

## **DEBT RULES**

### **WEB BUZZ 2008.04.21**

**Both the stock market and the bond market have been range-bound for months. Neither one has yet to make up its mind which way it should go. We believe this is directly related to the two questions of the day: 1) *is the current recession going to be a typical short and shallow affair to be followed by a normal recovery and expansion, and 2) are we headed for inflation or deflation or something in between?* The consensus at best is 50/50 on both matters; thus the vacillation of stocks and bonds between well-defined parameters.**

**As you know, we are firmly on the side of a long, extended recession of still unknown severity. What we are confident of is that this recession will not be a normal one. There is too much debt and too little personal income for it to be anything like that.**

**It was only the acceleration of debt on the part of the consumer that led to the most recent expansion, which has come to a close. That source of funds is long gone; i.e., the housing ATM. In our opinion, the only way for the consumer to obtain additional funds is through selling assets—the most liquid, of course, being marketable stocks and bonds. As far as we are concerned, the consumer—which is 70% of the economy—is out of bullets. While the Austrian model estimates the consumer is 40% of the economy, the result is the same—no more ammunition.**

**As far as the inflation/deflation question is concerned we, as you know, come down firmly on the deflation side. Liquidation of debt, which is the side of the coin we are presently transversing, is deflationary. This can only be delayed by a new bubble. We see none in sight, although we still have an old one that has yet to be burst—i.e. commodities.**

As concerns the financial markets, the strong equities-only cult has “learned” over the years to buy only stocks, and never bonds. Another “learned” behavior is that deflation is impossible, as the Federal Reserve can “print money” to its heart’s content. As you know, we have attempted to dispel that notion for the very simple reason that the Federal Reserve must work through the banking industry to create money out of thin air. My friends, the banks are broke and on the run. A borrower will have to prove that he doesn’t need the loan in order to get one. This, of course, is a generalization, but the point is, the days of high risk and speculation that have been aided and abetted and, in many instances, instigated by the financial community are over.

The above may not be apparent as of now, but it will be, and the reason again is simple—debt has grown out of control, and at some point (we think now) only income can pay it off. No more rolling over debt. Please note the following table:

<u>Debt Type</u>	<u>1988-97 Average</u>	<u>2007</u>	<u>Increase</u>
Non-Financial. ....	\$644.8B.....	\$2,344.1B.....	3.6X
Financial .....	\$336.0B.....	\$1,569.3B.....	4.7X
Total.....	\$980.8B.....	\$3,913.4B.....	4.1X