Friday, January 18. 2008

The Economy: Time to Panic? (Not yet, but wear diapers)

As a child, my mother remembers peaking through a window into the bedroom of her grandfather, my great-grandfather, who would sit at a table frantically counting and recounting a few gold coins in a bag. He had gone off his nut, basically, and this was his obsession: emptying a few coins out of his bag and recounting them into it. I was told this tale at a fairly young age and had taken it as a cautionary tale against being miserly or otherwise obsessed with money.

It was only during a recent visit from my mom that I learned the other piece of my great-grandfather's story. He was rich, already a wealthy man before all that "Great War" unpleasantness. WWI ended and he had all of his wealth in (wait for it...) gold. What happened next is what broke the man. A business partner of his convinced him that gold was old news and about as valuable as it was ever going to get (A "barbarous relic" in today's parlance). My great-grandfather agreed he may be right and liquidated the vast majority of his gold bullion and coins into cash. This was in around 1920's Germany, better known then as "The Weimar Republic". Ask any halfway competent student of history about the Weimar Republic and they will all say the one thing it was remembered for the most: HYPERINFLATION.

What is the best possible thing to have oodles of during a period of hyperinflation? Gold What's the worst thing you can do with gold just prior to an episode of hyperinflation? Sell it for cash.

That's what my great-grandfather did and he spent the rest of his days a crazed pauper with OCD. For some reason that story really, I mean really resonates with me on a lot of levels. If I believed in re-incarnation, I would say "I'm that guy, and this time I'm going to get it right goddammit. "

When I flipped past Larry King's show last night and the headline was "The Economy: Time to Panic?" I realized just how badly spoiled we are here in the west.Sure, the stock market is down 14%. That's 14% down from an idiotic high it had no business being near in the first place. But all told, a 14% pullback is peanuts. But in the mindset of the typical lumpenvestor, this is inexcusable and grounds for a massive government mobilization. What kills me about all this is the implicit assumption that consequences are for other people.

When this subprime unwinding really started to impact the market, the financial sector screamed bloody murder and demanded a bailout, the archetypical representation of the entire sector's ethos is captured beautifully by the now legendary Jim Cramer meltdown on CNBC. At around 52 seconds into the clip he says something interesting,

that something is along the lines

"he [Bernanke] has no idea how bad it is out there...I have been on the phone with the heads of all these firms in the past 72 hours and he has no idea how bad it is out there, my people have been in this game for 25 years, and they are losing their jobs and these firms are going out of business"

It is indeed a meltdown to behold and, as Bart Simpson would quip: "The ironing is delicious".

When GM or IBM or some other non-financial giant lays off thousands of workers, guys like Jim Cramer will quip that it's the way of the world and the stock price of those companies will actually bounce a bit. Who gives a crap, those workers are nothing more than cells in a spreadsheet. But when a bunch of bankers, who have been selling each other shit and calling it shinola for years finally get caught out and it all crumbles, the prospect of the consequences coming home to roost is unthinkable. That bankers lose their jobs and firms go underwater because billions of dollars of bullshit derivatives that they dreamed up themselves can't be marked to market is a bona fide crime against humanity.

Citigroup and Merryl Lynch coughed up a 20 billion dollar furball between them this week, then Bear Stearns (who kicked all this subprime mess off last year by having a debt auction that nobody showed up for) added the comedic punchline by upgrading the financial sector. With the exception of Goldman Sachs (who gave subprime such a wide berth they are being investigated by regulators, no good deed goes unpunished), the entire investment services sector looks like a bunch of financially illiterate retards and we're supposed to seriously heed their upgrade recos on the financial sector? These are the same guys who called people like me (contrarians who shunned growth stocks and bought gold in 2002) a bunch of idiots that "just don't get the new economy".

Now the US president has mobilized into action, back from the middle east where he begged the Saudi king for lower oil prices he's crafting a 150 billion dollar stimulus package to ward off a recession that no talking head in Washington will even admit is happening. Everything is fine, but suddenly a 50 basis point cut on the 30th probably won't satisfy the street, it needs an unheard of 75 basis point cut now and if they get it, somewhere some twit will in the same breath re-iterate America's commitment to a "strong dollar policy". We live in truly Orwellian times folks.

I started off last year predicting predictions for a "second half recovery" in 2008 and I haven't heard that magic phrase...yet. The R-word (recession) has only begun to be usable in polite company the last couple weeks and suddenly it's everywhere, but it's still being used in a benign, unalarming context. "Recession? Yeah, I guess there's a remote possibility that we could have a mild recession" but if you read between the lines, alarm bells are ringing, central bankers and politicians are scrambling and the people who see behind the scenes are crapping their pants. Who knew?

Posted by Mark Jeftovic in Venture Crapital at 13:23

Everything below is a guess regardless of langauge to the contrary. In the interest of brevity, I shall not keep typing "I guess".

One dollar of Monopoly money has no gold backing. One dollar of U.S. money has only about one cent of gold backing. This is not a big difference. Furthermore, no one cannot get get the U.S. government to give even that tiny amount of gold, one cent's worth, for a dollar. If one goes to the U.S. Treasury with Monopoly money or U.S. money, the amount of gold one will be given in exchange is the same.

Moreover, some other countries back their money with the U.S. dollar. How valuable is a currency which is backed by the U.S. dollar, which has about as much backing as a Monopoly dollar?

It is sometimes said that the American economy has immense strengths. If someone is dying of liver cancer, it matters little that his lungs and pancreas work well. Worhtless money is perilous for a country.

In theory, the U.S. government could cure the currency problem by measures such as buying huge amounts of bullion and paying off much of the U.S. national government's debt. This is highly unlikely.

American money is widely used in international commerce even for transactions in which no participant is American. I think that most American dollars are outsiee America, not in America. However, international commerce gradually is shifting toward the use of other cuurencies instead of the U.S. dollar.

For a long time, the value of the U.S. dollar has been going down.

Why didn't America have a severe depression 30 years ago, 10 years ago, or two years ago? I don't know.
Anonymous on Mar 9 2008, 08:12