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A Contrarian's Take on the World

*Interview With Rudolph-Riad Younes, Co-manager,
 Julius Baer International Equity Fund*

By **SANDRA WARD**

RUSSIA IS THE PLACE TO BE. TAKE THAT HOT TIP to the bank, since it comes straight from the lips of one of the most successful international stockpickers, Rudolph-Riad Younes. He and his colleague, Richard Pell, consistently have outperformed the broad market averages and their international benchmarks by a wide margin, by being contrarian and opportunistic. More remarkable, they have continued to do so even as the collective assets for which they are responsible have mushroomed to \$63 billion. This year, their fund is up a smart 18.4%, compared with 6.6% for the S&P 500 and 13.4% for its peer group. In the past five years, the **Julius Baer International Equity** Fund has advanced 25.6% a year on average, versus 11.6% for the S&P 500 and 21.3% for the MSCI EAFE index. Riad recently sat down with us at Julius Baer's Manhattan headquarters to share his thoughts.


Barron's: *Are you more sanguine about the markets now that some of the calamity you expected has occurred?*

Younes: We are in an age of decadence, as I have said in the past, and the trick is understanding whether we are going to stay in that age or enter an age of renaissance. There are no Mother Teresas among us, from top to bottom, from the government and the Federal Reserve to the intermediaries to accounting firms and credit-rating agencies, down to CEOs, financial investors and regular citizens. If there is one panacea, it is fixing the inflation index. At the Fed we need more courage and less politics, and we need to reverse many of the changes that were made in the early 1980s to the inflation index, beginning with the decision to remove house prices from it and replace them with equivalent rents.

What is the problem?

Under this revision, inflation rates consistently have been below those of the past. For example, under the old method, inflation in the past 10 years would have ranged between 8% and 10%. Under the new method it has ranged between 2% and 4%. Had the inflation method been kept intact, inflation readings would have been 4% to 6% higher and, in response, interest rates would have been much higher. We would have grown more slowly during the boom, but avoided the bubbles and the ensuing bust. The inflation index, to use an analogy, reminds me of a parent who invents Santa Claus for his children and then begins to believe the fantasy himself. The government invented Santa Claus in order to cheer up the children -- pensioners and laborers -- who were worried about their parents' ability to pay for their entitlements. The children were happy with the yearly gift added to their benefits; the parents were satisfied the children were buying the fairy tale, and spending was reined in.

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But inflation is well under control, say a lot of people.

Look where the dollar is. Look at commodity prices. Look at your bills. Besides bond managers and insurance companies, I don't know anybody who wants to own government bonds. There is no debate.



Gary Spector

"The inflation index reminds me of a parent who invents Santa Claus and then believes the fantasy." --
Rudolph-Riad Younes

Foreign governments still own our bonds.

That may change. Sovereign wealth funds are waking up, and slowly but surely will buy fewer bonds and more real assets, equities and maybe foreign bonds. The biggest losers will be U.S. bonds; we are going to see much higher yields in the next five years. The bigger winners will be equities and real assets. The dollar will be a small loser.

What's your overall outlook?

The subprime issue is deeper than people thought. We started talking about \$50 billion in losses and now we're talking about \$500 billion in potential losses. Most likely, the government and the Federal Reserve will do a lot of maneuvering to minimize that. The financial markets are betting the U.S. decouples from Asia and emerging economies.

What are you betting?

We're going to extend this growth and delay the day of reckoning. We're going to cut rates aggressively, which may buy us time, but it will create another bubble along the way. The market is expecting a 25-basis-point cut when the Fed meets Dec. 11. The Fed may even go to 50 basis points [half a percentage point] or include some other measures along with 25 basis points to ease the liquidity crunch. If you look at Libor [London interbank offered rate, a key benchmark], rates continue to rise despite the Fed cuts. There is definitely stress in the system.

Interview -- Part II¹

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