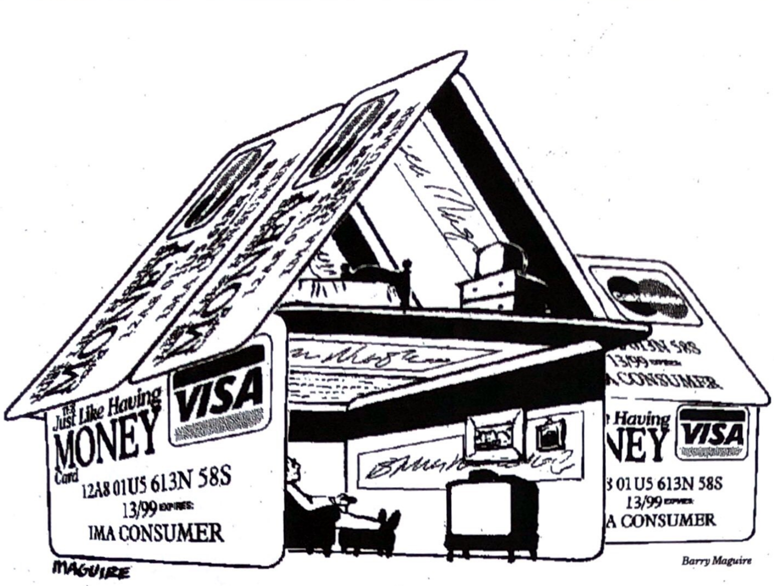
OPINION



Barry Maguire

The coming financial tsunami

By George Mullen

World economies, including that of the United States, have been built not only on a house of cards, but on a foundation of beach sand as well. The tide, which had been going out for some time, convinced us of the soundness of our financial structure and the brilliance of our government stewardship and individual decisions. However, the tide is now coming in again (via the Federal Reserve), and we are failing to grasp the magnitude of the danger before us. It is a tsunami.

Let's take a hard look at what has transpired over the past decade:

- From 1995 to 2000, the United States experienced a boom in the equity markets, which evolved into one of the greatest financial bubbles in history.
- From 1997 to 2000, real estate prices began producing remarkable growth rates based largely on the dramatic wealth creation of the congruent equity market bubble.
- From 2000 to 2002, the U.S. economy suffered the enormous shocks of the collapsing equity bubble (Nasdaq — 75 percent, Standard & Poors 500 — 38 percent) along with the Sept. 11, 2001, terrorist attacks. Nearly $7 trillion of U.S. investor wealth was wiped out.
- Sensing that political talk was not enough to avert a financial disaster, the Federal Reserve took the unprecedented action of reducing the federal funds rate from 6.50 percent in January 2001 to 1 percent by June 2003 — the policy being to keep consumers purchasing to prop up the economy.
- Despite the equity market collapse and the destruction of nearly $7 trillion of investor wealth, real estate defied gravity and unbelievably began appreciating at an accelerated rate from 2001 to 2005. Demand clearly was outstripping supply, but with the Nasdaq down 75 percent, it certainly wasn't demand driven by new wealth created in the economy. In truth, it was based on the Federal Reserve's artificially engineered low interest rates matched with the easy money loan programs of banks that had decided to throw aside caution in exchange for earnings. (Proof of the demand acceleration is evident in the homeownership rate which grew from 64 percent in 1994 to 69 percent in 2005.)
- According to the February 2005 Housing Affordability Index of the California Association of Realtors, the median-priced home in San Diego has now reached $580,860, a level only 11 percent of the area households can still afford to purchase.
- According to the National Association of Realtors, 36 percent of all new homes purchased in 2004 were secondary homes either for investment (23 percent) or vacation (13 percent). This is evidence of rampant speculation.
- Speculators in California and Florida are reportedly day-trading homes and lots and using the illiquid rise in value in one spec home to finance the purchase of yet another. Echoes of the margined equity day traders of 1999 to 2000.
- According to the Federal Reserve, U.S. homeowner equity as a percentage of total home market value went from 57 percent five years ago to 56 percent at the end of 2004. At first glance this appears rather benign, but it is shocking when we account for the fact that U.S. home values increased an average of 50 percent in the same five-year period. Where has all that growth in equity gone? (Answer: Toward leveraged real estate speculation and leveraged consumer spending.)
- Over the three years of this "supposed" economic recovery, wages have increased a meager 4 percent, a startling 10 percentage points behind the 14 percent average wage gain of the five preceding cyclical recoveries.
- The personal savings rate in the United States has declined from 6 percent in 1993 to under 1 percent today. (Note: the personal savings rate has averaged 7 percent over the previous three decades.)
- By February 2005, Americans were carrying a record $803 billion in revolving credit card debt, up $40 billion in the past year alone. (Note: debt levels typically do not increase in economic recovery periods.)
- Beginning in 2004, the Federal Reserve began steadily raising the federal funds rate in an attempt to unwind the overtly easy money fueling the expanding real estate bubble.

The tide is now moving in on our house of cards (built on a foundation of beach sand) at an escalating rate: higher interest rates on adjustable loans, higher oil and gasoline prices and creeping inflation are steadily diminishing the consumer's cash flow and purchasing power. Yet in the wake of this, the real estate bubble appears to be holding its own and may even still be expanding, but for how much longer? (Remember the Nasdaq — it went much higher than any imagined before the inevitable 75 percent collapse.)

History tells us that asset prices built on perception alone are remarkably fragile and have dramatic downside. Is the perception of real estate any different than the perception of the dot-com stocks? Is the same San Diego home purchased in 1994 for $230,000 really worth $800,000 today based on the new carpet and paint? The answer is yes so long as the demand continues to support the price, just the same as eToys at $70 per share. An important difference, you could only borrow up to 50 percent against your eToys stock, and you could liquidate it within minutes. With your real estate holdings, you can borrow 95 percent or more against it, but the normal market liquidation process is more akin to watching paint dry. When the bids dry up, look out below.

The principal cause of the Great Depression of the 1930s was the speculative bent of the late-1920s equity markets matched with the 90 percent margin rates. This dangerous combination led to a massive worldwide destruction of capital. Though a new 50 percent margin rate was instituted to prevent this from happening again in the equity markets, we have inadvertently allowed the same leveraged speculative scenario to exist today in the real estate markets. Are we on the threshold of another massive destruction of capital? This remains to be seen. However, if we are, we may be facing one of the most gut wrenching global economic downturns yet seen.

Just as a tsunami is nearly impossible to see as it travels through the deep sea, so too is this one, but it is coming, and it is big.

Mullen has been in the investment management business in downtown San Diego since 1987. He can be reached via e-mail at gdmullen@pacbell.net.

SCHOOL BULLIES AND SCHOOL RULES

By Dorothy Rich

Being bullied at school, especially among boys, used to be considered a rite of passage, almost as if we were saying, "That's what boys do."

Bullying was never benign even when accepted. Today, it is supposed to be non-acceptable and against school rules. That's what my grandson thought.

At recess, some of the boys in his first-grade class started a recess "club." Some kids were in, some were out. This changed every day along with a string of initiation rites. My grandson, for whatever reason, was not in everyday. But, he assured me that it was not a problem because the school had a rule that there were to be no clubs and no bullying. And he believed it.

The only problem is that the school did not know about this club or monitor the playground sufficiently to learn of its existence. And my grandson was sure that he did not want to be a "tattletale."

Situations like this happen all the time to a lot of kids at school. And while they are usually passing things, they nevertheless impair a bullied child's ability to do well and feel good in school.

Cruelty and meanness between children start early and keep going all through the grades. This isn't just a boy thing. Girls are known for their clubbishness and cliques from an early age. "You're my friend, you're not. You can't sit at our lunch table, etc." Add to that new anonymous instant messaging threats that teens are sending each other these days.

Many of these behaviors are young and petty and not necessarily the prerequisites to feelings of ostracism, anger, gang. But they are early markers on the road to real tragedy, to depression, to dropping out of school.

And, so when schools make rules about no clubs, no bullying, no cliques, there has to be monitoring and enforcement at school and at home. For sure, schools can't stop students from liking certain friends better than others, but on school time and on school grounds, tolerance and acceptance have to be taught and expected from all students. At home, parents may need to become tattletales and tell the school what's happening. I call these parents "whistle-blowers for their children." This is not weakness. It's showing parental responsibility.

It's tempting for teachers and parents to stay out of these messy situations that kids get into with other kids. But, if we believe that school should be place of safety along with academics, then we have to pay attention to how children treat each other.

This effort by school has got to be more than words. It needs planning and action. Bullies have to know that they will not to be tolerated and that their bullying has consequences that they will not like.

All students to be welcomed in a way that makes room for them at school. Children have to know that it matters that they come to school and that the school looks out for them. I know how important this is because I did not feel the school looked out for me.

I was a transfer student in the eleventh grade, coming from a small school to large city high school right after my mother died. I wasn't bullied in the usual sense. I was ignored. The cliques were already formed, and there was no school initiative about bringing newcomers in and making them feel welcome.

I am not being a "softie" when I say that emotional well-being at school is vital for educational success. Research and experience tell us this. One of the most obvious places for educators to find bullying is at recess and in physical education classes. I have seen older children cry when they talk about the razzing they had to take in gym and about being the last one to be picked for the team.

Schools can't ensure that every kid will be the first pick for the team. But, there has to be a fair way for making sure all kids get a chance and that adults look out for the kids in and out of the classroom.

Rich is founder and president of the nonprofit Home and School Institute, MegaSkills Education Center in Washington, D.C. (www.MegaSkillsHSI.org).

Lionel Van Deerlin

Money is corrupting politics — once again

For one who has seen 90 years in this vale of tears, mine must seem a sheltered life. Until three San Diego City Council members came under scrutiny for their purported interest in laws regarding strip joints, I never knew what "lap dancing" is.

Indeed, I would not have known much even yet, except for news accounts of the public corruption trial under way in our town. But without ascribing guilt or innocence, I've learned enough to know this case cries out for some really binding campaign finance reform. Public financing, maybe.

The facts: An owner of girlie clubs both here and in Las Vegas hankered to be done with the "Do Not Touch" rules, which local ordinance requires him to enforce. The entrepreneur, who's in dutch along with our councilmen and lesser lights, feels that if patrons can be allowed to fondle the lightly clad merchandise, they will open their wallets more eagerly, significantly enriching both management and those dancing dollies.

FBI intercepts leave little doubt that the two living councilmanic defendants, both 35, were promised generous campaign contributions. And that a number of discussions ensued dealing with stratagems that might help scuttle the no-touch law. It's left to jurors, of course, to determine what was in everyone's mind during these taped sessions, set against the backdrop of some favored San Diego dining spots. It will be argued that the monies thereafter tendered have been listed on campaign reports as the law requires.

A jury verdict, therefore, could turn on how favorably eight men and four women, all drawn from the citizenry, view politicians. More specifically, whether any and all financial help directed to public officials might be thought tainted.

Will jurors instead accept the notion that in an imperfect world, a donor's money buys "access" to an elected official — a chance to be heard, and nothing more?

After roughly a billion dollars was blown on a presidential campaign, this trial shows how high the stakes can soar on state and local elections as well. A little more than 50 years ago, San Diego's Mayor Harley Knox uttered words that are preserved in John Gunther's "Inside USA." Knox, a dairyman able to underwrite a considerable portion of his re-election campaign, was informed that an opponent intended putting up $35,000 against him. His response: "Anyone spending that kind of money is not buying good government."

No San Diegan today could hope to wage a winning campaign for school board with as little as $35,000. An incumbent City Council member won't feel safe with much less than a quarter-million under the mattress.

What's to blame? Television, mainly. In peak time periods, a network station may charge up to $6,000 for a single 30-second TV spot. Broadcasters once regarded political advertising as a nuisance, a source of income so enmeshed in equal-time law and kindred regulation as to constitute more trouble than it's worth. Today, with the Federal Communications Commission far less interested, political advertising (during and between elections) has become a major dollar producer for many stations. Moreover, station owners, who pay nothing for their licensed access to the nation's airwaves, no longer feel a responsibility to present candidates in unpaid time as "public service" justifying the station's spectrum space. Congress, in happy obeisance to hometown broadcasters, looks the other way.

An incidental result are tens of thousands of "political action committees," a legally authorized, though virtually unregulated, form of giving which enables a corporate entity or any special interest — even politicians themselves — to maintain permanent fundraising systems. (House leader Tom DeLay's troubles come to mind.)

It happens that these PACs had the noblest of beginnings. Dan Kimball, who was President Truman's undersecretary of the Navy, later assumed management of Aerojet Engineering in Pasadena and Sacramento. During election campaigns, Kimball invited major partisan candidates to address his work force on company time. Afterward, he invited workers to contribute a few dollars to campaigns of the candidates they liked best. No one was forced to take part, and the disbursement of campaign dollars, independent of management, depended on how well the individual candidates had connected.

Alas, PACs have become something very different, their cash input a legalized form of laundered money.

Voters in Maine and Arizona have decided public financed election campaigns are the answer — that taxpayers can save a bundle, overall, by bearing the brunt of necessary campaign costs, while limiting all others.

If not something like this, do we wait another 2,000 years to drive moneychangers from the temple?

Van Deerlin represented a San Diego County district in Congress for 18 years.

The San Diego Union-Tribune

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By George Mullen
June 9, 2005

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