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Detroit's Demise and Japan's Future

As many are aware, Detroit filed for Ch. 9 bankruptcy, the largest muni bankruptcy in US history, with the value at $20BB. Detroit is a city comprised of 700,000 residents. The warnings were looming for many years, after the automakers filed for bankruptcy a few years ago, along with many related companies such as auto parts manufacturers. Meredith Whiitney, the reknown analyst who made the prescient calls on the large financial institutions in 2007 also made a similar forecast for munis back in 2010. She seems to be a few years early, but there are noticeably more downgrades than upgrades by credit rating agencies. The overall trend is worst economics for the munis and this spells disaster for the States, and in turn the Fed, who will print more dollars to resolve this issue.

The obligatory pension payments have sucked dry the automakers and now, the cities. This is why we stay away from investing in companies with large unions and pension obligations, since these expenses are perpetuities. It is a hole that leaks money. Sure, the recipients who built the company benefit, but at the risk of toppling the very company.

$369MM in GO bonds for example, or general obligations are paid by the backing of the taxpayers. Should the State of Michigan not bailout the investors, the investors might want to settle for 20% of par, which was offered recently.

As a result of the filing, the city is looking into selling assets to pay off the debt i.e. artwork in museums, parks, airports. This is a really sad event, especially for the city and residents. Muni investors are enjoying higher yields from a year prior, with 30 year yields at 4.4% vs. 3.6% for Treasuries. The market in general is treating this as a one off, not representative of the national muni condition.

Recently, I told an asset management industry veteran about my concerns over Japan because of its' high debt/GDP, over 200% which is accompanied by the likes of Greece, Jamaica, Portugal. He said not to worry because Japan still has a lot of assets to payoff the debt. I imagine Japan may have to sell trillions in financial assets, and their overseas holdings when the time comes. With an aging population and severe competition from China and Korea, we may see a similar catastrophe in Japan in the near future. The social welfare programs are bleeding Japan dry and the national debt can only grow worse as time passes. If it was 20 years ago, Japan may have been able to claw itself out of this rut, but today we have China. China will take market share away from Japan. It has the brainpower, finance and political sway to outmaneuver Japan.