

Borrowing Our Way to Poverty

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We cannot seem to get off the debt subject when it comes to attempting to make reasonable judgments concerning the outlook for the economy and the financial markets. A recent piece done by Caroline Salas entitled *Companies Have Not Been in Such Shape Since the Depression*, caught our eye on Bloomberg the other day. The following are some interesting tidbits concerning the \$5 trillion corporate bond market.

1. Already 20% of the market is classified as junk - \$1 trillion.
2. Today there is an additional \$88 billion that will probably be downgraded to junk before long.
3. General Motors, Ford, Sears, and Eastman Kodak are now junk. All names were considered untouchable just 10 years ago.
4. The number of potential new downgrades to upgrades as of a week ago was 618 companies to 318.
5. History indicates that when once classified as junk only 3 of 10 make it back to investment grade.

The above, along with the horrible debt condition of the American consumer, is why we believe the economy and the financial markets, except government bonds, are an accident waiting to happen. As an aside you had better not call for and/or hope for a federal balanced budget. If it goes to surplus under present conditions, you had better head for the hills. We remain puzzled to understand why Wall Street and Washington continue to trumpet the soundness of this economy when the consumer today has to borrow money just to pay his debt service. This is compound interest in reverse and a bonified economy killer if there ever was one.

Total non-federal yearly borrowing has increased 107% since 1997, just 7 years ago. It looks as if borrowing will be up 17% in 2005 over 2004. By far the largest percentage increase during the 7 years ended 2004 have been in home mortgages – almost 300%. The yearly rate of growth in corporate debt has actually decreased vis-a-vis 1987. Isn't it interesting that one hears little about consumer debt problems where there has been an unprecedented increase, but much about corporate debt where there has been an actual decline in the yearly increase? Who is fooling whom around here?

To the above add the debt that will be assumed by someone for the remake of New Orleans etc... From this debt will come little in the way of additional assets. Many continue to point to this rebuild as an economic plus. Again, we say if that is the case let's hope for more and more hurricanes. In the short run inflation may occur in certain areas, however with the current consumer debt load and Fed induced higher interest rates it will only hasten the downturn in economic activity. The growth in money supply is declining, next will be consumption, housing has peaked and the liquidations of assets will follow. All signs, after an initial easy source of funds, point toward a bull market in government bonds. Who will buy these bonds? Those who have felt common stocks were the only place to make money – are you one of those?