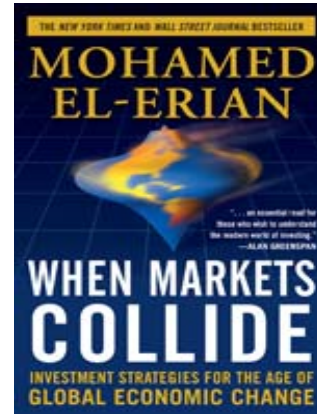


Review of When Markets Collide by Mohammed El-Erian

Mohammed El-Erian is widely followed on Wall Street and for good reason. He spent 15 years at the International Monetary Fund. He was the CEO of Harvard Management Company where he was in charge of managing the university's \$35 billion endowment. He is currently the co-CEO of PIMCO where he served as an emerging markets bond trader before taking the Harvard job.

His philosophy of asset allocation has similarities to David Swensen—who manages the endowment at Yale University. I have personally concluded that this is the most effective way to manage assets as an individual investor.

By including a mixture of low-correlated assets (domestic stocks, foreign stocks, real estate, bonds, commodities, currencies and absolute return funds), you can avoid big losses in most years while obtaining solid growth. The avoidance of big losses is likely to keep you invested through tougher periods and allow you to be invested when the returns are large (usually when pessimism is highest).



El-Erian takes a difficult subject matter and attempts to explain it to the layperson. He gives his view of what is taking place in the economies and markets around the world. My takeaway was that El-Erian believes the US economy prospered on an imbalance for a long time. The US consumed while emerging economies saved. The marriage worked for many years. But now that imbalance is reversing. The US consumer is strapped. He/she must increase savings going forward. Fortunately, the emerging economies will increase consumption. This scenario means that the global economy will likely see a difficult short-term transition but a long-term optimistic future.

El-Erian favors international stocks to domestic stocks. He recommends having an allocation of foreign stocks that is double the allocation of US stocks. He thinks we are in a long-term commodities boom and advises an allocation to commodities in the 11-15% range. He also recommends a small allocation to infrastructure investments which some would argue is a further commodities play. He believes the US economy will be spending money to repair roads, bridges, levees and other infrastructure. It is hard to argue with his logic.

One of the areas that I found most fascinating about the book was the discussion of the prominence of sovereign wealth funds. Sovereign wealth funds (SWF) are created when nations have a savings glut. This is happening with oil rich nations like Saudi Arabia and UAE (Abu Dhabi). Norway, South Korea, China, India and Russia also have billions to invest. All total, there is around \$10 trillion in SWF's around the globe. El-Erian explains that in the past this money has piled into US treasury bonds. In the future, it is likely to be invested in stocks and real estate as the SWF's seek returns that are similar to large institutions and college endowments. This trend is likely to be very positive for the return prospects of global stock markets.

El-Erian mentions three circuit breakers to economic pessimism and gloomy scenarios.

1. Policy makers around the world seem willing to intervene to keep financial markets stable.
2. Large pools of cash in SWF's and an underexposure of SWF's to risk assets.
3. The breakout of emerging economies provides the global economy a degree of resilience that has been lacking in the past.

I would certainly not describe El-Erian as a wild-eyed optimist. But he confirmed my view that despite current economic difficulties, the future looks bright.

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