

Financial Analyst Michael Campbell Says: Follow the Money



Photo: Alan Bird

In Conversation with Val Wilson

An avid curiosity propelled Michael Campbell through an undergraduate Arts BA at both Carleton University and UBC, followed by a Masters degree in Political Science at UBC and further graduate studies at the University of Sussex in England. He wanted to learn about the developing world and how economies grow. He maintains, however, that his current depth of knowledge was not acquired in university.

Michael stated in the preview for our Fall Cover Story: “We are in the throes of the most dynamic changes for personal finance and investment in over a generation.” In this fast-paced, thought-provoking interview, Michael calls it the way he sees it. Here is his straightforward outlook on today’s economy—locally, nationally, and globally.

The Scrivener: *Let’s start at the very beginning, Michael. Where were you born?*

Michael: Right here in Vancouver in 1951. I have two brothers and a sister; I’m the youngest. My mother was a single parent from the time I was 8; she was a secretary at our high school. Financially speaking, we were below the poverty line.

The Scrivener: *What were your early aspirations and your first job?*

Michael: My first job was in the shoe department at Army and Navy for 80 cents an hour. I was 15 and saving money for Expo ‘67 via a 12-hour day. I went up and down three flights to fetch shoes for the salesmen.

Like a lot of young boys, I wanted to play football; I was sports-driven. I played college football at UBC and played basketball at Carleton for a year and at the University of Sussex in England, where I did some graduate work.

I went from political science into economics because I realized I couldn’t

understand politics if I didn’t understand economics. I then realized that I wouldn’t understand economics if I didn’t understand business, so that moved me into business studies.

My first career job was in the investment business. I worked for Merrill Lynch. At that time, everyone trained in New York. I had the good fortune of being trained by some very good people. I was attracted to that business because it has tremendous flexibility and is very measurable-results oriented. Hard work and merit were going to be reflected and measured.

The Scrivener: *Did you have a mentor and a coach?*

Michael: If you go to a class and you’re greeted by someone who is enthusiastic and a good teacher, that can sometimes influence you in a variety of ways, including what the pursuit of study entails. I was taught by a fine fellow named John Wood who, as far as I know, is still a professor of political science at UBC. I pursued his course right through

a Masters. I pushed myself into economics and tax and business stuff. I've always been interested in how the world works and how societies work within it.

I want to be clear that I learned way more, dramatically more, after I left university than I ever did *in* it. To this day universities don't have heavy emphasis on how currencies move and how money moves. That to me is the key to understanding how economies work. There was certainly no university in this country teaching anything about foreign exchange trading 10 years ago.

University is a very valuable experience; you learn how to process information and gather information and how to research. But I can't think of anything at university even right through graduate school that I used; I don't think they're teaching the right stuff. Academia is a different world.

The Scrivener: *What's happening in the economy today, locally and globally?*

Michael: The pivotal issue for us is the weakness in the US dollar over the last two years. I might add I'm not a "Johnny-come-lately" to that. I broadcast two years ago that the US dollar drop was going to be the key to understanding the financial markets.

Right now we're watching Canadian exporters struggle with a 15 percent increase in the Canadian dollar. Not many of them had a 15 percent profit margin so you can imagine the problem. The euro has come from 80 cents to the dollar to \$1.15 generally, with a high of \$1.20. You're watching the Japanese scramble because they don't want the yen to rise against the dollar which, with the US dollar's weakness, it is. It's all about how the capital is moving from one country to another. It's moving out of the States. I still think that exodus will remain the key dynamic to understanding the economy in the next several years.

The Scrivener: *Why has the US permitted this to happen or is it beyond their control?*

Michael: Part of it is beyond their control. Keep in mind that the people in

our major financial institutions—with the exception of Jeff Rubin of CIBC World Markets—have been wrong about the dollar for 12 years. If you read their prognostications in the '90s, it was always about a rising Canadian dollar. They failed to understand that trillions of dollars of capital were moving into the United States from Japan, from the mid-'90s right through to 2000. That shot the US dollar up and relatively speaking, the Canadian dollar fell down to its 63 cent level in December of last year.

The United States has several structural problems that people are just becoming aware of, which is driving money out of the country. Their budgetary deficit is going to be about \$1 trillion in the next two years.

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Second, the balance of trade shows terrible numbers. We're in trade surplus here. Theirs is really negative. In the neighbourhood of \$1.5 billion to \$2 billion a day must go into the States to support their trade at this point. That isn't going to continue. There is no example historically of that continuing.

I think we're going to see a lot more fireworks. Look at the implications for Canada. What if the Canadian dollar goes to 80 cents? At some point that becomes a non-doable proposition for some of our exporters. We've already seen evidence of that in the last five months with Canadian exporters struggling with a 74 cent dollar. Every country is in the same boat, which is why I have been commenting for years about the competing currency devaluations. Every country wants to steal exports from its neighbour.

The Scrivener: *Are any other major trends apparent today?*

Michael: The rise of China as a manufacturing power is just starting to be recognized. It has now surpassed Japan in terms of exports to the US; the implications are staggering.

The bottom line is that the Americans buy Chinese goods and pay US dollars. The Chinese take those US dollars and put them right back into the States in the form of Treasury Bills. The Chinese are going to own the States soon (laughs).

The other main dynamic we're facing has to do with China and how its rise impacts the tug-of-war between the forces of inflation and of deflation. While many US factories have a great deal of excess capacity, China keeps exporting billions in low-priced goods. The result is that manufacturers have no pricing control and the costs of many items keep falling.

On the other side, the Federal Reserve and other central bankers are fighting deflation by dramatically increasing the money supply. In the States they're printing money at the rate of over a trillion dollars a year. The only problem is that the US consumer is using the money to buy Chinese goods.

The Scrivener: *When I was a kid, US paper money had to be backed up by gold stored in Fort Knox.*

Michael: You've hit on one of the absolute keys to understanding what's going on. In the early 1970s, Richard Nixon delinked the dollar to gold. Now it's based on no more than the goodwill of the government. When you think about it, it's laughable. Without the link to gold, government can literally print as much money as it wants, which is what's happening today.

What happens when you increase the supply of something dramatically? The price falls. So they've increased the supply of US dollars dramatically and the price of US dollars falls. But this is the real key: overriding other trends that garner more attention today, I believe, is the unravelling of paper currencies as we

know them. That is an inconceivable concept to most of us.

The new system at some point will have to be linked to something. Here's an example. Why should anyone trust the Argentinean peso? Two years ago, they closed the banks for a whole week. At the end of that week, anybody who had had US foreign dollar deposits didn't have US dollar deposits anymore. They were automatically changed into pesos by the government. Then the peso fell 72 percent. Why would anyone trust that currency? We always think, "Well, that's just Argentina." Well, the same thing happened in Brazil. The same thing has certainly been happening in Japan as things unravelled there. People should be aware that in the history of mankind, no paper currency has ever survived.

The US Federal Reserve took over the defence of the dollar in the early 1900s and since then, the US dollar has lost 94 percent of its purchasing power. Look around here in Canada and you find a two-bedroom bungalow in Dunbar that costs \$600,000. What is that measuring? It's measuring the devaluation of the currency; it's not measuring real estate.

Paper has become worth less. Maybe we are on our way to worthless.

The Scrivener: *What's the implication for the investment markets?*

Michael: Massive amounts of money are being made and lost here. The huge bear market took the NASDAQ from 5200 to 1200; it has now rebounded to 1800. Massive amounts of money are coming and going. Gold is up 40 percent in the last two years and real estate has gone through the roof.

We've watched some currencies collapse—like in South Africa—and now rebound. Our currency is on its way and I believe will continue to recover. All currencies are a relative trade measurement. So even at our worst, we're a powerhouse against the Argentine peso. But we were weak against virtually every Western currency from 1991 to 2001. It's all relative. Mexico, for example, is still

weak against the US dollar—and very weak against the Canadian dollar—while we improve against the US and make virtually no progress against the euro. It's all relative.

My bet is that the US bond market is in its last hurrah as foreign investors pull their money out to avoid the devaluation of the greenback, which in turn will force long-term rates up in the States. That could kill their recovery.

The Scrivener: *Won't that hurt Canada?*

Michael: One of the great farces this year was Jean Chrétien in April, flying to the G-8 meeting in Europe. For whatever reason, he decided to lecture the whole press on how bad George Bush's economic policies were. It is such delicious irony; he wasn't even in the ballpark and of course, our economy is now weaker than the States so I am not so sure if anybody wants to stand up and take pride and say "we did this."

My biggest fear is that we are not reacting to this massive change in the world. In fact we fight it.

And at the same time, I don't blame him either. In Canada we have great faith in governments. It is completely misplaced when it comes to economics. I think what government can do is either amplify trends or make them more intense or less intense.

If you're in an economic slowdown, you can have the right policies within reason to make that slowdown a lot less severe or if you're in a boom, you can have policies that curtail the size of that boom. But they don't create economies. I would have hoped we learned that from the situation in the former Soviet Union. There are many in the media and in the public domain who haven't learned that lesson. I don't blame Chrétien but then again, I didn't give him credit when we were better off.

The Scrivener: *What is your greatest concern or fear regarding all this fluctuation?*

Michael: First from the individual point of view, most individuals are really slow to react. Governments are slow to react, while corporations are a little better. Clearly the world has changed dramatically for Canada in this last year. A currency rise of 15 percent against your major trading partner is enough to ripple through the entire economy, given that one-third of our economy is in exports.

Our exporters have had a challenging time. So what do companies do? I'll bet it was about 15 minutes past the rise in the Canadian dollar that people in the boardrooms were saying: *what are we going to do?*

Individuals react much more slowly. Most rode out the three-year decline in stocks. They have not switched holdings into gold and they've maintained their foreign RRSP content in the US. My bet is that the trend out of the US dollar isn't over, which may spell good news for commodities and bad news for US stock holdings. I also worry that some people are going to get killed in the long-term bond market.

Governments are even worse. They know their revenues are dropping dramatically but still the feds haven't made any budgetary adjustments.

My biggest fear is that we are not reacting to this massive change in the world. In fact we fight it. We fight it hard. Let me give you one example.

We can talk all we want about aging baby boomers but we know that one-third of Canadians have no retirement plan.

We also know that Canadian public and private pensions and corporate pensions are estimated to have a \$225 billion shortfall.

We know we have unfunded liabilities. That means we have made promises to pay you social security, for example, CPP, but money hasn't been set aside. The amount of money the

government has promised to pay out—but has yet to set aside—is estimated to be \$3.5 trillion.

In the States a report came out from the Treasury Department that put the deficit at 44 trillion; they have a bigger population that we do, of course. The point is: what have we done to react to this?

Look at the medical system. An aging population, in addition to increasingly expensive technological and pharmaceutical change, has clearly put massive strain on our health care system. We've talked a ton about it but I challenge anyone to tell me what meaningful action we've taken.

The Scrivener: *How soon do you think we'll see the problems associated with an aging population?*

Michael: The healthcare system all over the Western world is in trouble as governments cope with escalating costs. We've already seen a couple of pension plans talk about not paying out because they don't have the money. They made estimations about what returns they'd get in their plans and after a three-year bear market, they've come up very short. We have massive problems in every Western country in this regard.

That's why I think the broadest trend we're seeing may be the decline of the welfare state. It's simply not affordable. In the last several months, the French—with massive public protests from the public sector—have changed the eligibility rules for their public pensions. They're asking the public servants to work two-and-a-half years longer before they're eligible.

In Germany they've had to raise contributions again for retirees for their health plans. We've had to do that in British Columbia. What I find disconcerting is we don't seem to understand that these are worldwide phenomena.

The good news is that in Canada, one of the things we've done well—at least to this point—is that we had a look

at our Canada Pension Plan several years ago and raised the contributions. There may have been many other solutions to that problem but at least government acknowledged there was a problem. That puts us ahead of France and Germany and Italy right now.

The problems are mathematical in nature by the way. It's not politics. It's pure mathematics. A certain number of people are reaching the retirement age. A certain number are supporting them in the workforce. Promises have been made. An actuary accountant can tell you what those promises are worth. Where is the money going to come from?

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The Scrivener: *Would you recommend everybody put some gold coins away for safekeeping?*

Michael: Yes. Gold coins are meant for safety. Gold stocks are a growth vehicle. They are different vehicles. I personally hold assets in gold and gold shares. It's the only recommendation I made two years ago for RRSPs and I am happy about that recommendation to this day. They are up well over 100 percent.

I am very patient. Gold will have many ups and downs and the bull market will take a while to play out.

The Scrivener: *Let's go back to something you said earlier. What are the implications of the Federal Reserve's printing a trillion dollars a year out of thin air?*

Michael: More money has been created by Allan Greenspan as the Chairman of the Federal Reserve than all other Federal Reserve Chairmen combined. The US has arguably doubled the money supply in the last six years. This has resulted in a devaluation of the US dollar. The US

dollar is how we measure commodities. As the US dollar falls, commodities have to rise just to keep pace. That's why midway through last year, I also added many other situations in the commodity sector to my portfolio because I see the falling US dollar propelling prices higher.

The Scrivener: *This is an amazing amount of information. What has happened to those bags of gold in Fort Knox that have been delinked?*

Michael: The US hasn't been a major seller. Central Banks in Canada—in Switzerland and Great Britain—all got out of their gold near the low; they wanted to own things that produced interest instead. Gold doesn't make you any money while it sits there. The only way you can make money in gold is through appreciation. They changed their gold for government bonds or T-Bills. But that even further delinks them from reality. In the US they haven't been gold sellers at all. It just sits there in Fort Knox.

You are watching massive accumulation of gold in China and India. China is the one that interests me. China holds another huge key to understanding what's going to happen in the next several years. Again on a local level, ask people in the manufacturing business here, competing with China. They get it. They get that the Chinese are involved. The Americans do, too. We've been trying to attract everybody in North America. Obviously we want capital investment. More jobs, more plants, etc. Clearly North America has tremendous trouble. We have overcapacity in our manufacturing; the US lost 600,000 jobs in the last year but China has attracted 100 billion US dollars in direct foreign investment in the last two years. That's where the plants are getting built. People have asked me why the government lowers interest rates. They're trying to encourage consumers to buy. They say lower rates help the economy. Yes, but unfortunately, it's the Chinese economy that it's helped. The economy is explosive there.

Let me be clear. This is not a negative

scenario. It's only negative if you want it to be *the way it was*. The world is in dramatic transition; I understand that many people don't want to look at it because it's uncomfortable. For example, while everyone's saying it's been a bear market the last three years, people have made a ton of money in Euro Bonds and a ton of money in gold shares of every size: small, medium, and large. Nice money.

In commodities and commodity funds, depending on which ones—energy funds, for example—people have done extremely well with wonderful rates of return. It's only negative if you thought the only place to have made money was in the normal equity markets that had done so well in the '90s.

People are in danger because we've gone way overboard in debt. Individuals have taken on more debt than at any other time in history. That's a danger. If you're not one of those people, you might be in good shape. It's not negative. It's just different.

The Scrivener: *What changes would you advocate within the North American federal governments?*

Michael: The problem is the governments are hamstrung by the public; we are a public that resists any level of disruption to our nice lifestyle. Any level of pain is considered a catastrophe. So governments do all they can to flatten out the rough edges. The trouble is, as they do that, they make bigger problems.

The bubble has burst in the equity markets, primarily in the tech area. How does government try to solve that? By doing more of the same medicine that got us into the problem in the first place. More fiscal stimulus, more interest rate stimulus. Well, that gave people more time to get over their heads in debt. I worry that our Internet bubble, our tech bubble, has now given way to a real estate bubble in some areas; it definitely gave way to a bond market bubble that burst in June of this year.

What do governments do? They're hamstrung. The public refuses even the

slightest disruption and that's not realistic. That brings you toward a turning point.

The Scrivener: *What do you see for the BC Economy?*

Michael: Things are at least moderately getting better but it's not been a great global economy to operate in. Then you throw on the forest fires, the softwood lumber dispute, mad cow, a rising Canadian dollar, SARS, and our overall national economy getting slower. It's a very difficult time.

The most positive thing I can see happening to the BC economy is that energy prices are still strong, natural gas is going to be better, and real estate remains strong. That will at least create some opportunities in northern British Columbia.

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The Scrivener: *What's the key to improving the economy?*

Michael: The key to an economy is *attracting capital investment*. In this country we have a tremendous disrespect for the importance of the private sector in many areas. The reasoning doesn't make any sense to me. The private sector in the end is going to produce the products you want, the innovations you want, and also the capital base—the tax base for us. The success of a jurisdiction comes down to the ability to attract investment. That's why China looks so good.

I used to call this "Sam Spade Maltese Falcon" economics because he always followed the money. There's no doubt that's a fundamental of economics. When capital is flowing out of a jurisdiction, it cannot do well. When capital is flowing in, chances are the economy will be good. Who has been the most successful

province, through attracting capital, head offices, people? Alberta. It's a very positive environment, with a lower tax rate and a less interventionist government.

The Scrivener: *Michael, what do you like to do in your free time?*

Michael: I love to golf. I have three children that keep me very active and I coach basketball. My daughter has graduated but I still coach the senior girls team at her former high school. I have sons in grade 9 and grade 7, whom I also coach.

The Scrivener: *What value do you see in school sports? Why do you coach?*

Michael: Sports offer a great vehicle for young people to learn a variety of important success lessons. Whether you're talking about commitment or learning the value of just hard work, those are lessons. A lot of children connect with school through athletics. Others may connect through music, others through parties or dances.

For me it's never about the sport. When people are 40, the fact that they could do a lay-up at 18 doesn't help them. But maybe they learned about team work, maybe they learned about how people get successful, maybe they learned goal setting.

I hope players and coaches all understand this: everyone has a role to play, just like in a business. You may think the CEO is the most important person. Try a day without a receptionist to answer the phone. We'll find out who is important.

It's the same on a basketball team or a football team. Everyone has a role to play. We're not all star players. A team dynamic works because you have people who appreciate their role; the most valuable players understand there is a team operating here.

The Scrivener: *Can you apply the team philosophy to the economy?*

Michael: We don't have a team philosophy in the economy. We have a confrontational model in operation in

our economy in many areas. Certainly our employer/employee relationships are adversarial. I can't believe anyone would think that's the best method for success—that conflict is the best way to advance anything.

Ireland exploded when the trade unions got together with the government and business. Poverty is no fun. Neither is a low standard of living. To all of their credits, led by the trade unions, they created a new environment. They traded labour peace in exchange for tax cuts.

The Scrivener: *Is the confrontational model the main obstacle standing in our way to prosperity?*

Michael: I talked to Michael Porter, an MIT Harvard professor who did a huge competitiveness study for the federal government in the early '90s. I asked him what the biggest obstacle was to Canadian competitiveness. I was expecting an answer that touched on comparative taxes, labour regulations, what have you. He shot back in a second with his answer: "an

anti-business attitude." Ten years later, I interviewed Robert Mundell, a Canadian from Columbia University, where he won the Nobel Prize for economics about two years ago. I asked him the same question. He responded that our anti-business attitude is the biggest drawback.

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I believe much of that anti-business attitude is founded in a lack of understanding of how economics works. Too many consider the economy to be like a pizza pie and that if someone has a slice, then someone else misses out. They see no win/win situations where everyone benefits from freely entering into business arrangements.

The Scrivener: *What can we as individuals do to initiate positive change?*

Michael: Our biggest challenge is taking on the vested interests. Many benefit from the current *status quo*. The only problem is that it will soon become unaffordable. Our first step is to understand that changes need to take place. Some will be uncomfortable. We've had it easy for a long time because we've been willing to borrow on an individual and societal basis, as opposed to earning our lifestyles. There is a limit to that approach; I believe that the aging baby boomers will push that limit.

The change is inevitable and the sooner we recognize it, the less traumatic it will be.

The Scrivener: *What is most important to you in life?*

Michael: My family, in a heartbeat. My family and friends. It's as simple as that. Fortunately, I have healthy and happy kids and a great wife. That's why I spend so much time with them. ▲