



“‘Zombie Economy’ May Scare Markets in October”

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With October being the month of Halloween, a discussion of a “zombie economy” only seems appropriate. We all know what a zombie is; an animated corpse that is not quite living but not quite dead. But is this an accurate description of the economy?

In a word, yes. But this requires a little explaining. We’ll start with the banking system.

A healthy, living bank pumps life into the economy by borrowing (from the Fed or from their depositors) and lending to individuals and to up-and-coming businesses. But when banks scale back their operations—as they have since 2008—they have precisely the opposite effect. They suck life out of the economy by starving it of the funds it needs to grow. And this is made worse by the presence of bad “legacy” assets that the bank has a hard time getting off its books. When banks carry delinquent loans on their books, they tie up capital that now cannot be lent elsewhere.

But companies can be zombies too. At the risk of getting political, consider the controversial government-controlled reorganizations of General Motors and Chrysler from a few years ago. In a competitive economy, inefficient or poorly run companies die in order to make room for healthy, better-run companies to grow and reach their full potential. By keeping General Motors and Chrysler alive, the government did little more than contribute to the glut of automakers. Meanwhile, capital that could have been used to fund the next great technological breakthrough instead gets tied up in an aging, inefficient automaker that is certainly not dead yet but not quite alive either. General Motors is a zombie.

You could argue that the federal government itself has become a gigantic incubator of zombie economics through our entitlement programs. This is not to knock Social Security or Medicare; millions of Americans depend on these programs to meet their needs in retirement. But as spending on these programs continues to grow unchecked, a larger and larger percentage of our national budget goes to funding these entitlements (the figure is now more than half of all federal spending). This means less money for everything else—roads, ports, education, research and development.

Again, I don’t want to get political here. I’m not calling for any particular policy action, and I don’t see any one politician or party that has all the answers. But I think we can all agree that reform is needed, and there will be economic consequences irrespective of who wins in November.

Returning to the headline, the zombie economy may or may not scare the stock market in October. We may actually get a year-end rally due to election politics and Federal Reserve easing. Either way, I’m far more concerned about the long-term, because that is what really matters when forming a financial plan.

Over the long-term, we’re going to have to get creative. A buy-and-hold mindset is not likely to meet our retirement goals. We need to be tactical, taking advantages of opportunities as we see them. And we will need to focus on securing reliable sources of income.

We'll call it becoming "economic zombie slayers."

Sincerely,

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