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MONEY WISE

HOW QE3 CAN AFFECT YOUR SAVINGS

For several decades the QE2 for many of us was a proud ocean liner. Today people are more likely to associate QE2 with the second round of quantative easing (read for that 'printing money') by the US Federal Reserve. You may wonder why this should be our concern.

QE3 is the third attempt by the 'Fed' to stimulate the US economy and reduce the high rate of unemployment. This round is different from QE1 and QE2 in that it is intended to continue indefinitely until unemployment falls to an acceptable level. It consists of the purchase from banks of mortgage securities to the value of $40 billion a month.

Will the move be successful or is it just a political ploy? The immediate reaction of stock markets on September 13, the day of the announcement, was positive. On the surface! But many analysts saw things differently. Forbes for example pointed out that the 'Real Dow' actually fell in reaction to the announcement. The 'Real Dow', which is the Dow Jones Industrial Average divided by the price of gold, fell by 0.65% on September 13, the day that QE3 was announced. While the Dow gained 1.6% on the day, gold went up by 2.2%.

How money can fall in value

Marc Faber, publisher of the Gloom, Boom & Doom Report, told Bloomberg that *"the fallacy of monetary policy in the U.S. is to believe this money will go to the man on the street. It won't. Mr. Bernanke is a money printer and, believe me, if Mr. Romney wins the election the next Fed chairman will also be a money printer. And so it will go on. The Europeans will print money. The Chinese will print money. Everybody will print money and the purchasing power of paper money will go down".*

It is interesting to note that since Bernanke was appointed in early 2006, the price of gold has increased from $570 an ounce to more than $1,700 an ounce. In the same period, the price of silver has surged from $9.70 an ounce to over

$34 an ounce. After QE3 was announced, gold quickly increased by $38, while silver jumped more than $1.

The US Dollar has fallen against most currencies, but not against the Rupiah.

The US debt now stands at over $16 trillion. Check out http://www.usdebtclock.org/ for a fascinating display showing the latest figures in real time.

How politics impede progress

What we are seeing throughout the world are policies that are driven by politics, rather than by commonsense. Politicians seeking popular support will always resist austerity plans or measures that would help the economy and eventually the people. The fuel subsidy in Indonesia is an example. The reluctance of the US to tackle their debt problem is another. Europe's woes today are also due to excessive borrowing and spending. If we handled our finances the same way we would be leaving a terrible legacy of debt to our grandchildren.

So what should we, as investors, be doing?

We don't need to make the same mistakes as governments. We can avoid getting into debt and if we are in debt we can make an effort to get out of it. Politics should not come into it – unless there are similar issues within the family!

Assuming there are no debts, other than perhaps a manageable house loan, the challenge is how to make the best of disposable income.

Cash reserves are essential but beyond that cash is a poor long term investment. For real long term growth it must be put to work. A regular savings or pension plan is one way. The performance of these plans has not been inspiring over the past decade but it is still a good way to build up wealth gradually from spare income. Larger sums of money could go into a portfolio of diverse assets, the bulk of which should consist of traditional stocks and bonds.

'Real assets' will hold their value

Printing money does not create wealth. It may provide a temporary stimulus but it is not adding real value. To protect ourselves against the ravages of inflation, which will surely return, we should look to real assets. Land and property is an obvious one for the long term. Investments in gold and precious metals will also give protection against the fall in value of money. You don't necessarily have to buy the physical products but can invest via bullion or mining funds. The same applies to oil which you can access via energy funds. Diversification, as always, is the key to managing risk.

'Collectibles' such as stamps, works of art, fine wines and vintage cars offer further possibilities but that is another story……

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