

The Great Recession: What is the individual to do?

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There is no Santa Claus

- Not a time when growth may be 2, 3, or 4 percent
- A time of great uncertainties—*scenarios* that no one can predict

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Scenario 1: A V-shaped Recovery

- A small dip, and on we go
- No evidence for this

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Scenario 2: Rip-roaring inflation

- Government is releasing so much money, inflation is inevitable
- Price of assets (real estate, art work) will go through the roof
- Money held as “cash” will lose its value

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Scenario 2a: Stagflation

- Price of everything goes up
 - Living on a fixed income is very difficult
- No growth in the economy
 - Unemployment remains high
- No real return from investments

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Scenario 3: Deflation

- Price of tangible assets drops
- Those who hold cash end up winners

Reasons for Optimism

1. This is American—we always bounce back

Reasons for Pessimism, 1:

- Depth of the Bear Market—it is the worst since 1929
 - We've lost half the value of equities in 15 months
 - We're back to 1997, 1996, 1995 . . .
- 25 percent down already this year
- We have reached the “point of capitulation”
 - A generation (or two!) of investors may never return to the stock market

Reasons for Pessimism, 2:

- Level of government expenditure is unprecedented
 - Close to half of the Federal budget will be borrowed
 - Risks: Inefficiency, do nothing, outright fraud
 - Risk: Permanent bloat in the Federal budget
 - The money goes for consumption not investment

Reasons for Pessimism, 3:

- At some point, not enough money to keep stimulating this dead horse

Reasons for Pessimism, 4:

- The Bush years were 8 years of Keynesian stimulus
 - Overspent the budget as a reaction to 9/11
 - Homeland security, \$0.5m “command centers”
 - Unfunded wars—never paid for, just borrowed
 - The economy was already over-running
 - Compared to the rest of the world

Reasons for Pessimism, 5:

- Hugo Chavez and Hu Jintao must be having a field day:
“We told you capitalism was too risky.”
- Risk that the rest-of-the-world will turn against free markets
- The 20th Century saw the death of communism—the 21st Century will see the end of capitalism

Reason for Pessimism, 6:

- There is no Social Security Trust Fund
- We’ve spent it all
- The “consolidated budget” hides how much we are spending on the current account
- Only way to repay the IOUs will be huge raises in taxation for our grandchildren

Reason for Pessimism, 7:

- TARP I was a failure
 - Not nearly enough money to wipe up the mess
 - No clear plan
 - Troubled assets—no! equity investments, no! let me rethink
 - You get what you pay for:
 - Give people a lot of money and they spend it on giving each other bonuses

Reason for Pessimism, 8:

- The Bear Sterns / Lehman distinction was never explained to us
 - If BS was “too big to fail” and would “bring down the entire financial system” what about Lehman Bros (5x bigger)?

Reason for Pessimism, 9:

- Banks that were “too big to fail” are now even bigger
 - How’s that working for you?
 - Bank of American + Merrill
 - Chase + Washington Mutual
 - Wells Fargo + ((Wachovia) + World Savings)

Reason for Pessimism, 10:

- Geithner is a poacher, not a gamekeeper
 - AIG is mud on his hands
 - Four bailouts and its still wobbly
 - Since when was it legal for the Federal Reserve of NY to loan money to a private corporation?

What to do?

What to do? Macro

- Elect the right people
- Obama has been calling people out:
 - **This crisis is neither the result of a normal turn of the business cycle nor an accident of history. We arrived at this point as a result of an era of profound irresponsibility . . .**

What to do: Micro

1. Take stock—it is what it is (and won't get better any time soon)
2. Reduce, defer expenditures
 - a. Live of fixed income, don't rely on investments
3. Take a part-time job
4. Sell assets

What to do: Micro—Investments

- Buy & hold no longer has any appeal
- Consider selling taxable assets for a tax loss
 - Consult your tax advisor or accountant
- In tax-protected accounts, depends whether you think there'll be
 - Rip-roaring inflation
 - Deflation

I can't tell you which will happen

Investments: Buy a laundromat

- Producing businesses are likely to do reasonably well

What will the future be like?

Possibility A: Return to the Carter Years

- No real growth in the economy
- High inflation
- High unemployment
- High “misery index”
- Widespread pessimism

Possibility B: We catch the Japanese Disease

- A “Lost Decade” (or more)
 - No real growth in the economy
 - No return on investments
 - Huge Federal deficits
 - Japan has borrowed 170 percent of GDP, we’re at 60 percent (2007)
 - Endless stimulus packages and make-work projects
 - Bridges to nowhere, unused airports
 - Poor employment prospects for youth

Possibility C: End of life as we know it

- China and Korea tip into recession
- China, Japan and Korea stop buying our bonds
- Cyclical global melt-down in trade

Possibility D: We are Denmark

- GDP/capita \$40,000 not \$48,000
- Public debt about 20 percent of GDP
- Right-sizing the economy
 - Your hairdresser does not need a Lexus SUV

What would “Denmark” be like?

- Less consumption
 - One Volvo per family
 - Fancy vacation every-other-year
- Increased saving
 - From -1 percent of income to 5 percent or more

How long would “Denmark” take?

- If stimulus fails, perhaps 5 years
 - Take the medicine, tip into “real” recession
- If we keep stimulating, 10 years or more
 - Carter or Japan until we get it right

Some More Reasons for Optimism

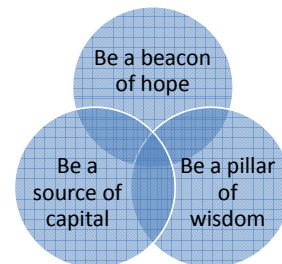
Reasons to be (weakly) optimistic

1. We absolutely knew we were doing this to ourselves—it's no surprise
You can't "monetize" \$1 trillion a year of housing for 4 years and expect nothing to happen
2. Dollar strengthened as stocks have cratered
3. China and Japan must have our purchases
4. Government must get the stock market up or all states and municipalities will tank on retirement funding

What you can do

Three courses of action

What you can do




Be a beacon
of hope

- Help young people see the distant horizon
- Have confidence in our nation
- Don't fire your gardener

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- Hard work
 - Thrift
 - Education

Be a pillar
of
wisdom



Be a
source of
capital

- You are incredibly wealthy
 - Compared to the rest of the world
 - Compared to your childhood
- Think whom you should be helping now

Your Questions & Comments