

The End, or the Beginning?

By Robert Avila

Almost a year ago, we asked an economist and former colleague of ours, Robert Avila, to give us his thoughts about the state of the economy. That column proved so prescient that we have asked him back to let us know if there's any light at the end of the tunnel ... and, if so, whether it's a new dawn or the 7:25 express to Grand Central..

War has frightful beauties which we have not concealed; it has also, we acknowledge, some hideous features. One of the most surprising is the prompt stripping of the bodies of the dead after the victory. The dawn which follows a battle always rises on naked corpses.

— Victor Hugo, *Les Misérables*, Chapter XIX, “The Battle-Field at Night”

We've all been in them, the elephantine McMansions with their cavernous two-story rooms, devoid of form or furnishing. The almost touching hints of idealistic attempts at “decorating” have long since been overwhelmed by the cruder, but somehow more authentic, function of warehousing and storage space for endless accumulations of purchases: CDs, DVDs, toys, parkas, sports equipment, magazines filled with striking photos of celebrities, all unread, unused, unworn, unplayed-with, never watched nor listened to.

There they are, these gargantuan collecting bins, side by side in landscaped winding rows, convenient to even more elaborately landscaped shopping places lest, gods forefend, more things might not be at hand to further fill that yawning maw called home. Two careers, each requiring 24x7 devotion, plus a multitude of credit lines, are required to finance this continuous appetite for more.

And now, alas, it seems it all must end.

The ever more rapid trading in which abstract derivatives of reality algorithmically engaged in a virtual tap dance up the financial stairway to paradise has stopped, and most players now discover that they do not have a chair. De-leveraging is upon us. Easy credit, which droppeth like the gentle rain from heaven upon the place beneath, encouraging all things to

spend, has turned to drought, and payment is demanded. Currency, and not credit, is all the rage; cash, not goods, is in demand; and for all its ills, the U.S. dollar still, despite its profligacy, rises in value as the only global means of payment, while mere stuff like oil and gold and corn plummet.

And yet, on Black Friday, bloodied but unbowed, American shoppers, Thanksgiving feasts undigested, trampled long before the crack of dawn into malls across the nation to buy still more – more, even, than they had the year before.

Admittedly, retail had been down for a number of months, as horror-struck consumers sat watching 401-K portfolios plummet and talking heads selling that movie sequel, *Great Depression II*, far scarier than any seen before, just in time for Halloween.

But with time, even melodrama begins to cloy, so back they came to shop for bargains. Perhaps, retailers whispered, we cut too deep.

As if to commemorate Black Friday, the National Bureau of Economic Research came out the following Monday and announced that yes, indeed, we have been in a recession, even though GDP had been growing for almost a year. A year of recession, 2.5 million jobs lost, the stock market rolling on the floor like a binge-drinking teenager the morning after, and pessimism, gloom and panic everywhere. If one did not know better, it would all look a lot like a classic bottom.

Can the case be made that all this hoarding of cash, all this anticipatory firing of innocent workers, all this nervous reduction of inventory in expectation of a disastrous Xmas, all this throwing of trillions upon billions of federal cash and credit willy-nilly at any-

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one with well manicured hands extended, all these discoveries that forthright and upstanding, socially responsible investment managers were in fact mere Ponzi schemers on a Homeric scale might actually be bringing this final nightmare of the Bush years to an end? It can.

As we all know, market economies are a rational process composed of fear and greed. The market price of any asset is the discounted present value of groundless expectations and unfounded confidence. When those expectations turn negative and all confidence is lost, no amount of interest rate reduction can prop up asset prices. In Japan in the '90s, they actually turned negative, and yet the economy continued to sulk.

What is needed to restore life to the market is a killing or two.

There is a wonderful passage in *Les Misérables* where, following the battle of Waterloo, bodies are being stripped of rings and shoes and anything else of value, and one participating entrepreneur inadvertently rescues a French officer. This heroic event becomes the base for the entrepreneur's subsequent prosperity.

Such opportunities abound in today's post sub-prime mortgage carnage. Over the next few months, CNBC, CNN Money, Fox Business and the rest will begin reporting similar stories of heroic individuals who had the courage and foresight to act, and how they made their killing. Companies that had been carefully nurturing new products and ventures, that in panic had dumped their cherished creations into a collapsing economy, will find themselves to be market leaders in whole new industries. Dumb luck will once again be celebrated as wisdom, and even bankers will begin to lend.

None of this recovery will stop Washington from having hearings and a wide variety of rules will be up for changing, and, most assuredly, wherever rules are changed there is even more wealth to be had.

The visible hand of regulation never moves without malice aforethought. In the name of reform and re-regulation, fortunes will be made.

Everyone of course will not emerge as a winner; that never happens. But the game will be engaged; expectations in entirely new areas, some divined by chance, some by clever manipulation of legislation, will turn positive; and ultimately, confidence bands will close to certainty, raising asset prices and creating wealth.

There will be no announcement that the recession is over until long after it has ended – long past the time that the real money has been made. The press, of course, will catch on only later, but the individuals who did not mind poking amongst the carnage of the battlefield, who were unafraid of taking advantage of markets and individuals in distress, who enjoy the process of making sausage with legislators anxious to impress constituents that they are getting something done, will have gotten rich.

Now is the time to act like American "Xmas shoppers" who sense that the battle is over, prices have been cut too low, and that it is time to trample in and strip some junk off of the honored dead – and maybe, just maybe, find a shallow-breathing French officer amongst them.

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