

Will the Bailout Avoid a Recession/Depression?

by John V. Kamin

During the mid 1930s, a number of things were going on and a number of traditional activities weren't. Those under 50 years of age probably learned very little about the Great Depression of 1929 to 1940. Unemployment rose to exceed 25% during the 1930s.

Underemployment was rampant where people did any job, day work that they could get for \$1 to \$2 per day. Hamburger was 10 cents a pound, coffee 5 cents and a loaf of bread was 10 cents. A 50 pound bushel of apples was 50 cents and a 100 pound bag of potatoes was \$1.

You could buy a decent house or a working farm for \$1,500 in the Midwest. A nice large two-bedroom apartment rented for \$12 to \$15 per month in the big city. A new fully equipped six passenger Chevrolet was \$595 delivered list price and you could dicker for a discount. Gas was 15 cents to 17 cents per gallon depending on where you lived. Amidst refinery price wars in South Jersey or East St. Louis, you'd buy eight gallons for \$1 and they'd give you a free set of glassware or dishes with a fill-up.

Reflating the Economy Translates to Inflation

If you relate a flat tire, you inflate the tire. Don't be fooled by 2008 economic terminology. FDR wanted to "reflate" the economy from 1933 onward, but how to pay for it? Simple. Roosevelt called in all the gold that citizens had (with a little publicized collector exemption) for \$20.67 per oz. Shortly after the recall, FDR raised the price to \$33.67 then up to \$35 per oz. after he got most of the gold by force.

During the 1930s a standard mortgage loan was three years to five years on a farm or house. You had to pay principal plus interest monthly or quarterly, no automatic loan renewal, no 30 year loans as today. But one third of the banks failed in the mid 1930s – no FDIC insurance. Therefore, if you lost your money in the bank and couldn't pay your loan, your loan was not renewed and your property was confiscated.

I asked one senior banking executive who'd been a teller during the 1930s what happened to all of those confiscated properties. "Did your bank make money on them?" He didn't know, but promised to check. Afterwards, he said, "Yes, we made huge amounts of money" upon reselling those properties over the years.

But so many people were losing their properties during the 1930s that Roosevelt declared a moratorium on foreclosures. What happened then? No one, surviving banks included, would make new loans if lenders couldn't have access to collateral when loan payments were not made!

The dust bowl and drought sabotaged many farming operations in the plains states. You may recall Steinbeck's "Grapes of Wrath", resulting in nationwide migrations. When the

farms were abandoned, they could not be resold and the livestock perished, as did the crops.

Will New Loans Expand Or the Credit Squeeze Continue?

FRB Chief Bernanke studied the depression. Now, he prods forward the 2008 bailout. Is it guaranteed that the \$700 billion bailout following September's \$300 billion bailout for GSEs and insurance companies will succeed in averting depression or recession? No, there's no certainty it will work; but it might. So, USA leaders wish to push ahead.

There's the old joke about the friend coming into a room and seeing his buddy banging his head against the wall. "Why are you doing that!" he shouts. The wall banger replies, "Because it feels so good when I stop!"

Time will tell whether the bailout is a wall banger. Fact: USA consumers, businesses, builders, lenders, plastic pushers and users have become addicted to borrowed money and several generations have grown up knowing nothing else. It's quite likely that doing nothing (lack of normal credit facilities) will throw sand in the credit gears.

Frankly, I'd prefer a little more certainty about whether printing nearly one trillion dollars and monetizing debt will work, before approving it. But such certainty is not forthcoming.

"Crowd-Think" Makes Money's Purchasing Power Sink

There have been many examples of manic crowd foolishness throughout the centuries, often causing great populations to lose even greater amounts of money. From the 13th to the 15th century, alchemy was popular; the delusion that you could turn base metals such as iron into gold. So pervasive was this nonsense, that in 1404, England's Parliament passed a law making it a felony to turn anything into gold and silver.

But by 1455, King Henry VI granted patents and encouraged the turning of such lesser substances as iron and mercury into gold, believing it fully possible.

Moving on, tulipomania in Holland bankrupted thousands of the wealthy. By 1720, John Law, an Englishman, helped bankrupt France through the issuance of unbacked paper money and investments in the "Mississippi bubble" schemes. Fiat money literally caused the heads of France to lose their heads, which led to the ascension of the dictator Napoleon.

Napoleon had his own delusions, which caused him to invade Russia at the onset of winter. His wars led to the demise of millions of Frenchmen and opponents and the impoverishment of a great nation.

No stranger to crowd-think, the Florida bubble of the early 20th century had followed the canal bubble and railroad bubble of the 19th century closely. By 1929, Wall Street frenzy

was ready to punish the entire nation with a decade-long depression, which even today in the 21st century influences 2008 bailout schemes and national policy.

Those who wish to read more about crowd-craziness may refer to the interesting (1841) book entitled Extraordinary Popular Delusions and the Madness of Crowds by Dr. Charles McKay with a forward by Bernard Baruch. (Noonday Press, 1970, 18th printing.)

Contrarian Views

What Does it all Mean?

It may be heresy to point out that those who quietly held gold (coins) throughout such delusionary periods survived with wealth intact and often growing, added purchasing power.

Other forms of hard assets may help, provided owners can adjust quickly to changing conditions and massive inflation, shortages, newer delusions to succeed the old crowd-think. One observer said, “The markets will figure out the way to punish you the most, and then do it, at the most inconvenient moment for you, the public.”

Contrary Thinking

Example. During 2004-2005-2006, the Forecaster begged people to sell their worst properties now! We also reminded them constantly that real estate is an illiquid asset, more reminders than many wanted to hear in their buying frenzy. When interest rates were pushed down to record lows, we told them to pay off their debts and at least refinance their unpayable debts at a low fixed interest rate. Now, amidst a 2008 credit crunch, a liquidity squeeze and a soggy property market, many wished they had taken Forecaster advice. More truths are still unpopular.

There are those who still think gold is “risky”. Perhaps it is, but gold is unlikely to go to \$300 or \$100 per oz. And in an extended period of higher inflation, gold coins, including collectibles such as resalable rare coins, which may even go higher.

Subscribers were urged to buy a duplex, triplex or fourplex instead of buying a house during 2008, to let tenants pay off the owner’s 15 year FRM (fixed rate mortgage), amidst a long-term trend of rising rents, while living in one unit and renting out the rest. Rental real estate that generates income is less illiquid than property that generates no income, but costs money to own (homes).

Pity or PITI

Pity those whose house equity is vanishing faster than their house payments. But property that generates income sufficient to pay PITI (**P**inciple, **I**nterest, **T**axes, **I**nsurance) through monthly rental is relatively stable and less illiquid, (since income properties are priced based upon the income they can generate). Even rentals of any individual kind of hard asset (houses vs. residential income property) demonstrate there are vast differences among properties that can treat you financially better.

Many PBs (proprietary businesses that one person controls), can adjust quickly to new trends, such as higher inflation, while larger businesses run by committees and controlled by one may not be able to adjust quickly to economic changes and the different phases of business cycles! Some examples are that rent controls can sabotage even income generating property and bureaucracies setting prices such as food, rent and restaurant prices (as in Venezuela) can cause business to flounder.

The Warning

Dr. Alan Greenspan put it very succinctly to a Texas meeting of bankers in August 2004 saying "Bad loans are made during good times!" The bankers did not heed Greenspan's repeated warnings, hence 2008 bailouts.

Think of yourself as a general leading monetary troops - (dollars). With the 2008 business cycle on the verge of a downtrend of unknown duration, do not commit your forces to do (money) battle too soon since there are other unknowns in the mix, such as whether your taxes will be higher or lower in 2009 to 2012. It's still too soon to commit your monetary troops into ill-timed brushfire conflicts. Stay the course.

Prediction: There is more monetary chaos to come.

John Kamin is a Consulting Economist and publisher of The Forecaster, 19623 Ventura Blvd., Tarzana, CA 91356, (818) 345-4421. Subscription cost is \$180 per year. For more money-making ideas, order his latest book Active Money Strategies & Hidden Wealth Builder Secrets For Young Adults: What They Were Afraid To Teach You In School. If They Ever Knew! \$20 + \$4 shipping and handling plus \$1.65 tax. (95 pages.)

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