



## On the “Course” to a New Normal

Analyzing why people play golf is like exploring the intricacies of string theory – there are so many permutations lacking scientific observation that physicists or golfers can pretty darn well say anything they like and the explanation might stick. When it comes to whacking that little white ball, the possibilities are nearly endless: People play to relax, to be with friends, to get close to Mother Nature, to enhance business connections, to compete and excel. Gosh, I don’t know, the Zen explanation for why we play golf could even resemble the old saw about climbing a mountain: People golf because it’s there. Whatever the reason, it is the most frustrating, damnable game ever conceived – alternately elevating and depressing you within the span of mere minutes. I love golf. No, I hate it.

Personally, the reason that golf draws me to its intricate web of psychological entrapment is epitomized by a simple six-inch trophy: a chartreuse ball resting on top of its ebony base, preening on a bookshelf in the family room at our desert home. Its inscription reads, “Hole in one, March 15<sup>th</sup>, 1990, 14<sup>th</sup> hole Desert Course, 155 yards.” Well and good, I suppose – the ace of my life – except it wasn’t. It was the ace of my wife. Above the inscription rests the name Sue – not Bill – Gross. It was a great shot but it wasn’t *my* shot, and I guess therein lies the explanation for why I continue to tee it up.

Actually, two years ago I did tee it up in the sweltering 105° June heat of the Palm Springs desert. No one, of course, was crazy enough to be with me including my “ace” role model wife who was sipping a cool lemonade in the comfort of our air-conditioned home. Now, there is an “unwritten” rule in golf that in order to be official, a hole-in-one has to be witnessed, and that you have to play a full 18 holes. Otherwise, I suppose, you could stand on the tee with a bucket of balls and hit hundreds or thousands until one of the little guys went in – whatever. The fact is, on this particular day, I was playing only one ball, but I was alone, and – good God! – it went in! The trophy with ebony base and spanking white Titleist ball would read: “Hole in one, June 7<sup>th</sup>, 2007, 17<sup>th</sup> hole, Mountain Course, 139 yards.” Or was it? Does a falling tree make a sound in the middle of a forest if no one’s there? Is a hole-in-one a hole-in-one if no one else saw it? I say emphatically – yes! That damn ball went in and later that day Sue agreed with me (although she had a funny look in her eye – especially since she didn’t know a thing about the rules of golf). No one else though. No one else agrees with me. Not a soul. I suspect they’re jealous and, in fact, I’ve seen a few of them hitting buckets of balls at dusk from that very same tee when they think nobody’s looking. I’m watching, though, which brings up a funny question. If they sunk one, would theirs be

a hole-in-one because I was a witness? Like I said – a damnable game.

“Is a hole-in-one a hole-in-one” may not strike you as the most critical question of the hour, and I would readily agree. “Will we have a New Normal global economy (and investment market)?” would probably usurp it on even Tiger Woods’s top ten list. This “new” vs. “old” normal dichotomy was perhaps best contrasted by Barton Biggs, as I heard him on Bloomberg Radio in early 2009, when he said he was a “child of the bull market.” I thought that was a brilliant phrase, and Barton is a brilliant phrase-maker. He went on to say though, that his point was that for as long as he’s been in the business – and that’s a long time – it has paid to buy the dips, because markets, economies, profits, and assets always rebounded and went to higher levels. That is not only the way that he learned it, but that is the way, basically, that capitalism is supposed to work. Economies grow, profits grow, just like children do. I think that’s why he said he was a *child* of the bull market, not just because he had experienced it for so long, but also because economic growth and higher asset prices are almost invariably a natural evolution, much like the maturation of a person. That’s how people grow, and so I think Barton was saying that capitalism just grows that way too.

**Well, the surprise is that there’s been a significant break in that growth pattern, because of delevering, deglobalization, and reregulation.** All of those three in combination, to us at PIMCO, means that if you are a child of the bull market, it’s time to grow up and become a chastened adult; it’s time to recognize that things have changed

and that they will continue to change for the next – yes, the next 10 years and maybe even the next 20 years. We are heading into what we call the New Normal, which is a period of time in which economies grow very slowly as opposed to growing like weeds, the way children do; in which profits are relatively static; in which the government plays a significant role in terms of deficits and re-regulation and control of the economy; in which the consumer stops shopping until he drops and begins, as they do in Japan (to be a little ghoulish), starts saving to the grave.

This focus on the DDRs – delevering, deglobalization, and reregulation – may be conceptually understandable, but nevertheless still a little hard to get one’s arms around. Why would they necessarily lead to a new, slower growth normal? A little easier to grasp might be the following approach, which feeds off the same concept, but which extends it a little further by suggesting that DD and R lead to a number of broken business or economic models that may forever change the world we once knew and make even Barton Biggs a chastened adult. They are as follows:

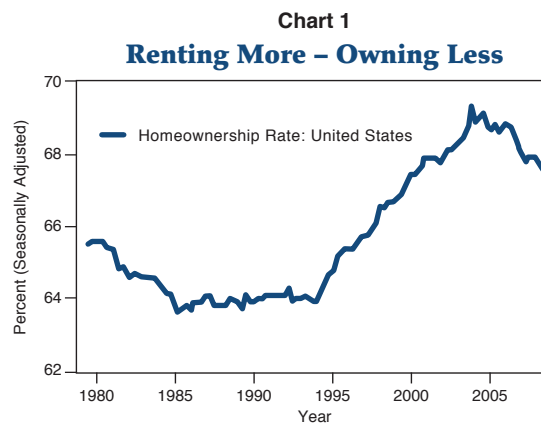
- 1) **American-style capitalism and the making of paper instead of things.** Inherent in the “great moderation” of the past 25 years was the acceptance of a sort of reverse mercantilism. America would consume, then print paper assets and debt in order to pay for it. Developing (and many developed) countries would make things, and accept America’s securities in return. This game is over, and unless developing countries (China, Brazil) step up and generate a consumer ethic

of their own, the world will grow at a slower pace.

- 2) **Private vs. public-driven growth.** The invisible hand of free enterprise is being replaced by the visible fist of government, a temporarily necessary, but (if permanent) damnable condition itself in terms of future growth and profits. The once successful “shadow banking system” is being regulated and delevered. Perhaps a fabled “110-pound weakling” may be an exaggeration of where our financial system is headed, but rest assured it will not be looking like Charles Atlas anytime soon. Prepare to have sand kicked in your face, if you believe you are a “child of the bull market!”
- 3) **Global economic leadership.** It’s premature to award the 21st century to the Chinese as opposed to the United States, but if the last six months have been any example, China is sort of lookin’ like Muhammad Ali standing over Sonny Liston in 1964 yelling, “Get up, you big ugly bear!” Not only has China spent three times the amount of money (relative to GDP) to revive its economy, but it has managed to grow at a “near normal” 8% pace vs. our “big R” recessionary numbers. Its equity market, while volatile and lightly regulated, has almost doubled in twelve months, making ours look like that ugly bear instead of a raging bull.
- 4) **United States housing and employment.** Old normal housing models in the U.S. encouraged home ownership, eventually peaking at 69% of households as shown in Chart 1. Subsidized and tax-deductible mortgage interest

rates as well as a “see no evil – speak no evil” regulatory response to government Agencies FNMA and FHLMC promoted a long-term housing boom and now a significant housing bust. Housing cannot lead us out of this big R recession no matter what the recent Case-Shiller home price numbers may suggest. The model has been broken if only because homeownership is declining, not rising, sinking to perhaps a New Normal level of 65% as opposed to 69% of American households.

Similarly, the financialization of assets via the shadow banking system led to an American era of consumerism because debt was available, interest rates were low, and the livin’ became easy. Savings rates plunged from 10% to -1%, as many (if not most) assumed there was no reason to save – the second mortgage would pay for everything. Now things have perhaps irreversibly changed. Savings rates are headed up, consumer spending growth rates moving down. Get ready for the New Normal.



Sources: U.S. Census Bureau/Haver Analytics

I could go on, reintroducing the negatives of an aging boomer society not just in the U.S., but worldwide. Increased health care may be GDP positive, but it's only a plus from a "broken window" point of view. Far better to have a younger, healthier society than to spend trillions fixing up an aging, increasingly overweight and diabetic one. Same thing goes for energy. Far easier and more profitable to pump oil out of the Yates Field in Texas or even Prudhoe Bay than to spend trillions on a new "green" society. Our world, and the world's world, is changing significantly, leading to slower growth accompanied by a redefined public/private partnership.

The investment implications of this New Normal evolution cannot easily be modeled econometrically, quantitatively, or statistically. The applicable word in New Normal is, of course, "new." The successful investor during this transition will be one with common sense and importantly the powers of intuition, observation, and the willingness to accept uncertain outcomes. **As of now, PIMCO observes that the highest probabilities favor the following strategic conclusions:**

- 1) Global policy rates will remain low for extended periods of time.
- 2) The extent and duration of quantitative easing, term financing and fiscal stimulation efforts are keys to future investment returns across a multitude of asset categories, both domestically and globally.

- 3) Investors should continue to anticipate and, if necessary, shake hands with government policies, utilizing leverage and/or guarantees to their benefit.
- 4) Asia and Asian-connected economies (Australia, Brazil) will dominate future global growth.
- 5) The dollar is vulnerable on a long-term basis.

Like playing in an Open Championship, future golfers/investors need to play conservatively and avoid critical mistakes. An "even par" scorecard (plus some hard earned alpha) may be enough to hoist the trophy in a New Normal world. Holes-in-one? Maybe if you're lucky. But make sure someone's watching, and that their eyes are focused on the New Normal. As for golf, even Sue, my only supporter, has asked me to move my ball, on its own ebony base, away from her more authentic and perhaps the still solitary ace made by Gross family golfers. What a damnable condition.

William H. Gross  
Managing Director

*Past performance is not a guarantee or a reliable indicator of future results. Investing in the bond market is subject to certain risks including market, interest-rate, issuer, credit, and inflation risk; investments may be worth more or less than the original cost when redeemed. Equities may decline in value due to both real and perceived general market, economic, and industry conditions. Investing in foreign denominated and/or domiciled securities may involve heightened risk due to currency fluctuations, and economic and political risks, which may be enhanced in emerging markets.*

*This article contains the current opinions of the author but not necessarily those of the PIMCO Group. The author's opinions are subject to change without notice. This article is distributed for informational purposes only. Forecasts, estimates, and certain information contained herein are based upon proprietary research and should not be considered as investment advice or a recommendation of any particular security, strategy or investment product. Information contained herein has been obtained from sources believed to be reliable, but not guaranteed. No part of this article may be reproduced in any form, or referred to in any other publication, without express written permission of Pacific Investment Management Company LLC. ©2009, PIMCO. IO086-083109.*

#### **IO Podcast...**

To download Bill Gross' **IO Podcast**, check [pimco.com](http://pimco.com) or [iTunes.com](#).

#### **Facebook...**

Stay up to date on PIMCO with **Facebook**. Search "PIMCO."

#### **twitter...**

Stay in touch with PIMCO. Search "**PIMCO**."

P I M C O

840 Newport Center Drive  
Newport Beach, CA 92660  
949.720.6000

[pimco.com](http://pimco.com)