E$caping Oz

Introduction

Financial Land of Oz

In the movie *The Wizard of Oz,* twelve-year-old Dorothy Gale sees her new landscape and remarks to her dog Toto, "We're not in Kansas anymore." Our economy is nowhere near Kansas either. We didn't get to Oz suddenly in a tornado – we got here on a burro. The yellow brick road to the Emerald City will lead us to the Wizard who will help us get home. The Wizard is supposed to be a supernatural being standing tall and strong capable of giving us what we wanted. When Toto pulls back the curtain, the Wizard we will ultimately find is someone insignificant who created this false image of omnipotence. All along, we felt we had to trust the Wizard, but the Wizard will ultimately not have the answer. We will have to be resourceful and find our own way home. Lucky for us, we can find our way home but it will require considerable work on our part. The Wicked Witch of the West will be plotting to steal our ruby slippers and setting other traps so we have to keep an eye out. We can melt this Wicked Witch with our economic fountain of knowledge. Our journey will have us questioning our minds, our hearts, and our courage but we will realize that we have what it takes to leave Oz and get back home.

In order to leave the Land of Oz, we need to figure out how we arrived. Retracing our steps will not be easy. It will be much more painful returning home than it was getting to Oz.

Our journey to Oz began long ago when we started manipulating the most important economic good, money. Yes, money is an economic good though society has forgotten. The definition of money changed. We forgot how to produce and save. We became addicted to credit. The wealth that so many thought they had was illusory. For many people that realization began in 2007 when the stock and real estate markets were crushed like the Wicked Witch of the East. Investors found out that wealth was not the perceived equity in a home nor was it the paper gains in the stock market.

Many feel, and simply are, poorer. Here are ten sobering statistics about the Financial Land of Oz:

1. 61% of Americans live paycheck-to-paycheck.
2. 36% save nothing for retirement.
3. 43% have less than $10,000 saved for retirement.
4. In the last year ¼ of American workers postponed retirement.
5. Personal bankruptcy filings have been over 1 million for 11 of the last 15 years despite statistics like GDP indicating the economy grew for all but 2-3 of those years.
6. Only the top 5% of households earned enough income to match housing price increases since 1975.
7. Banks own a greater share of residential housing net worth than all Americans put together. Mortgage debt exceeds home equity by multiple trillions of dollars.
8. The bottom 50 percent of income earners in the United States now collectively own less than 1 percent of the nation's wealth.

9. The average Federal worker earns 60% more than his counterpart in the private sector.
10. 40 million Americans rely on food stamps and 21% of children in the U.S. live below the poverty line.

For many Americans, the feeling of being poorer began with the roof over their head. As one of the statistics indicated, banks own a greater share of housing net worth than homeowners themselves do. While the residential real estate market has experienced pronounced declines, greater declines lie ahead. The sub-prime market was the first catalyst for this decline and the wave of resetting - less than prime - Alt-A loans will provide fuel for the next price collapse. This decline should push more banks to the brink of insolvency.

The stock market made its high in 2007 before experiencing a dramatic fall. Investors could not get over the shock of a market that was supposed to head to Dow 40,000. The rally beginning in March 2009 reignited hope. Hope is all this market has.

Government came to the rescue by trying to spend money the public was otherwise saving. Spending reached such a level that in fiscal 2009, expenditures in Medicare, Medicaid, Social Security, and other mandatory programs were *greater* than Federal receipts. Government had to borrow just to cover the mandatory spending deficit! Deficits ballooned to the point where discussion of a trillion plus dollar shortfall rolled off the tongue with ease. The current administration has no qualms about maintaining this rate of spending in the near future. Such spending has no historical precedent. It is ironic that the United States used to chastise other countries for reckless spending.

The Federal Reserve came to the rescue as well by taking on assets dragging down the banking system. Their action increased the amount of money banks had in their coffers. The money made available in the economy, by this action alone, increased by well over a trillion dollars. However, the money has not found its way into the economy since banks have not lent it.

With trillion dollar government deficits and trillion plus injections of money in the economy, we should be in the middle of a massive hyperinflation, right? That is conventional wisdom; add money to the economy and you should have inflation. Despite government and Fed action, there is no massive inflation. In fact, we have many signs of deflation.

Most of us have no idea what deflation is – do you? Deflation is a reduction in the amount of outstanding money and credit. In a credit-based society, the reduction of credit is fatal to expansion and the continuing rise of prices. Banks become more hesitant to lend. Consumers saturated with debt are unwilling to assume any more. The deflation seen thus far in our economy is a sign of things to come.

Unfortunately, economic realities cannot be repealed. Economies in our time expand and contract resulting from credit cycles and social mood. Attempting to fight these cycles only prolongs the eventual outcome.

Future America

America, your future is threatened. These are not words I say lightly. The nation's deteriorating financial condition, both public and private places its welfare in great peril. I am talking about our standard of living, our way of life. You picked up this book for a reason. Maybe you feel nothing can be done and simply want a way to protect your family's wealth. Maybe you want to be part of a solution. Both are necessary for financial health and security.

Before we try to lay the finger on any one thing that got us in this financial mess, we need to understand how we got here. Trust me; this understanding is of the utmost importance. You wouldn't want your doctor operating on you unless he understood the human body. You don't learn calculus before algebra. The approaches presented will make little sense without this understanding.

The human condition includes emotion. Emotion permeates our society and our economy. That emotion leads to trends and sometimes those trends are quite pronounced. Pronounced trends lead to speculative bubbles. Show me a financial panic and I will show you a speculative bubble preceding it. Not just individuals but governments play into the speculation.

When you speculate, it is with your own or family's money. When governments speculate it is also with your family's money. This is something people overlook. Government produces nothing and has no money of its own; they are custodians for our money. Government is only what the people allow it to be. Unfortunately, we the people allowed government to become an unrecognizable leviathan. Politicians aided the growth of the leviathan by pandering to *we the people*.

I constantly hear politicians boast about how they create jobs. Let me say this very clearly. Politicians do not create jobs. The only things politicians can do is take money and spend it, also known as fiscal spending. The word "fiscal" comes from the Latin "fiscus" which described a basket used to collect revenues for the Roman emperor. Our politicians demanded a larger basket so they could spend more and we gave it to them. When the basket was still not large enough, they added more baskets. The next time you hear a politician claiming they created a job, roll your eyes.

I don't want to diminish the role of government in our society. We need government but we don't need them to do so much. Government has two important roles in our society and we will discuss those roles. We the people also need to quit asking government to do so much. Our government's fiscal policy is a reflection of our own financial habits. We asked government to do more but we were unwilling to give them the money to do it. In the 1980s, the matter of cutting taxes while increasing spending became political dogma. Government got so good at spending that we are in a long-term trend where personal income comes less from private sources and more from government transfer programs or government salaries. Individually we did the same as government; we spent more but only through debt. The culture of debt replaced the culture of thrift. Why save money for something you really wanted when you could borrow.

We lived in self-indulgent times. Remember Gordon Gekko in the movie *Wall Street*? "Greed is good." Marketing slogans in the early 1980s said, "You can have it all." Consumerism emerged with its own doctrines like "bigger is better", "faster is better", "more is better". Consumerism by itself is not a bad thing. Economically we should strive for a better outcome. If we produce more we can consume more. Our problem emerged when we began to consume more without producing more. The only way to make that happen was to borrow from the future to consume now.

All of this borrowing made the economy and our financial system more complex. Imagine a group of people sitting in a circle throwing a ball of yarn back and forth. When the yarn ball is completely unwound, you end up with a complex pattern of threads spanning the diameter of the circle. If I asked you to pull up on a single thread, could you do it without moving another thread? Not likely. This is our economy. Each of those threads affects us personally. Pull on the retirement thread and you move health care. Pull on the vacation spending thread and you move the one sending your kids to summer camp. Pull on the tax thread and you move spending on highways and bridges.

We will no longer have the ability to make single-threaded decisions. One decision will at least affect another.

Those decisions are already raising questions about how you might fare economically in the future. If you are in your 20s, you are probably concerned about the debt you accumulated going to the university that was supposed to give you that choice job. If you don't have a job, you were reacquainted with family and are living in your old room. If you are in your 30s, you might be thinking about how you are spending money on your kids. Will they go to private school? Can they go to sports camps? People in their 40s are worried about having to pay for their kids' higher education. Have I saved enough for retirement? People in their 50s and 60s may be postponing retirement since they have nary enough saved.

You will have to be personally responsible for your economic recovery. There is a television commercial where a restaurant patron asks a bunch of questions about things on the menu and then segues to something completely unrelated to dinner. The commercial continues with the person in front of their doctor. After explaining a few things, the doctor asks if there are any questions. You can hear a pin drop. You cannot be silent in pursuing your economic recovery. Ask questions. Ask your financial planner. Ask your elected officials. Ask your school. Ask your banker. If you are not satisfied with an answer, ask more questions.

Economic problems, if severe enough, can also bring social upheaval. This could be a good thing or a bad thing. Some of the worst demagogues in recent memory preyed on the ignorance of the masses. Don't let a demagogue prey on ignorance. These demagogues may pretend to be the Wizard but we know there is no such thing. In the worst case, they may be nothing more than the Wicked Witch of the West posing as a friend. At best, they are just someone pulling levers behind a curtain making the problem worse.

Even if no demagogue appears, you will have a government navigating unchartered waters. Under these conditions, governments can become more draconian. They can enact new rules and regulations. They may have to quell civil unrest. You need to understand why these issues are so important or you will face a more strict government.

We can return home to Kansas. Kansas will be a different place than it was before but it will still be home. If we sharpen our minds, strengthen our hearts, and build our courage we can get back home without the Wizard's help.

Layout of Book

Part I of this book gives you a background on our crisis – why we have a financial balloon in the first place. I realize not everyone may have an interest in reading the whys behind our crisis but I implore you to read Part I anyway. Consider Part I to be all about the fundamentals. Part I will allow you to gather the necessary tools in order to learn to think for yourself. You will need that skill in the days ahead particularly in regards to your money. For too long our society has been on autopilot and we did not take notice of what was happening.

Part II discusses our economic crisis. The fundamentals we learned about in Part I led to the decisions that ultimately led to the crisis. After we got into the crisis, our Wizards tried to figure out how to get out of it. Can the Wizards really help?

Part III uses the information from Parts I and II to suggest a course of action for investments and wealth preservation. Part III also explores how most investors make decisions and who you are as an investor. Now more than ever, it is important to preserve your wealth rather than swinging for the fences and hitting a home run. This is your path to Kansas.

I provide a summary of the important points explored at the end of most chapters. For those with an interest in chapter skimming this is an alternate approach to understanding the book's content.