

# A Lot of Debt, But Little Income: A Recipe for Disaster

October 4, 2004

During the middle of September, the Federal Reserve released the 2<sup>nd</sup> quarter “Flow of Funds\*” report. Again, it makes some interesting reading. The following is the annualized numbers for the 1<sup>st</sup> two quarters of 2004, as well as the previous annual amounts.

<u>Year</u>	<u>Amounts</u>
1st Half of 2004	\$2.67T
2003	2.64
2002	2.16
2001	1.97
2000	1.70

Alan Greenspan and his fellow Open Market Committee members continue to be very pleased with their handling of monetary policy, which has rendered the recession of 2001 relatively harmless and is now fostering a recovery of sorts. However, only is this true as it pertains to the GDP numbers. When one looks at employment, wages, and other economic measures it is obvious that something else is going on.

The above table of net new additions to debt is the downside to their policies. For example, if one looks inside the net new debt, one finds that the consumer has increased his debt a whopping 22% over the last 2 years. So here we are, well into the third year of economic recovery and the consumer’s real income is almost nonexistent and his debt is going through the roof. If you please, a reminder of our often stated concern – debt can be repaid in the long run only by income or default and the payoff date may not be too far off.

We wonder, where is the income? Who is going to suffer the defaults? Wall Street and the banking industry have, through securitization, spread the risk to the pension funds, endowments, and individuals. There are already huge problems in these areas and more are sure to come. We are afraid that the advisor and consulting industry along with Wall Street have miserably failed the investing public.

\*Total net debt creation by the entire economy.