Bazookas and Teddy Bears

By The Mogambo Guru

06/28/04 How do you raise your net worth? You read Mogambo. Unless you are Mogambo, in which case you go and search the couch for coins, and maybe the neighbors' cars too.

I was recently urged to read "A People's History of the United States" by Howard Zinn, probably as a result of the utter contempt I have for the whole Bush administration…(someone out there must have whiffed my secret Leftist leanings).

So, as my wife was going to the library, I asked her to pick up a copy for me. Naturally, I thumbed through it quickly, looking for pictures of pretty girls in swimsuits. I quickly determined that 1) there weren't any such pictures, and 2) it is the history of how Americans, mostly us white Americans, routinely raped and murdered and pillaged our way through everything and everybody. Just like everybody else in history. But let's not get into all that.

It is the last entry on the last page of the book that drew my attention. It tells a tale, a tale of the future. It is a verse by Shelley, the poet, which underscores the quintessential weakness of democracy: that the majority will always tyrannize the minority.

"Rise like lions after slumber
In unvanquishable number!
Shake your chains to earth, like dew
Which in sleep had fallen on you -
Ye are many; they are few!"

But on the other side of Shelley's coin, there are those anxious people who say "They are many; we are few!"

Now, let me just flash my credentials – I am a guy who has experienced many episodes of "They are many, and I are few!" and I note, for the record, that it never really worked out for me.

Median-Priced Houses: 1 in 129 Are Millionaires

I bring this up because the recent news is that one out of every 129 Americans now has a net worth in excess of one million bucks. Well, all that money that the Fed has been creating for all these decades had to go somewhere, I guess. But at the same time, you will notice that there is a hell of a lot of people, and I bandy the figure 25% of the working population to mean "A hell of a lot of people," who make less than $18,000 per year. Average household income is now less than forty thousand bucks a year, which used to be a hell of a lot of money, but now can hardly buy you a pot to peer in. This is because prices have risen so high.

These are people whose net worth is actually negative; it rises and falls with the number of coins that are behind their couch cushions and the few bucks you can glean by sending the kids to search the neighbors' cars for coins carelessly left in the ashtray. If they didn't even take the common-sense precaution of locking their damn cars, it's their own damn fault. And yet, here they come, predictably whining and crying that it is somehow MY fault that their cars are ransacked and now reek of some peculiar odor of some sort.

And pretty soon, as the income level rises, you find yourself in the minority, the ones we heretofore refer to as "the few." These people have a high net worth, and about $50,000 in their retirement plans. Of course, this may not seem like a lot to you, dear reader, because you are so brilliant and wonderful and you haul down the Big Money. But just a paragraph ago, didn't I tell you that prices have inflated so much that a $40,000 gross income is insufficient! Exactly, so how far do you think that $50,000-retirement plan, in terms of buying power, is going to get you? About as far as you can throw me, I'd say…

Median-Priced Houses: Real Estate Appreciation

And most of that 'high net worth' is due to the appreciation in real estate. Anecdotally, buyers here in Florida were shocked to discover that, when they paid an astronomical price for their house, the assessed value of the house instantly went to a new, higher valuation, based on the price they actually paid. Thus, their property tax bills are several thousand dollars higher than the bill paid by the former owner. Bummer!

I notice that Richard Russell, he of the Dow Theory Letters, is getting more somber in tone these days, too. He doesn't actually mention, in black and white, how his hand reflexively clutches the handle of a powerful handgun and how his trigger finger occasionally spasms and how he is drinking bourbon straight from the bottle to try and drown his fears, like I do, but you can be sure he sits there like that from the way he writes. But anyway, he says that houses are not a good buy because they don't pass,what he calls, "The acid test." If you can't buy a house, rent it out, and cover your costs, then it fails the acid test. As you already know, today, there aren't many houses out there that pass this test. In other words, it's far cheaper to rent a home than it is to buy one. This situation has always indicated that house prices are over-valued.

So either houses have to 1) go up in value to make them MORE overvalued, or 2) hold steady while rents increase, or 3) both, or 4) none of the above, or 5) one or two of the above, one more than the other, depending, maybe. As you have guessed, I have no idea either, as it depends on a lot of other things, like fiscal things, for instance. All I can do is look at what has happened in history, and when I do, I quickly chug the last swig out of the bottle and scurry back into my little rat's nest of a hiding place under the stairs like the gutless little coward that I am and spend the next few hours whimpering pitifully with a bazooka in one hand and a teddy bear in the other.

Median-Priced Houses: Median Price $453,590

Meanwhile, the PRNewswire says that only one in five Californians can afford to buy a median-priced house. The median, in case it has been a week or more since you took statistics class, is that point where half the houses cost more, and half cost less. In this particular case, the median-priced house in California costs $453,590. So, half the houses in California cost less than that. And half of them cost, gulp, more.

The report says "The minimum household income needed to purchase a median-priced home in California in April was $102,550." And this is a low-ball estimate, based on "a typical 30-year, fixed-rate mortgage at 5.42% and assuming a 20% down payment."

Last year, the minimum household income needed to purchase a median-priced home was $84,510. Now it takes $102,550. God knows what it will be NEXT year! And the year after that! And the year after that! No wonder people are buying houses with such abandon!

And what, dear reader, happens if 'minimum household income needed to purchase a median-priced home' doesn't rise as fast as prices or maybe even falls because of unemployment and low-wage competition from Asia?

I recommend a bazooka…and a teddy bear,

Regards,

The Mogambo Guru
for The Daily Reckoning
June 28, 2004

—Mogambo Sez: Although the Fed raising Fed Funds rates by a quarter of a point isn't much to a high roller like you, but moving from 1% to 1.25% still represents a 25% jump in the rate! And to raise it to 1.5% would entail a jump of 50%! Increasing rates by 50% is damn significant stuff!

This is the big week. This is the week that the Great Enabler, Alan Greenspan, begins to undo what he did so well.

At least, that is what people expect.

Faced with the threat of a deflationary slump, the Greenspan Fed took emergency measures. It cut the key lending rate and cut it again…and kept cutting until there was not much left to cut. At 1%, the rate had never been so low – except in response to the Great Depression and World War II!

But it seemed to work. Along with tax cuts, spending increases, and EZ credit terms, 1% seemed to be just what the market wanted. The slump was postponed. Stocks rallied. Employment stabilized. Prices didn't fall. The economy seemed to revive…the latest figures for the first quarter of this year show GDP growth of 3.9%. And yet, the Fed's lending rate remains at 1%. What is the emergency, people ask.

On the surface, there is none. Quite the contrary. Judging from almost every indicator, investors and consumers have never, ever been so un-alarmed. Never before have they bought and sold so many houses. Never before have they taken out so many mortgages…and never before have so many selected variable rate mortgages. Never before have they been comfortable owing so much money to so many people.

Now, these same people who jumped to take advantage of the Fed's ultra-low, 'emergency' rates…are sure the maestro can pull off the same trick in the other direction.

For, just a week or two ago, Greenspan announced that the vigil against deflation was over. Deflation concerns, he said, were now "safely behind us." What lie ahead are inflation concerns.

"Inflation returns, worldwide," announced last week's Economist. "Once again the specter of inflation is haunting the financial markets."

Can we count on the Fed to put these ghosts safely behind us too?

When you give money away for less than the inflation rate you have to expect someone to take it. After two years, so many people have taken up the Fed's offer that the world's entire economy has come to depend on it. Without cheap credit, Americans will be unable to continue spending. Without American buying, China's factories will not have enough customers. Without anyone to buy up the output from existing factories, China will have to stop building new ones…and stop buying such vast quantities of oil, copper, steel, and other primary commodities.

This week, Greenspan is supposed to begin the long, slow process of getting the fed funds rate back where it is supposed to be. The smart money is betting that the key rate will rise by a quarter of a percent – enough to show the Fed is responding to inflation concerns, but not enough to put the kibosh on America's credit-dependent economy. After all, if you think your house will rise 10% again next year, what difference does it make if short-term mortgage rates rise by .25%? Still, anticipating higher rates has apparently sent house speculators into a "buying frenzy," says CNN/Money. People are panicking into houses the way they once panicked into tech stocks. [Ed. Note: 'Buying frenzies' don't last long in an environment of rising interest rates. The new environment starts tomorrow with the Fed's latest decision.

A few months ago, America's central bankers worried that the rate of inflation was becoming too low. Now they worry that it may soon be too high. For those people with nothing better to do than watch central bankers, the dramatic tension is rising. Will the Fed be as effective against high inflation as it was against low inflation, they wonder? Optimists say yes. Pessimists say no. We will not say. We do not presume to know whether inflation will be too high or too low. 'Both,' is our guess.

What we know is that the Greenspan Fed has been giving away money for a long time; it has not dealt with an emergency …it has created one. By enforcing a phony stability with a phony lending rate…it has destabilized the planet's financial system. Its fastest-growing economy gobbles up resources in order to make things for people who can't really afford them. Its poorest people save a quarter of their incomes so they can lend to its richest, who save almost nothing. Its biggest economy is also its most indebted. And its biggest debtors buy and sell each other's houses – and think they are getting richer.

Inflation? Deflation? Yes, most likely.