

## **How Will the “Real Misery Index” Affect You?** by Nilus Mattive

Santa Barbara is hardly the picture of poverty. Oprah's mansion is there, and the city's median house is worth a cool million. Heck, I proposed to my wife there — we ate some tremendous sushi on State Street and relished in the city's upscale vibe.

So imagine my surprise when I learned that 12 of Santa Barbara's parking lots have recently been converted into nightly homeless shelters!

A CNN story highlighted the case of a car dweller who sleeps in one of these parking lots every night. Were drugs a factor in her demise? Nope. How about mental illness? Not at all. Rather, the 67-year-old woman is jammed into her Honda, along with her two dogs, primarily because of the housing bust and a slumping economy.

The former loan payroll processor was laid off earlier this year. Because her rent ate up 75% of her income, she was forced to move into her car. Even with a new \$8-an-hour job and her Social Security checks, she cannot afford a place to live. And she's not alone -- here's a quote from the coordinator of this new parking lot program: *"The way the economy is going, it's just amazing the people that are becoming homeless. It's hit the middle class."*

Think about that: Twelve parking lots full of middle-class homeless people in one of the nation's most affluent areas. It's sad.

It speaks volumes about the state of the economy ... the situation many soon-to-be-retirees are finding themselves in ... and just how quickly things can go wrong. It begs the question ...

### **Why Isn't the "Misery Index" Reflecting This Economic Pain?**

Back in the 1970s, the misery index was widely cited. The measure, which was created by economist Arthur Okun, combines the government's unemployment and inflation rates to give a quick picture of the on-the-ground economy.

Right now, the U.S. misery index is hovering around 8.9 (inflation of 3.9 combined with unemployment of 5%). That's not great, but it's hardly alarming by historical standards. In the 1970s, the index was running near 15%, and it hit a record of 20.6 in 1980.

So on one hand, we've got anecdotal evidence pointing to plenty of misery even in posh places like Santa Barbara. On the other, official measures make everything look hunky dory. What gives?

I think the real reason that the current misery index looks so tame is because of the way the government measures inflation. See, the misery index is based on the Consumer

Price Index (CPI). And as I recently told my *Dividend Superstars* subscribers, that thing is fishier than a river full of salmon!

Here are four reasons why the CPI is a totally bunk measure of inflation ...

### **1. Hedonic Regression**

That's the government's fancy way of saying that technological improvements in a given product mean you're getting more for your money. Let me give you an example of how this supposedly works:

Say you bought a basic car in 1980. It probably wouldn't have had airbags or a CD player. Today's basic cars come with both. So rather than just admit that the average price of a basic car has risen by the exact percentage, the people who calculate CPI might readjust the number to reflect the fact that CDs and airbags represent substantial improvements for today's car buyers.

In other words, they might lower the real rate of price increases to reflect this fact. Never mind that you might not want a CD player. The fact that manufacturers put them in the dash and force you to buy them means you're coming out ahead!

Hedonic regression is used for clothes, computers, and more. And it lends some credence to the old saw that while figures don't lie, liars can certainly figure.

### **2. Product Substitution**

This is like the evil twin of hedonic pricing. Under this scenario, if corn gets too expensive, the government just figures you'll switch to carrots. So they stop tracking corn and start tracking carrots. But that's a rather huge assumption. And I'm still waiting to hear what the substitute for gasoline is!

### **3. Most Taxes are Excluded**

CPI calculations don't factor in federal, state, or local taxes, even though they are probably sucking away half of your income. Nor does it matter that property taxes have increased substantially for many homeowners over the last few years. Nope, that's not inflation for regular, old urban consumers!

### **4. Bizarro Real Estate Figures**

You'd think the housing bubble would have pushed the CPI through the stratosphere ... after all, it makes up a quarter of the CPI-U.

But Washington doesn't measure housing prices like normal people. Instead, it uses a measure called owner's equivalent rent (OER). This is what homeowners think they could rent their houses for. And as you probably know it's been a lot cheaper to rent than own throughout the housing bubble. It still is, especially in the nation's hottest real estate areas. Take it from someone who's currently being subsidized by his landlord!

So the CPI has totally missed much of the run-up in housing prices. And now, if a weak housing market forces more people to rent, the CPI may actually show increased inflation!

I should also note that there are plenty of reasons to find fault with the employment side of the misery index, too. For example, if someone is unemployed but has not looked for work in the last month, they are excluded. Peculiar, isn't it?

Oh, and what about Barbara Harvey, the aforementioned Santa Barbaran? What would the government say about her? Well, even though she might be looking for a full-time job, she wouldn't be considered unemployed because of her part-time job. Technically, the government is right. But "technically" doesn't always paint an accurate picture of what's really going on. Here's the bottom line ... ***No Matter What the Statisticians Say, Real People Are Suffering Real Hardship.***

### **Consider Taking These Protective Steps ...**

Look, Washington can say inflation is tame till they're blue in the face ... they can tell us that the unemployment rate is totally under control ... and they can say we're not in a recession because GDP remains positive.

When it comes to investing, I use common sense and my own two eyes. And right now, I see lots of people suffering from sinking home values, job losses, and massive price increases for life's basic necessities.

Even more worrisome is that I see plenty of people in retirement, or very close to it, who are having a tougher time scraping by. I mean, the fact that a Social Security recipient is sleeping in a parking lot pretty much says it all, doesn't it?

Sure, it's an extreme example. But it really proves the point that, in the end, we're on our own when it comes to shoring up our finances and securing enough income to live comfortably in our golden years. So, with that said, here are three steps I suggest taking to make sure you won't end up sleeping in your car:

#### **Step #1: Save for a Rainy Day**

It's not easy to forego flat screen televisions or designer handbags, but the sense of security that comes with a big nest egg is well worth the restraint. No matter how much you make, or how much you've already accumulated, times like these are gentle reminders that a little cutback here or there is worth undertaking.

#### **Step #2: Make Sure You Have a Liquid Emergency Fund**

I always advocate keeping a few months worth of your income stashed in a very liquid savings vehicle such as a Treasury-only money fund. You never know when you'll need it to help yourself, a family member, or a friend. And having all your money locked into

volatile investments might prevent you from quickly accessing your cash when you need to.

**Step #3: Consider Dividend-Paying Stocks to Help Your Nest Egg Outpace Inflation**

I'm always singing the virtues of dividends. And right now, I think many beaten-down dividend payers represent tremendous value for longer-term investors.

Not only are many of my favorite companies *currently* paying out better annual yields than other traditional income investments ... but those that steadily increase their payments can help your portfolio beat inflation, whether it's running at 3.9% or 9%!

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