



## Stan Druckenmiller is Leaving

So the hedgies are in retreat and, in some cases, on the run. Ken Griffin at Citadel is considering cutting fees, and Stan Druckenmiller at Duquesne/ex-Soros is packing his bags for the golf course. Frustrated at his inability to replicate the accustomed 30% annualized returns that his business model and expertise produced over the past several decades, Stan is throwing in the towel. Who's to blame him? I don't. I respect him, not only for his financial wizardry, but his philanthropy which includes not only writing big checks, but spending lots of time with personal causes such as the Harlem Children's Zone. And at 57, he's certainly learned how to smell more roses, pick more daisies, and replace more divots than yours truly has at the advancing age of 66. So way to go Stan. Enjoy.

But his departure and Mr. Griffin's price-cutting are more than personal anecdotes. They are reflective of a broader trend in the capital markets, one which saw the availability of cheap financing drive asset prices to unsustainable heights during the dotcom and housing bubble of the past

decade, and then suffered the slings and arrows of a liquidity crisis in 2008 to date. Similarly, liquidity at a discount drove lots of other successful business models over the past 25 years: housing, commercial real estate, investment banking, goodness – dare I say, investment management – but for them, its destination is more likely to be a semi-permanent rest stop than a freeway. The New Normal has a new set of rules. What once pumped asset prices and favored the production of paper, as opposed to things, is now in retrograde. Leverage and deregulation are fading from the horizon and their polar opposites are in the ascendant. Some characterize it in biblical terms – seven fat years to be followed by seven years of lean. Others like Michael Moore and Oliver Stone describe it in terms of social justice – greed no longer is good. And the hedgies – well, they just take their ball and go home. What, after all, is the use of competing if you can't play by the old rules?

Whoever's slant or side you choose to take in this transition from the old to the

“new” normal, the unmistakable fact is that future investment returns will be far lower than historical averages. If a levered Druckenmiller, Soros, or Griffin could deliver double-digit returns in the past, then a less levered hedge fund community with a lower yielding menu will likely resign themselves to a high single-digit future. If a “stocks for the long run” Jeremy Siegel grew used to historically “validated” 9 to 10% returns from stocks prior to writing his bestseller in the late 1990s, then the experience of the last decade should at least temper his confidence that the “market” will deliver any sort of magical high single-digit return over the long-term future. And, if bond investors believe that the resplendent and abundant capital gains of the past 25 years will be duplicated from yield levels of 2 to 3% – well, they just haven’t been to Japan, have they?

There are all sizes and shapes of “investors” out there who have not correctly visualized the lower return world of the New Normal. *The New York Times* just last week described the previous balancing act that pension funds – both corporate and state-oriented – are now attempting to perform. Their article describes their predicament as the “illusion of savings,” a condition which features the assumption that asset returns on their investment portfolios will

average 8% over the long-term future. No matter that returns for the past 10 years have averaged 3%. They remain stuck on the notion that the 25-year history shown in Chart 1 is the appropriate measure. Sort of a stocks for the long run parody in pension space one would assume. Yet commonsense would only conclude that a 60/40 allocation of stocks and bonds would require nearly a 12% return from stocks in order to get there. The last time I checked, the investment grade bond market yielded only 2.5% and a combination of the two classic asset classes would require 12% from stocks to hit the magical 8% pool ball. That requires a really long cue stick dear reader, or what they call a “bridge” in pool hall parlance. Best of luck.

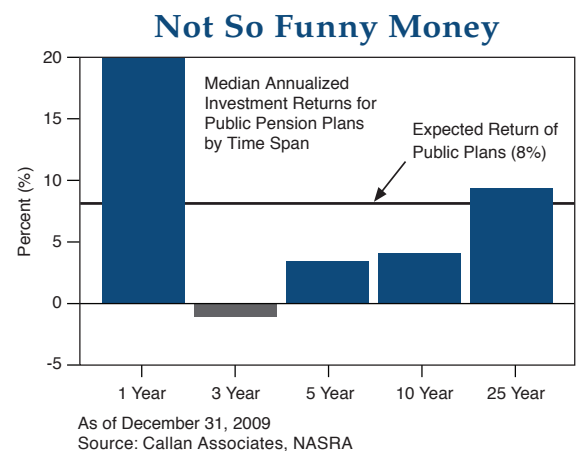


Chart 1

**The predicament, of course, is mimicked by all institutions with underfunded liability structures – insurance**

**companies, Social Security, and perhaps least acknowledged or respected, households.** If a family is expecting to earn a high single-digit return on their 401(k) to fund retirement, or a similar result from their personal account to pay for college, there will likely not be enough in the piggy bank at time's end to pay the bills. If stocks are required to do the heavy lifting because of rather anemic bond yields, it should be acknowledged that bond yields are rather anemic because of extremely **low new normal expectations for growth and inflation in developed economies.** Even the wildest bulls on Wall Street and worldwide bourses would be hard-pressed to manufacture 12% equity returns from nominal GDP growth of 2 to 3%. **The hard cold reality from Stan Druckenmiller's "old normal" is that prosperity and overconsumption was driven by asset inflation that in turn was leverage and interest rate correlated. With deleveraging the fashion du jour, and yields about as low as they are going to go, prosperity requires another foundation.**

What might that be? Well, let me be the first to acknowledge that the best route to prosperity is the good old-fashioned route (no, not the dated Paine Webber road map utilizing hoped for paper gains of 12%+) but good old-fashioned investment

in production. If we are to EARN IT – the best way is to utilize technology and elbow grease to make products that the rest of the world wants to buy. Perhaps we can, but it would take a long time and an increase in political courage not seen since Ronald Reagan or FDR.

**What is more likely is a policy resort to reflation on a multitude of policy fronts: low interest rates and quantitative easing from the Federal Reserve, near double-digit deficits as a percentage of GDP from Washington.** What the U.S. economy needs to do in order to return to the "old" normal is to recreate nominal GDP growth of 5%, the majority of which likely comes from inflation. Inflation is the classic "coin shaving" technique of government since the Roman Empire. In modern parlance, you print money faster than required, pray that the private sector will spend it to generate investment and consumption, and then worry about the consequences in a later decade. Ditto for deficits and fiscal policy. It's that prayer, however, which the financial markets are now doubting, resembling circumstances which in part are reminiscent of the lost decades in Japan since the early 1990s. If the private sector – through undue caution and braking demographic influences – refuses to take the bait, the reflationary trap will never snap shut.

Investors will likely not know whether the mouse has grabbed for the cheese for several years forward. **In the meantime, they are faced with 2.5% yielding bonds and stocks staring straight into new normal real growth rates of 2% or less. There is no 8% there for pension funds. There are no stocks for the long run at 12% returns. And the most likely consequence of stimulative government policies that strain to get us there will be a declining dollar and a lower standard of living.** Stan Druckenmiller is leaving, and with good reason. A future of low investment returns, and a heap of trouble for those expecting more, is what lies ahead.

William H. Gross  
Managing Director

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**PIMCO**

840 Newport Center Drive  
Newport Beach, CA 92660  
949.720.6000

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