLY

He makes a convincing case, in charts and newspaper clippings, for his thought that there's little that will stop this downturn until the speculative bubble in stocks and spending is completely deflated.

It is not so, yet. For example, he notes that consumer spending has dropped in every recession since the 1950s, but not in this one. Stock valuations remain high, despite the long downturn.

He notes that the Federal Reserve has engineered 12 interest rate cuts and still the market has not responded. In practically every other instance when the Fed cut rates since 1921, stocks rebounded.

"I would have brought you more information," he said Friday. ``But I didn't want to ruin your lunch."

When will O'Higgins' depression end? "I suspect it'll be a long time," he said.