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Prologue

While I'd like to be known as a best-selling author, there are broader goals. The direction of our country's future lies in the balance. Please consider how your financial health will affect the nation as a whole.

For years, I sensed that things did not feel quite right. I remember my cousin entertaining employment at a company called Household Finance Corporation (HFC) in the late 1980s. HFC was one of the first companies providing consumer loans under an installment plan – the borrower paid in monthly installments rather than a future lump sum. It was the epitome of credit creation. This company offered money at high rates of interest. The lending tactics seemed predatory to me and to attorneys general in the U.S. causing the company to settle a suit for millions in 2002. In the late 1980s I coined the expression "The Wonderful World of Credit".

Credit seemed like magic to me. I was not raised to embrace credit. I don't recall my family having anything other than a house payment. If you could not afford something, you saved and then you bought it. Not one of my relatives in Panama owned a dwelling, they rented. They could not make a large

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down payment and there were not many lenders willing to extend credit for 30 years, something we take for granted today. I remember a next-door neighbor who was from South Korea telling me that her family did not believe in credit even for a house. This is quite different from today where our government steers people towards home ownership. Money is not a problem for us since there is always a lender eager for you to sign on the dotted line.

When I left graduate school and became a working stiff, I remember how enthusiastic I was to purchase my first car. It was a blue Toyota Supra, with 200 horsepower and sleek lines - the sports car of my dreams. Granted I was single and had no obligations or debt though my dad questioned how much I spent on that car. After discount, the car cost \$16,000. My starting salary in my new job was \$33,150. My dad asked me how I felt about spending nearly half my salary on a car. I really did not think twice about it since I had no debt and was sharing a townhouse with two other guys, making my car payment quite manageable. My dad also reminded me that I really was not making \$33,150 but something far less thanks to taxes. Heck, I spent more than half my annual salary on that car!

Today, I cannot imagine spending half my annual salary on a car even if I were in the same circumstance. Though I was raised to think about saving, the allure of that brand new sports car was too much to resist. I could buy the car only because a lender was willing to give me money. The lender had confidence that I would pay off the loan in three years and I had the confidence that I could as well. Three years later, I owned the car outright but was shocked to learn the vehicle was worth 55% of its original value.

Why did I underline “confidence” in the previous paragraph? Confidence is necessary allowing lenders to lend and borrowers to borrow. The lending is credit and the borrowing is debt. In my example, I wanted the car and a bank

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lent money. I had no other financial obligations and made a good salary. It was a slam-dunk decision for the bank's lending officer.

Our economy became overly dependent on non-productive lending and borrowing. When that was insufficient, our financial system devised new ways of lending more. Politicians got involved and did what they could to facilitate more borrowing and lending. The public could not get enough, so they became more risky in their borrowing practices. There is a difference between non-productive and productive lending, which we will explore.

We find ourselves, not just as a nation, but also as a world economy in truly uncharted waters. Christopher Columbus had nothing on us. One of my favorite subjects in college was money and banking and I had little idea of the destructive capability of excessive credit creation. The Austrian economists conclude that when an economy creates excessive credit, it deflates like a balloon. The more credit, the bigger the balloon, the bigger the balloon the more air will be expelled. I don't think any economist, government official or financial analyst can argue that the amount of credit generated in our world economy is beyond imagination. An Austrian economist would expect a whole lot of air to come out of that balloon.

Letting air out of the balloon is the only way to keep it from popping. The market let some of the air out from 2005-2008 but governments and central banks worked to reflate. If the balloon pops, we face something for which we have no manual. If we let the air out, it will be painful but at least we will still have a balloon.

The deflating balloon is a metaphor for the credit deflation that I anticipate in our economy. Signs appeared in housing. Society has grown so accustomed to having a large balloon that we really don't have a plan for living with a smaller one. Not only can we live with a smaller one, we have done so before.

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Most of what I will propose will be contrary to what you have heard or read. I realize that going against conventional wisdom is a risky approach. I can see what's going to happen to the balloon and it's not pretty. While the economic balloon may not pop, I *can* guarantee the balloon has never been anywhere close to this size – this is a problem on a mega scale. While events may not unfold as I describe them, the economy will deal with the size of the balloon.

Jim Mosquera, January 2015