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LUNCH MONEY

The long and the short of it

Michael O'Higgins still betting on gold and against stocks



WILLIAM HANLEY
in Bal Harbour, FL

Michael O'Higgins chuckles. "I hope I'm not ruining your lunch," he says after outlining why he still thinks the stock market has much further to fall as a depression threatens in the wake of the biggest speculative boom in history.

We're sitting on the shady side patio at Cafe Carpaccio in the posh enclave of Bal Harbour just north of Miami on a hot Florida day, a fountain burbling coolly nearby. You could call it the Third Annual O'Higgins Carpaccio Lunch Money, the venue and timing being identical for three consecutive years. And the message from the man himself has not changed much, either, from the winter of 2002: Short stocks; buy gold. "There's never been an instance of a central bank or government being able to reverse a post-bubble deflation," O'Higgins smiles. "Maybe this is the first. But it doesn't look like it is the way things are going."

That means that things have been going just fine for him and the clients of O'Higgins Asset Management, Inc., headquartered just down the road in Miami Beach. While the recent decline in the gold price and, before that, in gold stocks has hurt short-term performance, holders of O'Higgins funds enjoyed returns of 35% in 2002, 127% in the three years to the end of 2002 and 369% in the five years to the end of 2002 versus a five-year loss of 5.5% for the Dow

Jones industrial average.

And there's more where that came from, O'Higgins says, with financial distress and a looming depression never looking so good if you're making the right bets on the markets.

What, we're wondering, goes well with a lunchtime filled with happy talk of depression, of uplifting ideas about how to prosper in down days. We reckon it has to be something substantial, so we order the swordfish pizzaiola, a meaty grilled fish steak with a pizza-like sauce that actually works.

It comes with mashed potatoes and vegetables. Our guest sticks to the annual luncheon script, ordering a Riviera salad with shrimp, just as he did on a hot day last year.

What has worked in the markets -- and what O'Higgins reckons will keep working -- is the belief that things will get worse before they'll get better, that demographics are squaring off against stocks. He outlines why the millions of Baby Boomers on the verge of retirement, who have learned the hard way that they can't risk relying on stocks to fund their retirements, are going to have to save more, which is bad news for an economy fuelled by consumer spending.

"At 20% a year, your money doubles in three-and-half years. At 4%, you double your money every 18 years. It means you've got to save a lot more money."

Such acute reasoning has put a lot more money into O'Higgins Asset Management, which has doubled the money it manages to more than US\$200-million in the past year. (Clients need to bring at least US\$1-million to invest.)

Mike O'Higgins was a top performer long before he created a stir in the early 1990s with his book *Beating the Dow*, which outlined the Dogs of the Dow strategy. Essentially, "Dogs" entails building a five-stock portfolio using the highest dividend-yielding and lowest-priced among the 30 issues in the Dow average. But there are many variations.

He moved to Miami Beach seven years ago from Albany, N.Y., where he began his investment management career in the early 1970s and earned a reputation on Wall Street as a canny money manager. He moved on from the original "Dogs" strategy in the mid- to late-1990s by championing bonds, a strategy he outlined in the book *Beating the Dow with Bonds: A High-Return, Low-Risk Strategy for Outperforming the Pros Even When Stocks Go South*, published four years ago.

His concentration on zero-coupon treasury bonds also

proved a winner, beating the Dow even during the bull market in stocks. But he thought it was time to move on -- this time to gold -- in late 2001. "I got out almost perfectly. I took the money and ran. Gold going up was a negative idea for bonds. Sentiment is still overly bullish on bonds and interest rates."

What is interesting to him is the fact that there have been only two instances in which easing by the Federal Reserve did not work to turn the economy and the market around: The early 1930s and now. "The only thing that's up in both cases is gold," he says, noting that Homestake Mining rose strong from 1929 to 1932 even as the average blue-stock was falling 90%.

O'Higgins is still looking for the Dow - now near 8000 - and gold - around US\$350 - to meet at some point, whether it's 6000, 3000 or even lower. Even at the long-term average Dow-gold ratio of 11:1, gold could go considerably higher. He's looking for US\$400 an ounce by year's end or sooner, and war in Iraq could play a major role.

"My guess is the result of the war will be the opposite of the Gulf War. When the bombs started dropping, the market went up 20% in a month after falling in the lead-up. War was overly discounted. This time, I wouldn't be surprised if we go up in anticipation of the war and go down in the aftermath. Prices were a lot lower then and it was a single incident. This is totally different. It's being set up as a crusade and it's going to be very expensive and long-lasting."

So far, the widespread ownership of real estate and the ability to refinance homes has helped offset much of the damage from the three-year bear market in stocks. "It's had the effect of delaying the actual crunch," O'Higgins says. "But how many times can you refinance your house and take the money out and spend it?"

Though he and his clients have profited from his dark view of unfolding events, he's not particularly happy with the way the world is going. "It's sad and it's going to get sadder," he declares as the surprisingly modest bill arrives.

Looking around Carpaccio at the beautiful people on this beautiful day, we find it's difficult to contemplate a completely unsunny scenario. But we do note that this year, there are no jostling lineups at Carpaccio, that traffic is extremely light in the Shoppes at Bal Harbour. As we say goodbye, Lunch Money makes a mental note to check out the action next year when we meet Mike O'Higgins again.