America: Is Our Culture Greater than Our Crisis?
We understand the common obstacles and opportunities people encounter when managing personal finances. Throughout, the principles to building wealth remain constant and true. We partner with our clients and apply our considerable experience and know-how to maximize efforts to accumulate wealth.

Our approach has received an overwhelming response as evidenced by our excellent client retention.

Working with a firm that is confident in its strategy and methodical in its implementation is central to business and to your overall investment experience.

Our founder, James Studinger, began working in the industry in 1996. Since the beginning, our focus has been on a macro level - increasing personal net worth's.

James is the author of *Wealth is a Choice*, Vice Chair of the Michigan JumpStart Coalition, frequent guest on Fox News *Money Matters*, and Financial Advisor, ChFC.

Questions and feedback are welcome. Please contact James Studinger directly through phone at (248) 643-6550 or email james@jpstudinger.com.
America: Is Our Culture Greater than Our Crisis?

James Studinger
Preface

Our head tells us that something is definitely wrong, but our heart tells us a collapse of the American economy just couldn’t be.

According to Richard Curtin of the University of Michigan Consumer Sentiment Index, in October 2011 only 38% of consumers expected income increases in the next year, the smallest proportion ever recorded in the history of the surveys. Only 7% of consumers found current economic policies favorable and 57% judged policies unfavorable, the highest proportion ever recorded.

While corporate fundamentals have some growth stock managers beating the drum of opportunity, consumer sentiment tells a different story. The gut of most Americans is that things aren’t right. We’ve been burned with wild swings and losses in the past. The aging population feels they can’t afford extreme declines again. Many people garner their information from the water cooler and media headlines; outputs where the shocking wins our attention best and fosters irrational investing ideas.

This paper works to align some of the facts for our brains to process with our soured-gut intuition. While the numbers you’ll read are scary, the outcome is not predetermined. I spare you catchy headline drama and instead deliver thoughtful analysis that has been compiled from meetings with numerous economists, scouring through Federal Reserve reports, and reading multiple books and articles. I can’t promise an easy or light-hearted read. But I can provide you with information that can help you make logical decisions in a seemingly illogical world. Information which I feel is much needed so you can better protect what you have in the event that the weight of the debt is more than we can withstand.

For the past few years I have already been building portfolios that strive to have a more protective strategy. With the recent developments, and most importantly our government’s responses to them, I’ve designed another investment platform called “Track II” that aims to help protect assets in a collapsing environment while retaining sufficient flexibility to profit under normal conditions. For most of my clients I’ll incorporate a portion of the old portfolio with the new Track II to try and align desired risk and reward metrics.

In the event that there is a correction, coming out of it could provide some real and exciting growth opportunities. Recognizing that this will require ongoing thought and analysis, I’ve pre-designed modifications to the portfolios given the various stages we may experience.

By the end of reading this report I hope that you have more real information on the state of our economy than most of the rest of America. I’ll provide you with detailed analysis of investments that could function in a deep global recession. Given that the timing or
occurrence of such a collapse cannot be predicted, I'll give you investment advice that can fair in good or bad economies. I'll also lay out what you need to know about investments such as college savings plans, work retirement plans and insurances so that you can better manage these assets.

In addition to investment ideas, I’ll provide you with action oriented money habits and tools to help manage income through tough times and possibly profit immensely when opportunities arise.

Although you could skip to the end and just read the advice sections, I highly recommend you read all the way through this report. What you learn up front will help you make logic based investment decisions.
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According to www.federalbudget.com our national debt is at 15.2 trillion (as of December 31 2011) and rising. At 1.2 trillion dollars in 2011, our current (2011) federal deficit is running at 46% of total federal revenue (according to US Treasury and Federal Reserve Flow of Funds reports) of 2.6 trillion.

Let’s put these numbers into a household scenario as the trillions tend to warp our thinking. Say you’re having coffee with your neighbor and they start to open up about their “short term” money problems. They explain that income is 100,000 but they spend 146,000 per year. This excessive spending has magnified their debt, of which most is not long term fixed mortgage obligations but very short term (less than one year) maturities and subject to increasing interest rates.

They overspent for decades and now the total amount they owe is almost 6 times what they make coming in at a whopping 584,615. They can’t afford to pay for everyday living and make the interest payments out of borrowed money. They’ve only made occasional principal payments to the debt in the past 30 years. They have virtually no savings at all and can only afford unexpected expenses by borrowing more money.

On top of that, they used payments from their elderly parents from both sides of the family to build a wing on the house to care for them in their retirement. The aging parents haven’t moved in yet, but it’s inevitable that they will within the coming years and your neighbor will have to pay for their necessity expenses once they do. To make matters worse, they’ve accepted money and extended the offer to their parent’s friends.

After your neighbors have cried on your shoulder for the past hour you tell them that you’re sure things will be o.k. But when you go inside your house and relive the conversation with your spouse the truth comes out, “don’t lend the neighbors any money, they are screwed royally!”

What could save a family in that situation? Short of a miracle, it would appear not much. They need income greater than expenses and control on the debt burden and future legacy expenses before interest rates go up and force them into absolute failure.

Our government’s income is ultimately at the fate of America’s productivity, which is fueled by the very spirit of our country’s existence, the “American Dream”. The spirit drives a force so strong, creative and never ending that I hesitate to bet against it. This financial challenge we see before us however may prove too difficult for us to overcome without a significant correction.

America is an amazing and awe inspiring country. She was made so by the generations of men and women who came before and some who still grace our presence today. On a bookshelf in my office rests a framed letter from a former President of the United States,
Harry Truman. In the frame is a picture of a handsome sailor, white cap, navy blue suit, and complete with a tied scarf around his neck. Standing strong and proud, his hands are grasped behind his back and his right foot angled slightly outward. Maybe that’s why my own foot angles such, because he is my grandfather. The letter is in grateful memory of James Leroy Dewitt who died at sea in a submarine off the coast of Japan on December 13th 1945. Harry Truman writes, “He stands in the unbroken line of patriots who have dared to die that freedom might live, and grow, and increase its blessings. Freedom lives, and through it, he lives – in a way that humbles the undertakings of most men.

Our country has beaten formidable obstacles to have risen to the glory we enjoy today. More accurately, individual human beings in our country have done this. You may be one of those magnificent people.

Alan Beattie in “False Economy, A Surprising Economic History of the World” describes an interesting history and comparison to the economic tracks of the United States of America and Argentina. Some say Argentina’s fate may soon become our own. A country that had the potential to be a world super power has become instead the poster child for reckless debt and self-destruction. While both indulge in excessive borrowing practices, the founding principles of these two countries have much less in common, which may foretell completely different outcomes. Both countries’ gained early independence from European empires. The United State declaring independence in 1776 and the viceroyalty of Argentina, part of the Spanish empire, was overthrown in 1810. Both countries celebrated the rancher who traveled west to the new frontier; the cowboy and the gaucho. But there are big disparities in the way these newly discovered lands were developed. America preferred squatting, encouraging a large population to venture west and lay stake to property. Argentina favored landlords and sold large swaths of land to elite rich families or promised land to military officers who lead a fight inward against Native Americans.

Argentina rewarded those that already had the means rather than those with the desire to lay a stake in a newfound future. While America represented an unlimited pie of opportunity, Argentina’s elite hoarded resources, which began an ugly path of protectionism as compared to America’s uninhibited growth.

“Go west young man” and “America, the land of opportunity” are slogans embedded in us as a way of life, inspiring us all to realize the “American Dream”. The United States has rooted deep into the bedrock of its culture that anything is possible. Our country is great because of the people who made it so, including the infrastructure our founders laid that allowed others to prosper. The pursuit of happiness, untold rags to riches stories and the idea that anything can happen here is so engrained in our psyche that we know it as fact. Many are the proud achievers who prove that coming from a modest or lower income family is not an impediment for success in this country.

Many of us have lived good lives and would like to think our best is yet to come. In the spirits of our children we see the budding star, professional athlete, entrepreneur, or medical whiz that cures the diseases of the world.
It is difficult for us therefore to fathom the possibility that we may have misused the “Treasure” of our independence. Has our more recent path to prosperity from the 80’s been granted through excessive debt rather than a renewed revolution of organic enterprise? “Go west young man” once represented the entrepreneurial spirit and rewards when one dared to take personal risk and action to realize their dreams. In our thirst for efficiency have we sped up the effect of the American Dream with “Borrow much money young man” only to realize it’s a misguided and fractured foundation?

The authors of “America’s Bubble Economy” describe how in 1982 the federal government borrowed $150 billion, which was three times the deficit, in order to have a stimulus effect on a struggling economy. The debt “primed the pump” and would have been easy enough to responsibly pay back. But we didn’t just borrow in 1982; we did so again in 1983, 1984 and just about every year thereafter until we have finally arrived at the end of 2011 with a federal debt over $15 trillion dollars.

Not only did the federal government borrow, but consumers were introduced to revolving credit cards and so began the plastic revolution. Rather than using these convenient cards as an alternative to carrying cash, we racked up tremendous amounts of personal debt with high carrying costs. The cost of the initial purchases of products pale in comparison to the total costs when factoring in finance charges. It would have appeared that we confused the American Dream of real prosperity and replaced it with having the ability to purchase (through debt) tangible items. According to the Federal Reserve Flow of Funds reports consumer credit held by households grew by 61% from 1981 to 1985. We continued to feed our veracious spending appetite with debt going from 377.9 billion in 1981 to surpassing 2.4 trillion in 2006 where we have finally since come to some plateau. Simultaneously home mortgage debt over the same period has grown from 998 billion to over 10 trillion dollars.
One of the surest ways of creating wealth inequality is to saddle one wage earner with higher operating costs than another. Wealth isn’t measured by our purchasing capacity, rather our physical assets and resources that afford independence from personal labor. We were saddling ourselves, borrowing money from paychecks not yet earned as reward for achievements not yet accomplished.
Now as we dance from one recession to another and realize that we can’t turn all this stuff we bought into food on our plates, we look around with envy at who has the cash – corporations. Business has managed their cash flows much differently than households or our federal government. They need to turn a profit in order to stay in business. Those that behave recklessly eventually fade away as the stronger survive.

**Business Debt to Income**

(*in billions - source Federal Reserve Z.1 through 4th quarter 2011)*

According to the Federal Reserve Z.1 reports, total business debt has grown by 652% (20% per year) from 1980 through 2011. While that might seem like a lot, that pales in comparison to household debt growing by 844% (26% per year) and the federal government (including intra-government debt) of 1,577% (49% per year). Is it any wonder that business is looking better positioned than both households and the government today? Should we be envious of corporations’ cash? What good would it do to stifle a section of our nation that has performed as they should? Rather, maybe we should behave more like business.
Look in the chart above at the velocity of borrowing by both households and the federal government as compared to the rate of their respective income and overall GDP growth. There would appear to be no rhyme or reason for the massive disparity, as compared to business debt/income growth. Strategically speaking, business would borrow money in order to leverage more profits. This chart indicates that no such goal (increased income) existed for household or federal borrowing decisions.

If debt isn’t used to create income, then it instead becomes an increasing burden to (household/federal) income.

Can this trend be corrected and fixed, or is it already too late? That’s the trillion(s)-dollar question. First we need to understand the obstacles we face.
Has Our Economic Growth Been Fueled by Earned Demand or Debt?

That’s a tough question to completely answer, but let’s start by taking a look at the growth of debt as compared to the growth of GDP and incomes (federal, personal and business). GDP or Gross Domestic Product is the monetary value of all the finished goods and services produced within a country’s borders in a specific time period. It includes all of the private and public consumption, government outlays, investments and exports less imports that occur within a defined territory (Investopedia). GDP growth/decline is used as a measure of economic direction. According to the U.S. Bureau of Economic Analysis, GDP grew from 2,724.1 trillion in the first quarter of 1980 to 15,094.4 trillion through 2011. It grew by 10.9% from 1980 to 1990, and by 7.01% from the first quarter of 1990 to the first quarter of 2000.

According to the Z.1 Federal Reserve reports, GDP in the U.S. was 9.8 trillion dollars in December of 2000. By the end of 2011 it was 15.1 trillion. This represents an annual growth rate of 4.5%, however in the past four years growth has slowed to 1.4%.

Most of the conference calls and meetings I attend with economists representing investment firms say the main problem today is that the demand isn’t there. Companies have the money to invest in people/resources, but are hesitant to do so with current levels of uncertainty and lack of demand for their products/services.
Supply and demand are the first two forces learned in every accounting class. As demand increases, supply becomes limited and prices go up. As supply increases, demand goes down and prices decline. We have a situation today where there is more supply capacity than demand. Massive federal stimulus is designed to “prime the pump” of demand and get people spending again. But it would appear that it hasn’t worked. Why? Maybe we’re still starting at a level of demand expectations that is too high. It could be that previous demand was from too much borrowed money and not enough driven by real money produced by a healthy and sustainable economy.

Let’s take a look at the income to debt relationships of the national government, households and corporations.

**National Government**

According to the Z.1 Federal Reserve Flow of Funds reports F.106, federal income has grown from 2 trillion in 2000 to 2.4 trillion in 2010, a change of 1.61% per year. Federal expenses have grown from 1.9 trillion in 2000 to 3.5 trillion in 2010, a change of 8.54% per year. Did you catch the difference that spending outpaced income by a rate of 6.93%?

Granted, some of the current spending has been “stimulus” and is believed wouldn’t continue in the long term. The CBO (Congressional Budget Office) in their Baseline Budget Outlook have spending tapering down and from years 2010 through 2015 project it will grow closer to 3% per year. The flip side to the argument that government can retard spending through less stimulus policies or can cut large expenses such as the cost of our current wars is the fact that we have a tremendously large aging population nearing retirement with legacy costs beyond comprehension. This cost dwarfs the amount of stimulus or expense of the wars. This figure of “unfunded liabilities” is argued to be in the tens of trillions and subject for much debate as to the actual cost. Regardless of the most accurate figures, no one can deny that it is an incredibly daunting expense.

Another obstacle to cutting spending is that many economists believe that the only way we might avoid a recession today is because of excessive government spending. Those making fiscal decisions at the federal level are trying to avoid the patterns that lead to the Great Depression. Now after we’ve spent so much money to try and prop up the economy the political environment isn’t willing to stop spending and let the economy risk a free-fall.

According to the Federal Reserve, as of the 2nd quarter 2011, total federal debt was 14.3 trillion. 9.8 trillion is held by the public (8.1 trillion by private investors and 1.6 trillion by the Federal Reserve) and 4.5 trillion is held by foreign and international investors.

Amazingly it didn’t take very long for our debt to expand to the level it is today. According to [www.publicdebt.treas.gov](http://www.publicdebt.treas.gov), back in December of 2000 total debt outstanding was 5.7 trillion dollars. As of December 2011 the total debt outstanding had risen to over 15 trillion dollars.
For awhile, we paid for much of the expansion of the federal budget through borrowed money with domestic public debt. The more domestic money that buys U.S. government debt the less money is available for capital investments and spending. This constraint was alleviated throughout the 2000’s as we saw a large influx of international money.

According to www.treasury.gov, in December of 2000 foreign and international investors held 1 trillion of U.S. government debt. At that time Japan held 317.7 billion of U.S. government debt, with China coming in second place holding only 60 billion dollars. Fast forward to 2010 and the country of Luxembourg, which wasn’t even on the chart ten years ago, topped China’s year 2000 holding with 86.4 billion in total U.S. government debt. In 2011 China came in at a whopping 1.15 trillion; more than the composite total of all foreign debt a mere ten years earlier. Foreign owned debt went from 1 trillion in 2000 to 5 trillion through 2011, or a growth of 33% per year. Don’t forget that over that same time period, U.S. GDP grew by 4.3% per year.

China continued to increase it’s holding of U.S. government debt throughout 2010 by 30.5%. However through 2011 China actually decreased it’s holdings by 0.7%. Overall foreign debt through this time has only increased by 12.77% or 566.2 billion dollars.

Keep in mind that our deficit was almost a trillion dollars more than that. The Federal Reserve’s Quantitative Easing has helped make up for the deficit balance that foreign investors are not willing to buy. But the Federal Reserve plays a delicate game of printing money to buy debt and not creating too much of a future inflation problem. A balancing act all countries play and something that China, with its government subsidized growth,
is struggling with today. So the amount of debt that the Federal Reserve can continue to purchase is questionable.

Some people believe the sanctity of government debt can only be breached if the so-called “run on the bank” scenario plays out. They envision that there will be a sort of musical chairs where everyone scrambles to take their money back to avoid being the only one left standing without a chair. But there doesn’t need to be such a dramatic event to tip the scales into a serious problem. There simply needs to be a slowdown of money that is willing to invest in U.S. debt.

According to the U.S. Treasury, 36% of debt matures in less than one year, and the other 64% matures in 2 to 30 years. The total average maturity is just 4.3 years.

![Maturities of the Federal Debt](chart.png)

So a large portion of the debt is subject to short term maturities that need to be turned over into new terms. Plus, continued borrowing is necessary in order to simply finance our current budget - expenses, by the way, that we have become increasingly committed to.

The effects of a slowdown of investment capital willing to buy U.S. government debt can be illustrated through the example of riding a bike. Earlier this summer I did a half Ironman triathlon in East Tawas. Near the 18th mile of the bike portion I came to a much welcomed large and steep downward hill (not so welcome on the way up). My peak speed hit 39 miles per hour before reaching the bottom of the hill where the road flattened. I saw my speed drop quickly to 32 mph, and then 28 mph, before eventually
settling closer to 23 miles per hour. I hadn’t climbed any hills to slow down my progress; I just stopped going downhill and therefore lost the gain gravity had to offer.

Likewise, money doesn’t need to be pulled out of U.S. government debt in order for us to run into a potential fiscal crisis, the willingness of investors to buy new debt (which has been our force of gravity) simply needs to slow down.

As evidenced by the lethargic foreign purchasing of U.S. government debt throughout 2011, it would appear that this phenomenon, at least with foreign investment, has already begun.

Remember the debt limit debate that took place leading up to August 2nd of 2011? At that time the debt limit was 14,712 trillion and we raised it to 15.194 trillion. (Back in 2000 according to www.treasurydirect.gov the statutory debt limit was a mere 5.9 trillion dollars.) As of (according to Treasury Direct) December 31 2011 we were 13.663 billion away (remember our 2010 deficit of 1.3 trillion) from hitting the limit of 15.194 trillion. Shortly thereafter the limit was raised again, to 16.394 trillion. The limit only speaks to the amount of money the government is legally able to ask for, say nothing if people are actually willing to buy that much.

Another obvious problem to the size of our debt is the ability to service it. Government hasn’t been pushed into a corner yet of losing refinancing options like households have. Personal households have already run head first into hardship brought on by years of borrowing greater than their ability to pay. Households unable to keep up with the rising payments are defaulting on their debt.

Back in the year 2000 interest payments on our national debt was 362 billion dollars (according to Treasury Direct). In 2011 interest payments are only 454 billion dollars. How is it that the cost to carry the debt has merely gone up 92 billion dollars when our total debt outstanding has gone up 9.5 trillion?
Interest rates have come down considerably over the past ten years. According to www.publicdebt.treas.gov the average interest cost on the debt in 2000 was 6.642%. If that was the interest rates on today’s debt, the payment would be over 1 trillion dollars - about 39% of total 2011 government income.
What could drive interest rates so high again? First of all, 6.642% isn’t that high. Anyone who has owned homes for more than a decade remembers conventional fixed mortgage rates to be closer to 9% not the 3-4% range you can find them at today. Interest rates are subject to the same principles of supply and demand as riding my bike on the triathlon. While going downhill, energy was in great supply thanks to gravity. However when the road tapered, supply of energy decreased and the demand for more human energy (pedaling) increased. Even then I wasn’t able to get anywhere close to the speeds gravity offered.

In my opinion the gravity of those willing to buy U.S. government debt, albeit a large portion has been bought by printed money, has driven interest rates to historical lows. As the flow of funds that purchases debt slows, interest rates will need to be raised in order to attract the new (lesser) demand. CBO currently estimates the raise in rates to be modest, with three-month treasury bills in 2013 of 1.5% and ten-year at 4.1%, and not until 2017 before growing to 4% and 5.3% respectively. Depending on many factors, these estimates may prove to be on the low side.

Not only can supply and demand change interest rates, but so can inflation. Inflation is created by the central bank as they regulate the money supply. When money is added to the economy (printed) at a faster rate than the economy can use it, inflation is created. Unpredictable inflation causes widespread problems as it erodes the purchasing power of our money and also makes business transactions very difficult. If business to business is negotiating a sale on supplies and the price of the supplies is changing rapidly, either the
buyer or seller could lose big on the transaction. Governments work to keep inflation tamed by increasing interest rates.

Many of you remember all too well double digit inflation and interest rates in years past. And in Europe today we are witnessing the reality of how quickly rates can rise as the risk to the debt increases. As the world competes for limited resources, governments slow down the printing presses and demand for higher returns persist (to align with the risk); time will tell how high rates actually go.

According to the [www.whitehouse.gov](http://www.whitehouse.gov), “mandatory spending” takes up the lion’s share of the overall 2012 budget. Health care is 22.62%, social security is 20.04%, national defense is 19.27%, and welfare is 14.48% of the budget. Those four sections account for 76.41%, or 2.849 trillion, of the total projected budget of 3.729 trillion dollars. They expect total tax revenues to be 2.627 trillion, or 222 billion less than just the cost to maintain four cornerstones of the federal budget. They project the cost to service the debt at only 6.31%, or 235 billion dollars. That’s at current interest rates. But what if rates go up by 1% or 2% because of supply and demand or inflation?
The Congressional Budget Office (CBO) says spending has averaged 21% while revenues have averaged 18% as a share of GDP over the past 40 years. Some politicians have said that when times were good, income was closer to 20% of GDP. With 2011 GDP at 15.22 trillion dollars, this would put income at 3 trillion dollars (compared to the actual 2.5 trillion in 201). But even 20% wouldn’t have been nearly enough to cover actual spending of 3.8 trillion (201). We would have needed 25% of income/GDP to break even, let alone pay back any principal on the debt. If everything remained equal, 30% income/GDP would be enough to pay the debt down over 20 years, but that assumes interest rates didn’t change. If the interest rates on the debt were anywhere close to where it was just ten years ago, then the extra 5% of GDP for income wouldn’t even be enough to pay the interest charges let alone principal payments. Meaning, we could collect taxes equivalent to 30% of GDP (in 2011 federal income/GDP was 17% according to Federal Reserve Z.1 reports), almost twice the rate of taxes collected today, and still be running a deficit and increasing the national debt to new highs. Say nothing of what such a high tax base would do to our economy, driving many out of business or forcing them to move more operations out of our country in order to stay competitive in a global marketplace.
I’ve seen this phenomenon of seeking higher income as a solution with personal finances. People mistakenly believe that if only they had more money then they could get out of...
their financial problem. But when income increases they only find that their problems get worse. That’s because they were focused on the wrong problem. It wasn’t that they needed more money, it was that they were never efficient with the amount of money they had. If they were, then they wouldn’t have had so many problems in the first place. If operating efficient with less income, they would have reaped the benefits when their income increased. Instead, the higher income only drove higher spending and further delayed the day they might finally reach financial independence.

It’s unrealistic to think that we will ever be free of our national debt. That’s not really the question here. The debate is whether or not we can even service the amount of debt we have today and still provide the basic functions of national government.

In any event, U.S. government show downs like that which took place between Democrats and Republicans on August 2nd of 2011 will certainly gain in frequency, attention and mistrust in the federal governments ability to reign in spending. For a child, non-necessity items such as T.V. and video games feel absolutely necessary at least until they are lost entirely and eating out is replaced with cold cereal. The federal government (and therefore us all) could face a harsh reality soon enough.

**Household Debt**

According to the Federal Reserve, the American consumer makes up about 70% of GDP. With GDP in 2011 of 15.2 trillion dollars, the consumers’ portion comes to around 10.6 trillion. The census.gov website calculates the U.S. trade deficit with the rest of the world is 634 billion dollars. That’s better than where it was in 2006 at 827 billion.

So we consumers are a worldwide spending force to reckon with. But where does all our purchasing power come from?

National personal income (according to F.100 Distribution of Income Z.1 Federal Flow of Funds report) in 2000 was 8.4 trillion dollars and in 2011 it was 13 trillion dollars. That’s a difference of 4.6% per year.

Over that same time period, total household debt outstanding has gone from 7 trillion to 13.2 trillion dollars. This represents an increase of 7.4% per year, nearly twice the rate of income increases. Looking at the data a little closer; over the past 4 years total household debt actually declined by 4%. So taking a step back and evaluating the rate of personal debt prior to the recent deleveraging (a process of reducing debt through making payments or restructuring), household debt shows an even more outstanding figure. From the period 1981 to 2005 total household debt grew by 28.4% per year. Keep in mind that GDP growth over the past ten years averaged closer to 4.9% and personal income rose by 4.8%.
Either by force or by choice, it would appear that at long last the American household is beginning to deleverage from the decades of excessive borrowing far beyond their earning capacity. The good news is that people are adjusting their borrowing habits and tackling some of their debt problems while interest rates are still low.

But the hangover felt from overextended borrowing hurts in many other ways. Not least is that the main engine of GDP, the consumer, has decreased spending and increased debt service/savings. This has a direct affect on demand and productivity growth (GDP in general), which of course has a direct affect on jobs. On one side of the equation we want everyone to spend to boost the economy, and on the other we need everyone to save to become a truly wealthier nation. Another problem is that this deleveraging process can take a very long time, and during that time consumers are not “consuming”. In years past people with large credit card balances would consolidate them into a lower rate home equity loan. That option has been taken off the table and people have been forced to deal with paying down debts with much higher interest rates.

The after effects of easy money with no boundaries have already driven down the price of one near and dear item to catastrophic levels - our homes. Illogical lending helped drive the values of homes well beyond their actual worth. Back in 2005 a client of mine went to look at some new condos in downtown Royal Oak starting at around 500,000. She questioned the high price with the sales person at the front desk, and was told not to think of the home price, but instead focus on the cost of the mortgage. They suggested taking out an option arm mortgage, where the borrower had the choice of making an interest only payment, principal and interest payment or even a less than full interest payment.
(called a negative amortization mortgage). As bad as all that sounds, the interest rate was short-term and subject to change in a year. My client explained that they were self employed and didn’t have a large income. No problem said the sales person; “we’ll just use our no income verification (liar loan) to underwrite the mortgage.” To even further sweeten the deal, condos came fully furnished including (free) flat screen TV’s that were actually financed as part of the overall price and carried with the mortgage.

Not only were people borrowing excessive amounts to buy new homes, but higher appraisals on existing homes were a dime a dozen. Need (want) a new car, no problem, just appraise the home and then take out a home equity loan. Need (want) to take an all expense paid vacation, no problem, just tap into home equity. No income and no assets, no problem, just sign here for your new loan. The ATM machine at the bank might not have been flush with cash, but the home sure was. People grew comfortable sacrificing the sanctity of their home and racked up debt against the property to unsustainable amounts.

According to the Charge-Off and Delinquency Rates reports from the Federal Reserve, residential delinquency rates were 2.45% in the 4th quarter of 2000. By the 4th quarter of 2010 they grew to 10.52%. This means that over 10% of all residential mortgages were delinquent. But that doesn’t even tell the full story. In addition to that, another 8-10% of homes were and still are in a foreclosure process.

At least the past few years have shown that households have stalled debt expansion. But undoing the bad debt will take a very long time, and is difficult to manage from 14,000 feet. At the heart of every loan is a person with a real problem at hand.

I went downtown to talk with some of the gang sleeping out in Martius Park with Occupy Detroit. The first couple of guys I spoke with are attending college and working part time. When I asked why they were there I first heard how the banks got all the bailout money but the average person was left high and dry. Person after person described a similar theme. Similarly there were true heartfelt and personal stories of what has been happening in their lives and the struggles they are facing financially.

One college man was there to support his mother who was about to foreclose on her home after years of trying to keep it afloat. Her husband died a few years ago and then one of her sons died last year. She’s working to try and take care of the rest of her family on her single income, and keep up with the debt payments created by her and her husband. On top of that, she co-signed for a college loan for her son and now that he’s passed away she’s responsible for those payments. It sounds like the family is working together through the hardship, but even if the debt is eventually taken care of (one way or another) his mother is getting older and has no financial security to show for it.

Another young lady was there to support her parents. They live in, as she describes, “The Hood” of Detroit and she’s afraid for their safety if the welfare checks get cut. She believes crime will rise as people become more desperate to get by. She’s had years of experience of life in Detroit, and has seen her fair share of welfare recipients – including
for a short while being one herself. From her personal perspective, the people she met receiving welfare desperately wanted to work and felt uneasy accepting welfare. But they needed some help getting by while they looked for other work. She did see some of the drug users and said they are “sick in the head” and she admittedly has no idea how to rectify that problem. But she believes they represent the minority of welfare recipients. She had lost her full time job and is now working part time, raising her 3 year old boy and attends community college. She already has a bachelor’s degree through Wayne State, but isn’t having any luck securing a good job so she’s taking paralegal classes. I asked her how much her student loan debt is so far - 80,000. Right or wrong that the loan is so high, maybe it was only used for school costs, maybe it was used for other things, the reality is that it now controls all of her financial decisions. Paying that loan off (if she pays the loan off) on the salary within her field of work will keep her from becoming a productive buyer/saver for years, maybe decades.

Once getting past the initial rhetoric, not one person I spoke with denied their role that got them into the situation they are in. Nor did they deny the idea that there won’t be some saving grace that takes all their problems away. There is a revolving door of people that visit and stay; so on any given day you might have a totally different experience of discussion. Linda, a wonderfully nice homeless lady led me by the hand and introduced me to at least 15 people who were, if nothing else, establishing a community of friends that listened to the difficulties of their Martius Park tent neighbors and hopefully found encouragement to move forward in life in a most productive manner.

The not so obvious after effect of cleaning up a debt problem is that during the time it takes to do so, those people make little to no headway in their retirement or college savings. As the song “Sixteen Tons” goes, You load sixteen tons what do you get, another day older and deeper in debt, Saint Peter don’t you call me ‘cause I can’t go, I owe my soul to the company store.

While driving away I realized they had a medical tent, media tent, food tent, supply tent – but I didn’t see a solutions tent. For all the time they spend there, it would make sense to sit down and brainstorm how they can personally improve their lives, maybe even come up with some creative business ideas to create new income.

**Business Debt**

If there is a silver lining in the story this is it. By the nature of survival, business needs to be competitive and fiscally responsible to stay in business. If they run in the red for too long eventually they run out of options. The same is true for governments and personal finances; however their worlds are generally not as brutally competitive as business. Thus, you would expect business finances to look more favorable than both government and personal.

Recently I spoke at a personal finance class at Lasher High School in Bloomfield Hills MI. I asked the students if there was such a thing as good debt. One answered quite correctly, “If you use debt to make you money, then it could be good.” When business
borrows money it is with the intention that it will become more profitable in doing so. When households borrow money it is often to purchase a depreciating item that they’d rather own now than later. And governments borrow for all kinds of reasons, many of them not productive.

The D.2 Credit Market Borrowing by Sector report from Federal Flow of Funds Z.1 illustrates this perfectly. During periods from 1981 both households and the federal government increased their borrowing significantly. Households borrowed 105.5 billion in 1981 and increased that rate so that by the year 1985 they borrowed 313.2 billion. That’s an increase of 197%. The federal government borrowed 85.5 billion in 1981 and in the year 1985 borrowed 225.7 billion, an increase of 164%. Business borrowed 191.1 billion in 1981 and 256.4 in 1985, an increase of 34%.

Analyzing the numbers reveals further the disparity between productive and unproductive borrowing practices. In 1990 household borrowing for the year was 232.9 billion. Like business, their borrowing for the year was much less than it was five years earlier, but only by 34% as compared to business reduced borrowing of 99%. The federal government on the other hand increased its rate of borrowing by another 9% over the same time period. And then the differences become crystal clear. In 1991 and 1992 business actually had a negative borrowing rate (paid down their debt balances) while both households and the federal government borrowed heavily. The federal government reached new borrowing highs for the year at 304 billion. Fast forward to the late 90’s and into 2000 and something remarkable happened; the federal government actually had negative borrowing. Business was cranking as we excelled toward the giant tech bubble
and household borrowing didn’t skip a beat reaching near 600 billion by the year 2000. Then things crashed, business reduced borrowing from 562.1 billion in 2000 to 160.3 billion by 2003. The federal government cranked back up their spending machine, lowering rates and borrowing another 396 billion. And the American household responded in full force to the new low interest rates and topped the scales at a whopping 1 trillion and 6 billion dollars.

**Household Debt & Income**

*(in billions - source Federal Reserve Z.1 through 4th quarter 2011)*

Notice how (with exception to the years 2000 through 2007 with the low interest borrowing craze leading to the housing bubble) how household increases or decreases in the rate of household debt expansion moved in sync with changes in household income. It would appear that during the lower interest rate environment of the 2000’s, household decisions to borrow were based on the cost of servicing debt (monthly payments), rather than the total amount of debt they were committed to paying. Because of falling interest rates they may have been able to buy more “stuff” than they had in the past, even though their income might have been falling at the same time. However when interest rates increased and some mortgages grew more expensive to service, it changed the dynamics dramatically and many people quickly found themselves in a world of financial hurt.
Unlike household debt, federal debt expansion was at odds with income. As income dropped, the rate of debt expansion generally increased.
Of the three scenarios (household, federal and business debt), business debt was the only one that kept the rate of debt expansion predominately within the boundaries of income changes.

Now after three decades of excessive borrowing by households and the federal government, we’re looking at business and labeling them as greedy and hoarding cash. In fact, business was the only part of the equation that used debt as a strategic leverage and is therefore not being subjected to the same burdens of debt on the backside.

Notice in the chart above how the rate of corporate profits and business debt was much more in line, as compared to the debt accumulation of the federal government or households.

According to the F.7 Distribution of National Income report from the Federal Reserve Z.1 report, corporate profits went from 818 billion in 2000 to 1.9 trillion in 2011, or a difference of 11% per year. And what did they do with those profits? At least a good portion of the money was held in cash reserves. According to the Federal Reserve American nonfinancial corporations were sitting on about 1.9 trillion dollars.

As things stand today, business is the shining star in the equation. But disruptive policies or a failing economy could knock them down another level. As Abraham Lincoln said “You do not make the poor rich by making the rich poor.” Our solution to fixing the economy won’t be to punish those that have made the more prudent financial decisions, but for others to follow their lead.
Did We Get Our Bang for the Buck?

In difficult economic years the government spends, interest rates go lower and people subsequently borrow and buy, business revenues go up, and business then borrows and expands. But it appears the federal government borrows for the bad times and continues borrowing into the good times. So when difficult economies arise the government has to step up their game to a whole new level. At some point in time the rate of spending does not produce an equivalent rate of productivity. Meaning, for a dollar borrowed and spent we are not getting more than a dollar of positive influence on GDP, tax revenues, personal income and most certainly – debt repayment.

It would appear that the spending has more than outstayed its welcome and some form of correction needs to take place. There has been much discussion of an L shaped recovery compared to a more traditional V shape. V shape means that markets were driven down in price very quickly and when the recovery begins, they rise to new highs just as fast. An L shaped recovery would signify that the economy will continue to muddle through very slowly, and therefore so will the market. A sideways market could give the necessary parties time to deleverage and for the economy to “grow into” a sustainable level of government, personal and business spending. I would certainly welcome that as a satisfactory outcome.

However, given the magnitude of our problems, it wouldn’t take much of a crisis to trigger the recovery from an upright L to an upside down rotated L (sideways market followed by a free fall looking more like a 7), followed by a long sideways L before finally seeing true expansion.

Thanks to ultra-low interest rates, the cost of our national debt is relatively the same as it was ten years ago.
Baby boomers are tapping at the door, but as of yet we have not been overwhelmed with their (paid for and well deserved) entitlement costs. So barring a shift-changing crisis, it is possible that we can continue to finance our debt inflated issues for some time. But the gravity of failure has deep and long entrenched hardships for all the ill prepared. As the shock of 2008 revealed to the entire world, at times what keeps us together is nothing more than a thin thread of faith. Bear Stearns was here one day and gone the next. It became evident that many financial businesses, having endured through the decades, could fail at any moment. When the foundation is weak, the entire structure can come crumbling down with incredible force.

Today that thread of faith may rest on the belief that there will forever be massive buyers eager to line up for U.S. government debt. If we woke up one day and it all changed, the treasury store had too few customers to carry the load; then the crack in our government’s foundation could spread and impact the entire system as we know it today.

I have a good friend from New Orleans and he’s told me much about the events of Katrina. Many engineers knew the problems they would face if the right storm came along. Money was requested for the construction of improved levies, but not enough people wanted to do something about it. It seems rather foolish now looking back at that decision. Unfortunately it took many lives lost and absolute destruction to fix the levies to a level they can withstand such a storm.

Given that the calamity of widespread financial failure to our debt problem would be so severe – and especially because it is actually possible - we must consider how to best protect against it before/in case it does actually happen.
Efficiency – A Steadfast Rule in Nature

Rivers flow from a seemingly endless source and make their way through the most efficient path. They travel downhill and if dammed from their centuries old course will trickle through the landscape in search for the new most efficient route, leaving the old dry riverbed far behind.

With rivers, and just about everything in life, the power of efficiency trumps all else. I saw this lesson while learning how to swim for triathlons. Being a “near drowner” who couldn’t make it across the length of the pool freestyle, I thought signing up for a triathlon would be a good way to force myself to learn to swim. The triathlon came, and I survived, but not by much. Later a friend told me to look up the video “Total Immersion”. He said swimming is all about efficiency.

The speed at which we propel ourselves through the water is driven by a combination of efficiency and power. According to the Terry Laughlin, founder of Total Immersion, efficiency counts for about 90% of the equation. I struggled in the water and forced myself along, while others seemly glided right on by with ease. Once I grasped the concept I went from barely being able to swim 500 yards to swimming a mile or more with little problem.

The concept hit home with me because it is the same thing that I teach with money. Over all the years I’ve been in business I’ve seen people perplexed that they make more money than ever before but feel like they have less to work with. Their solution to financial problems had always been that they just needed to make more money. Unfortunately that was the wrong solution. They first needed to become very efficient with the money that they already made; then, and only then, would they realize the full benefit of pay raises.

We (government, households, business) – need to become increasingly familiar with the power of efficiency in managing money. I go to great length to illustrate this in my book Wealth Is a Choice, so I’ll stick to the cliff notes in this report.

In my book I describe income as offense, and spending as defense. The number one determining factor to whether or not someone will become financially independent rests not on how much money they make, but on what they do with the income they have to work with. Someone making 100,000 a year can easily become wealthier than a person making 1,000,000 a year all depending on their spending/savings habits.

Every dollar that passes through our hands goes into one of two places; I refer to them as Good and Bad Assets. Good assets are all assets that we intend on converting into income, and bad assets are everything else that depreciate in value and/or cost money to maintain. Back when I first wrote Wealth Is a Choice I put our homes in the bad asset category, and many people disagreed with me for that. But they don’t today.
The reason I said a house is a bad asset is because we need a place to live and very rarely use that asset to generate income. I said that if a person did generate income from the home greater than their cost to live and maintain it, then it might be considered a good asset. But the rest of us would be in neglect to consider it an “investment” for our future. I need a place to live just like I need to eat food to survive. Survival costs are necessity expenses; not profitable expenses. Sure, you could (and hopefully do again in the future) buy a home and later sell it for a higher price. But most of the people I see in that transaction do not take the profit and use it to create income; instead they roll it into another home.

One of the great misfortunes of all the people who didn’t see their home as a “bad asset” is that they used it as a cash flow machine and significantly increased the debt against it along the way. Now after the housing collapse, homes are underwater, credit is difficult to obtain, and they are looking at their situation and realizing the house for what it is; something with tremendous carrying cost.

Good assets are investments we make into assets that we expect will produce returns we can later convert into income. Not all good assets are necessarily “good” from the standpoint that we sometimes lose money in them. But the point is to have an affinity for buying and looking for returns on your purchases rather than in things that depreciate or cost money to maintain.

I recently spoke to a financial literacy class at a local high school and asked the kids there if they used a number of common and fun products (such as gaming or phone electronics). The entire class raised their hand. Then I asked them if any of them owned the same company stock. None did. Over the past few years the stock of those particular companies had risen incredibly. If they had bought the stock, they could have used the profits to own the products for free, and then some. Why is it that we buy depreciating products so willingly but don’t take the time to research and invest into the company? There’s not a good answer really, other than we just don’t think that way. As evidenced by our borrowing rates, we are a society of spenders not savers. At least not yet.

**Creating a More Efficient Government**

As I said earlier, the surest way to create wealth disparity is to saddle one wage earner with more committed overhead than another. Each day I read new reports outlining a growing gap between those that have money and those that don’t. I can tell you the equation to this disparity is quite simple. If you reinvest a good portion of your income then you have a legitimate opportunity to become wealthier. If you don’t, then you won’t. No matter our financial starting points, I believe that we need to adopt the habits of the wealthier if we wish to gain our personal financial independence. That might mean doing without some of the “bad assets” we desire, at least in the beginning.

If we want to improve our economy then we need to focus on areas of efficiency and power, not on areas that create drag to the system. Sure, just like in swimming, not all
actions can be entirely efficient. I need to breathe out of the water and when I do I create more drag. But if I don’t breathe then I’ll die.

The government has regulations and complying with those rules costs money. But some of the regulations are necessary for our long term survival, while others only create unnecessary drag. Spending too much money on inefficient businesses that couldn’t yet survive without massive subsidies is inefficient and creates drag. For whatever reason, much of the governments borrowed (stimulus) spending went into businesses that, to me, didn’t make any sustainable business sense (consider Solyndra Solar). You can create demand by making laws that force certain purchases, but you would no longer be following the natural force of efficiency. Like damming a river over and over again, constantly changing its natural direction. Eventually water will be backed up into large pools, and very little water will seep through the other end of the system.

In my opinion, when the government creates great uncertainty in their policies or regulations, engages in wasteful spending, initiates high costs of compliance (tax advice, legal advice and interpreting regulation), commits to unsustainable entitlement or excessive overhead (healthcare and other insurance expenses), or uncertainty with foreign energy, then it all adds massive drag to the system and keeps it (us) from reaching the full potential of its (our) output. I tell people that I can swim faster than Michael Phelps if I tie a big enough parachute around his foot.

On the other hand, if the government reduces unnecessary taxation (shifts the flow of funds from false demand such as Solyndra Solar and into real demand such as the purchasing decisions of each individual American), reduces uncertainty in government policy and regulations, shows a course toward fiscal responsibility, allows proper free trade to promote the best use of available resources, and recognizes that the possibility of a high return is paramount to success, then we can be on a better path. I hesitate to say “recovery” just yet, as I’m not sure we haven’t already created more of a problem than we’ll be able to handle without a correction.

Sitting at my desk there appears little I can do to influence what happens in Washington. But at least I can, before each voting opportunity, do as much research on the candidates as possible and vote for the ones that I believe will do the best work at all levels of our government. I’ve taken a much more active role over the past ten years than ever before, and at times I get overwhelmed with the information and decisions. My ballot is more diverse than ever as I discover great individuals trump a particular party affiliation. It would be much easier if their advertisements were accurate or that one party had identical beliefs as mine and I could simply show up and vote. But amidst the frustration, we must remind ourselves that this is the country that WE CHOOSE to live in and one of the great benefits we enjoy is the ability to participate in elections, which includes our own due diligence process on candidates.
A Quick Way to Become Poor

If you want to become poor very quickly then take all your income and buy bad assets (items that depreciate in value or cost money to maintain). Put none of your money into assets that have the ability to grow and create wealth or other sources of income. Furthermore, don’t try to subsidize your spending or profit from your talents by starting a small business. Have only a w-2 job with few tax deductions. Buy expensive one-time use purchases such as eating out often, traveling, and concerts. Don’t plan ahead and make many small “convenience” purchases rather than bulk. Buy cheap products that break down or have to be discarded often. Each month, sign up for new committed expenses thereby incrementally increasing your fixed overhead. And if you really want to speed up the process, do as much of this on credit as physically possible. Within no time you’ll be as poor as your heart desires.

If you want to become rich on the other hand - do the exact opposite.
Align Monetary Behaviors with Creating Personal Wealth

My research tells me that it is possible we have created a massive bubble of government debt that we won’t be able to easily undo, which could tip us into a large widespread recession. It is possible that it doesn’t take a crisis to teach us our mistakes, and we actually grow out of these problems. Unfortunately I think that is unlikely.

The timing or certainty of a correction is impossible to determine. Along the way, we need 1) financial behaviors and 2) investment strategies that can succeed in the event that we continue to grow, or that can save us in the event of a collapse. The investment strategies are much more complicated, but the financial behaviors are for the most part uniform in either event.

Successful Financial Behaviors in Any Market

1) Reduce Fixed Overhead

A business wants maximum use of its cash flows for security and opportunity. Personal finances are no different. Carefully examine your budget and determine how much of your cash flows are committed to fixed overhead vs. variable overhead. Because most budgets don’t measure the right components, I created one and have it available for free at my website www.jpstudinger.com along with instructional videos, under the free resources section.

The higher your rate of fixed overhead as compared to discretionary spending the more difficult it is for you to build wealth. And in a crisis, high overhead can accelerate your path to poverty. Because fixed overhead is not easy to undo, hence the name “fixed”, start now when times are good. Look at memberships, utilities, debt service, home costs, and car costs and then work out a plan to reduce money going to these places.

You’ll especially notice the difference if you are retired, but when your fixed overhead consumes less of your available income then you can finally realize what true financial independence feels like.

2) Carry Only Long Term Low Interest Rate Debt

I could never understand it when Alan Greenspan would be in front of America during 50 year historic low interest rates and actually encourage people to buy homes on adjustable rate mortgages. That seemed exactly opposite of good debt management. And as it turns out, it was. When you are financing, especially a large asset, then you want to bring a level of certainty into the equation. Remember, you are seeking maximum long term efficiency and uncertainty is a major drag to the system. In 2006 and 2007 people quickly found themselves with increasing rates that drove up their monthly obligations beyond
what they could afford to pay. It wasn’t only Mr. Greenspan encouraging this behavior. Back in 2005 I heard from a large number of mortgage brokers who actually made it their business strategy to put people on 1 year adjustable ARMS. A mortgage broker lives or dies by closing the next deal. Rather than hustle for a new customer, many found it easier to keep a revolving book of clients refinancing ARMS. That strategy came crashing down for all parties involved as soon as rates went up and home values came down, thereby canceling their ability to refinance.

It is not possible as it was in years past to consolidate undesirable debt into lower fixed rates. So if you have various adjustable or high rate debts, then you’ll need to build a strategy to be out from under them. I have no expertise in bankruptcy or methods of walking away from the obligation and can only advise on ways to strategically pay off the debt. I generally advise people to take their smallest balance debt (provided interest rates are comparable), pay the maximum amount per month they can afford, and pay it off as quickly as possible. Make only the mandatory payments to everything else. Once that smaller debt is paid in full, then take the payment that had gone to that debt (the minimum plus the extra payments that were made each month) and apply it to the debt with the new lowest balance. Once that debt is paid in full, then carry the full combined payment to the next debt, and so on. When you run the numbers it is amazing how quickly debt that seemed to linger forever can be reduced to nothing.

3) Solve Someone’s Problem to Increase Your Income

If you ask my boys, ages 6 and 8, how you make money they will tell you confidently that you solve someone else’s problem. Many people have grown accustomed to the idea that you work at a job, perform a manual and/or mental function and collect a steady paycheck, which makes up 100% of earned income. I believe that mentality needs to change.

There is growing concern of the reliability of pensions and social security, and rightfully so. When I first got into the financial planning business we used to talk to clients about having a three-legged stool in retirement. A third of income would come from social security, a third from a pension and the remaining from savings. That stool has been losing legs that people haven’t found ways of replacing yet. I believe one solution is to go into small business. We possess skills and talents that we can leverage to solve problems. Our brain doesn’t need to shut off the minute we leave the “job”; it can operate at any given time of the day and any day of the week. A side-business doesn’t need to make us rich, but it can help to reduce our personal overhead costs and create additional income. An added boon is that through experience of building small business we develop skills that help us succeed in other endeavors, including making prudent decisions with our personal finances.

I recently gave a workshop to clients on establishing a small business. To fully understand the benefits of small business, and how easy it might be for you to establish one, just download the audio www.jpstudinger.com/Free_Resources/tax_workshop.m4a.
Remember, business is the more successful portion of the three legged stool in our economy of government, household and business. As Bugs Bunny used to say, “If you can’t beat them, join them!”

4) Buy American – To a Degree

When I go camping with my boys we hang a trail camera out in the woods to take pictures of the wildlife sneaking through the forest. While investigating which type of camera to buy, I happened across this site, [www.trailcampro.com](http://www.trailcampro.com). They did a magnificent job of outlining the differences and talking with one of their employees on the phone, helped me narrow my search down to two companies. Functionally I liked the Bushnell Trophy Cam and the Reconyx HC500. Reconyx is made in the U.S.A., but I could buy two and half Bushnell cameras for the price of one Reconyx. Still, based on the advice from Trailcampro that this is the best camera out there, I decided to buy the Reconyx. I’ve been very happy with my decision and the quality is definitely top notch.

Don’t coddle an industry by rewarding junk and complacency. Allow them to compete in a global marketplace where the best ones win. Buy quality so it lasts, and I don’t have a problem paying a little extra for it.

Efficiency is the rule of the land. The global marketplace is a river that continues to find its most efficient path. Goods and services are imported into a region so that the region can use its own resources in the most efficient manner.

Take water for example. According to Alan Beattie with *False Economy* “Only recently have many people come to see that water is rather like oil: essential to the running of a modern economy.” Egypt, with the mighty Nile River running through it, has some of the most fertile soils. But this country that once supplied much of the wheat and barley to the Roman Empire now imports half its staple food. Why? It is a country with a large and growing population, unpredictable river flows, and very little rainwater. Therefore water for drinking, let alone agriculture, is in great demand. To solve this problem they import water via importing grain.

It takes about 1,000 cubic meters of water to grow a ton of vegetables, 1,450 cubic meters for a ton of wheat and 42,500 cubic meters of water for a ton of beef. By importing these products from water rich countries, areas such as the Middle East that are rich in oil but poor in water, are freeing up their water for other more productive uses and are therefore virtually importing water.

Trade allows these efficiencies to be discovered, and thereby regions are able to best utilize what their area has to offer. That is unless the government is putting down proverbial dams and redirecting the flow of the natural river to less efficient sources.

Alan Beattie also illustrates the interesting event that within an asparagus rich state such as Michigan, much of what we buy in grocery stores comes from Peru. He says that in an effort to fight drugs and reduce the crops of coca (to make cocaine); Peru got a special
trade deal in 1991 from the United States and Europe to grow other crops. The Peruvian asparagus industry benefited from lower tariffs and tens of millions of dollars a year in financial help from the U.S. government. Exports to the United States and to Europe skyrocketed at the expense of farmers in Michigan, who argue that the coastal asparagus regions are well away from the mountainous coca-growing regions and therefore not competing with the land that grows coca.

Removing potentially unnecessary government intervention with Peru’s farmers may prove that it actually costs less to grow asparagus in Michigan and ship it to Michigan stores than it does to grow in Peru and ship all the way to another continent before arriving in Michigan stores.

At times, even though the price may be higher, I do look for great companies making super products in my home state and certainly in the U.S.A. And I’m not the only one shifting to this way of thinking. For fun I made a website, www.calloftheyooper.com to highlight the treasures of the Upper Peninsula of Michigan. In the site I also give reviews of gear that I use for the outdoors. I searched for Made in Michigan Logos to highlight local companies, but couldn’t find any suitable. So I designed a logo and have it on the site. Interestingly, of the tens of thousands of views on the site this summer the number one search engine phrase for people finding the site was “made in Michigan logo”.

I recently bought a very functional campfire grill sold in one of my favorite smoked fish stops, Gustafson’s in Brevort Michigan. It’s a great grill and is made by a guy that lives in the area. I could have, for a few bucks less, bought a similar grill at Bass Pro Shop that was made in another country.

There are plenty of emails going around that are encouraging people to Buy American. I try to do the same, but also caution that we don’t interfere to our detriment with the river of efficiency and place dams where we shouldn’t. Argentina has a much more protectionist mentality and as described earlier, the actions of such contributed to their fall. It can become counterproductive and even destructive to subsidize companies that cannot and should not compete in a global marketplace. By rewarding inefficiency, we run the risk of lost innovation in our technology and people that could be driven to pursue much greater endeavors.

One email that does make great sense is supporting local services this holiday season rather than buying tons of toys, technology or gift cards from big box stores filled with mostly imported goods. Who doesn’t like a nice massage? We can get creative and give gifts of a night out at a fancy restaurant, membership to a gym, or some other local service instead of imported goods.

I do avoid at all costs is what I call the “Bobbleheads”. I often wonder what the Chinese workers think as they sit at their table and perform the same mindless motion minute after minute; hour after hour, day after day so that we can buy junk with no meaningful value that we pile into landfills in short order.
By paying as much attention to what we don’t buy we can help reduce the waste of inefficient purchasing and have more money available to support the products made with great quality within our borders. Keep in mind that these products are not always as easy to find, as many of them may come from people like the guy who builds grills in Brevort Michigan. He doesn’t have the budget or the marketing to run a nationwide campaign to gain name brand recognition and massive market share. Sometimes we have to look a little harder for him rather than simply buy the product that advertises most.

But in doing so, we can support a good living for many Americans and hang onto some of our trades and manufacturing skills. And as an added benefit we own quality products that can withstand the test of time.

5) Buy Your Large Ticket Items (car) before Interest Rates Go Up

If you have large expense items that would require financing, now might be a good time to secure that purchase. When eventually interest rates rise, so will the borrowing cost for large ticket items. A car purchased for 20,000 with a loan at 2% amortized over 5 years has a monthly payment of 350/month. That same car at 10% would cost 424/month, which equates to 4,440 more over the life of the loan.

I’m not advocating spending lots of money because interest rates are low, but just like in business, if you have capital expenses in the near future and strategically it make sense for you to make them now, then consider doing so while the opportunity exists.

6) Buying a New House or Staying Put

Like many other Americans, this is a decision that I struggle with.

JPMorgan recently issued an in-depth analysis of the housing market and claims that this is the time to buy. They argue that the degree of the housing collapse, with home equity falling from 13.5 trillion to 6.2 trillion (54% decline) since the first quarter of 2006, prices have been driven down to unprecedented levels. Charting median home prices as a percentage of personal income per household since 1966, by September 2011 we have dropped to 153%. Over that time period home price to income was typically over 180%, which is about where it was before the massive rally pushed it up to 251% in the mid 2000’s. They chart medium mortgage payments as a percentage of personal income to be at 6.9%, which is considerably lower than the average and much less than the near 30% range it reached in the early 80’s. While comparing average monthly rent with average monthly mortgage payment, the mortgage payment after rising in the mid 2000’s to well above the otherwise similar trend to renting, has since fallen well below the cost to rent.

Chart after chart makes a strong case to buy and emphasizes the idea that the price of homes is lower than many of the measures for historical comparison, and long term interest rates are lower than the historical averages. Therefore it is possible to buy a house at least cheaper than it has been, and to finance it at near rock bottom terms.
I can see the logic in their analysis. But another troubling statistic is the inventory of homes available. According to the Federal Reserve Delinquency Reports, nearly 10% of mortgages are delinquent, and another 8-10% are somewhere in the foreclosure process. In speaking with Scott Goldstein, President of NDeX who handles foreclosures around various parts of the country describes the current situation like the “pig in the python”. It is slowly moving through the system, but hasn’t been dumped on the marketplace yet. He said there is about a 2 year period from the time that a person stops making mortgage payments to the time that the house actually gets put on the foreclosure market, and that they haven’t come anywhere close to moving the inventory of homes that are in the foreclosure process to market.

To complicate matters, the mindset of a troubled homeowner has changed considerably over the past few years. When the housing crisis was hitting the headlines there was much debate over the ethics of walking away from your home. There was a time when a person wouldn’t think of ever skipping a mortgage payment and certainly would do everything in their power to pay the mortgage. For a variety of reasons, that set of standards is slipping and today there isn’t as much of a shock when the neighbor’s house goes on the market.

Keep in mind that we have no idea how many other homes in our own neighborhoods are currently in the foreclosure process. As the pig makes its way through the python and foreclosed homes start popping up with for sale signs on them, driving down the market values of other homes in the area, Scott speculates that it could trigger other homeowners who were on the fence of foreclosure to take that leap.

Interest rates for fixed rate mortgages are in the 3-4% range, and still the real estate and home builder market is struggling. That should be telling us something.

Is it because people are stuck and can’t move? Many are underwater with their mortgage and would have to stroke a large check to get out from the mortgage. This is quite a contrast to the decades old strategy of buying a new home when you could use existing equity as a large down payment on the new house and only have to come to closing with minor closing costs. Today many would have to pay down a large balance on their existing mortgage to sell at current market price, and then also come to the table with a large down payment on the new home they would like to buy. That double whammy of deposits keeps many from even considering the idea.

Or is it because there was a huge supply of homes built that still far and exceeds the demand for homes?

A novel thought would be that people are realizing a home for what it really is; a humble abode that is technically a “bad asset”. Meaning it depreciates in value and/or costs money to maintain. Quite possibly people are reassessing their priorities and instead of constantly “moving on up” into larger and more expensive homes every few years, are now settling into a comfortable home, paying down unwanted debt, investing and making strides to actually increase real personal wealth.
No matter the reason, it would appear that today we can’t even give homes away. I can’t imagine an increasing interest rate environment to be friendly to home prices. And I question that if we have a government debt crisis why wouldn’t home prices fall further from where they are today? The cost to borrow could be higher, but those that had saved and built liquidity to pay with cash could be well rewarded for their patience.

When in doubt, I go back to the idea of preparing for tough times. If my income (purchasing power) was cut in half today would I rather be in my current housing situation or having to pay higher carrying costs from purchasing a more expensive home? Someday I’d like to move into another house with more of the amenities we desire. Right or wrong, I’ve decided that today is not that day.

7) Above All Else – Invest Wisely

For the past decade and a half, investing through a diversified* long view approach has served me and my clients very well. I keep a portfolio allocated* among a broad selection of various stock and bond investments adjusted per liquidity needs. I spend a great deal of time managing the quality of the underlying investments but under most circumstances wouldn’t try to outsmart the markets. My research has shown me that more people incorrectly sell nearer the bottom and buy nearer the top when they try to time market cycles. Taking a disciplined and steady approach wouldn’t avoid all the sudden daily drops, but the longer term results could reward the patient investor.

It would be nice if that strategy could continue. But like the engineers who warned against the perfect storm in New Orleans, it may prove expensive to continue investing with only that approach.

I have for many years advocated against investing with an index. There are arguments on both sides of the equation, with the index pushers saying that it is cheaper and 80% of managers don’t beat the index anyway. I don’t know the accuracy of that 80% claim, but even if it is true, that means there are thousands of managers who do beat the index. Especially when times are volatile, I like to have money managers that take an active role in the buying and selling of investments rather than those investments that simply hold a bucket of stocks throughout the calendar year no matter the economic or stock specific environment.

In times like these, and especially in the bond category, I think it is extremely important to choose the best investment managers you can find. I don’t look for those with the highest performance. That would be the tail wagging the dog. Instead I look for managers that purchase investments based on metrics I agree with.

Common starting points for stock managers are things such as sector exposure, P/E ratios, company profits, debt levels, cash in the bank, fundamentals compared to peers etc.
For bonds I’ve been choosing managers that have a pulse for what is happening in the debt space, and I have given them a broader range of discretion to invest. Rather than looking for specific disciplines in a bond manager and then investing into a large number of different bond investments, I instead look for good managers with broad discretion to their investing, and then invest with a smaller number of those managers.

As the financial services industry consolidates, systems get larger which from my experience leads many advisors to become further removed from the fundamentals of investing. They can become sales machines for moving inventory. This is not the time to be running on auto-pilot. Be sure you are taking an active role with investing and/or working with a person who is paying attention and not just following the advice of higher ups.

Have an affinity of buying “good” vs. “bad” assets. Assets that you intend on converting into income in the future as opposed to assets that depreciate in value or cost money to maintain. Good assets come in many forms and are difficult to pinpoint the “best” one. Purchasing “bad” assets is the very behavior that got us into this mess. So by simply avoiding them, you’re already on the right track.

*Using asset allocation and diversification as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions.
Specific Investment Considerations

Here are some investments to consider if in fact we are headed toward a longer term recession; including what to carry throughout the process of deleveraging before we finally experience true growth. However as I discussed earlier, the specific investments are not as universally appropriate in any economy as are good financial behaviors mentioned above. Therefore, what I might consider to be a good investment today could change as the economic conditions change.

Investments listed are in my current opinion and should not be used as specific advice. Each person should do their own due diligence and/or speak with their financial advisor prior to investing to make sure it is suitable for their situation. In this piece I am only going to cover a limited amount of the details as to when a particular investment might make sense and under which circumstance. If you would like more clarity on investment ideas please call me at 248-643-6550 or email me directly at james@jpstudinger.com.

1) Stocks

By many standards, the current fundamentals look pretty good. But purchasing stocks today with expectations for short term gain would mean that the underlying economy improves, not deteriorates. Not all companies suffer uniformly during turbulent times. In fact, some do quite well. But on crisis driven selling, as we saw in the fall of 2008, it would appear that most stock prices can all suffer at the same time and nearly the same rate.

Stock selection can be paramount to success and therefore I would stay clear of index investing approaches. Even though domestic corporate balance sheets may look favorable, I would invest with more caution that optimism and most certainly abide by the rule of investing expecting long term gains and short term swings.

If there is widespread panic then most stocks will fall at alarming rates. Depending on how truly deep the crisis is, many of those stocks could remain at depressed prices for a long time. Because stocks tend to move prior to actual events, and then exaggerate actual outcomes, I would error on the side of keeping a smaller portion of funds in stocks than typically found in a conventional diversified asset allocation* strategy.

Reducing exposure to stocks could put someone on the sidelines during a preemptive rally (and we may see a number of them), but could also save a fortune from a sudden decline. Like I have said many times in this report, the outcome of our highly leveraged economy isn’t predetermined. Even if sustained recovery from our current level proves to be more than we can handle it cannot be predicted as to the timing or severity of a correction.
I continue to see that well managed stocks have a place but that other non-stock investments infrequently considered in the past could function as a much larger portion of the overall portfolio.

When we do finally recover, it could be a large and sustainable one, and something that stocks could do quite well with.

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2) Bonds

Bonds have historically received little attention relative to stocks. However, at least since 2008, bonds have stayed at the forefront of discussion. Rightfully so as the credit markets dwarf the stock markets in size and influence. Bonds have typically been viewed as the safer side of investing. But we are seeing the ugly side of debt when it is in the hands of borrowers who cannot afford to pay their creditors.

If you want to see a snapshot of what can happen to bond interest rates in troubling times you need look no further than across the pond. We lend money to those parties whom we believe have a good chance of paying us back. The interest rate charged for the loan is relative to the perceived risk of their ability to pay. As the perceived risk accelerates, so does the interest charged – sometimes very quickly.

In my analysis, bond yields have been artificially driven to historic lows by government holding rates low and pumping massive amounts of money into the system, and this can create a false demand for the debt. As the demand for debt recedes, the yield on future debt increases. As the yield on new debt increases the value of old debt usually falls. Logically this makes sense. If you owned a 10 year bond (matures in 10 years) and the rate it paid was 5%, but then the institution offered a new bond the next month with a rate of 6%, you wouldn’t be able to sell your current 5% bond for as much on the second market.

This phenomenon can make bond investors very nervous about their ability to sustain value in their bond portfolios during an increasing rate environment. It’s something that has been discussed for years (once interest rates started hitting historical lows) but we’ve yet to see the challenge as interest rates continue to push lower. Still, sooner or later rates will rise and you’ll want to have your money with the ones who manage that situation best.

I’d consider a bias toward low duration bond portfolios, giving them less exposure to interest rate risk. Given that the world bond market is so much more diverse and problematic than it has been in years past, I’d also look for bond managers who have discretion over the underlying bond investment strategies within their portfolio. It goes without saying to work with bond managers that have an intimate understanding of their
markets and are deeply connected intellectually with experts from many regions of the world.

Some of these experts may know “too much” and manage the portfolio wisely however ahead of the curve of everyone else. Be careful not to try and chase short term returns in a bond portfolio, rather pay a great deal of attention as to why the manager makes the decisions they make. You might be early to the party but it may be what is necessary to ensure you a seat at the table.

3) Commodities

I’d be leery of commodities in general as a recession will most likely drive down the demand for commodities and therefore also the prices. If buying broad commodities I’d look for something that offered downside protection.

4) Gold

This is one investment that I buy with great caution as it would appear it is one of the next bubble’s waiting to pop. In the early 1980’s gold was driven to a high price before crashing down and staying beneath those highs until the later 2000’s. That’s a very long time to wait to get a return on your money if you invested at the previous peak. Gold has few conventional fundamental metrics to help establish a fair market price. Stocks at least have metrics such as P/E’s where you can determine if a stock is above or below averages, and then formulate an idea for whether it can earn the current price or might fall lower yet.

Gold is the fear play that people buy when they have less confidence in traditional monetary and credit markets. That said, as evidence by the short term swings surrounding the European debt crisis, gold is certainly not showing up as the safe haven away from bonds. Part of that is because of liquidity reasons. When people pull cash out to cover their losses they pull from any source available including areas that had given them profits in the past. So the more recent short term trends in gold may not be indicative of its mid term performance potential.

Gold can be owned directly, holding coins, bars or jewelry in a safe or safe deposit box. Or it can be owned in a financial instrument. I would have a bias toward owning the metal, taking physical possession or at least owning it inside a financial instrument that backed their receipts with the actual metal.

Even though gold is possibly another bubble waiting to burst, I do think it has a place in a portfolio as a hedge against the catastrophic distrust (collapse) of sovereign debt.

Mining stocks have gained in popularity for people to search for a gold investment that carries with it more traditional fundamentals, such as P/E, cash on hand, profits, debt levels, etc. that can be traded based on these metrics. Given the idea that these purchases
are made as a hedge, I would have a bias toward mining stocks that are heavily invested with gold as compared to mining stocks that mine a broad range of precious minerals.

5) Silver

Touted as the poor mans gold this metal gains appeal especially for those who don’t want to pay the high price of gold. The other argument is that silver has industrial purposes as it is used in many electronic products. If being used as a hedge against a collapse, I wouldn’t buy silver. The idea that it has an industrial use goes by the wayside in a massive worldwide recession. It is difficult to determine the premium charged for the current price of silver due to its industrial uses and therefore not something that I’d be tempted to buy as a hedging strategy.

7) Currencies

Currency trading is a foreign concept to many but the principles are pretty straightforward. In any given day, the value of one country’s currency is more or less valuable than it was the day earlier as compared to another country’s currency. Currency investment can be non-correlated to the stock market as it is trading trends rather than value. In other words, two currencies can fall in value but one will fall at a different rate than the other, therefore a margin of profit can be made.

9) Timber

There is an appeal to owning timber land as that asset can be managed throughout a variety of economic conditions. Trees are used for pulp wood, building material, telephone poles and large specialty cuts. Each time the tree matures to another segment of usefulness the value of the per pound increases, as does the weight of the tree. The land also has many other recreational uses that can generate consistent lease income. Timber isn’t generally easy to obtain as it entails large upfront costs to purchase land, therefore most of us engaging in timber investments do so either through some sort of partnership or buying publicly traded timber stock.

10) Shorting the Markets

There are hundreds of investment options that allow you to benefit in the downside fall of a sector. There can be a large amount of risk when considering shorting any investment. This paper isn’t designed to cover the details of such an investment, only to point out that it is an option. Before engaging in any such strategy I highly recommend doing a great deal of due diligence and/or speaking to your financial advisor.

Given that the time or certainty of a widespread recession isn’t known I would be very cautious of utilizing a shorting strategy. You might find yourself trying to time the market swings and get it wrong on both ends, losing great sums of money along the way. For those lucky or smart ones who did get it right however, the returns could be substantial.
11) 401k

A trend that has troubled me for years is the direction of 401k investment options. The talk has been filled with reducing investment costs and complexity rather than performance potential. That leads to fewer investment choices and more of them being with a lower cost index driven chassis versus actively managed portfolios. If two portfolios invest into stocks and one of them follows a computer generated model that buys stocks within a certain index and the other one hires a number of highly educated economists that choose which stocks to buy or sell, naturally the computer generated model will cost less. But that doesn’t mean it will perform better.

Most of the 401k’s I review today have a very limited number of bond and stock investments, and a good majority of them are index driven. If you have a 401k with investments outside the traditional ranges including some of the areas I mentioned above, then you might consider incorporating them into your mix. If not, then you’ll want to choose the managers that are investing the money based on metrics you agree with. Look closely at the bond investments offered and see what their duration rates are to help determine how much risk you could be exposed to future increasing interest rates.

If the investment choices are slim and you are unsatisfied then let the management team know. If enough people express a desire to improve the 401k then maybe they will be inclined to do so. Too many institutions may choose the 401k based on ease and simplicity rather than performance ability. Unfortunately that can underscore the magnitude of the role that 401ks play in the future of our retirement picture. People don’t appropriately see it as the multi million dollar accounts that they should. They make decisions for what it might be worth today, not what it could be worth twenty years from now. Instead many may view it as a necessary evil and for the most part give it very little consideration. Take the necessary time to fully understand your retirement plan and the investment options within your plan and then make allocation decision based on that knowledge. Not only will you influence your performance, the knowledge you gain will give you the confidence to invest more often in it throughout your career.

12) College Savings plans

College is a tremendous expense that affects most families. Some people are proactive and save for college, discussing with their children the costs and strategies to pay for school. However, most people virtually ignore the cost of school until it’s upon them. Unfortunately the costs are real and impressive and whether or not a family is prepared for them, generally both the child and the parents bear their share of the burden. If not paid for proactively that usually means that college is paid for with debt, which can create decades of hardship for the student and take away decades of retirement savings from the parents.

One of the best ways to avoid this is to save into college savings plans. Each state offers unique plans and often carries a special tax incentive to the state’s residents. So first and foremost look to see what options your state promotes. If you have choices among more
than one plan then I’d look for the option that has the broadest and most actively managed bond portfolio. I believe that good bond management is of critical importance for college savings plans for multiple reasons. Bonds should make up the majority of the asset holdings as they enter high school and certainly when they are actually in college. Because of that, you want to be sure that the bond managers have the best ability to invest through a difficult bond market environment.

The major advantage to college savings plans is that they provide for federal tax free gains when used for higher education costs. It’s a shame when there are no gains to be had after years of saving into them because the bond portion of the equation underperformed when you needed it most.

If the funds aren’t used for higher education and spent for something else then there could be a 10% federal tax penalty and income taxes on the gain. On my website, www.jpstudinger.com, I have links to great college resources such as finding out the cost of any school in the country, what the future cost might be and how much to save and especially for Michigan residents, I have a breakdown of the details that Michigan has to offer with their three college savings plans.

13) Long term care insurance

The future of health care in this country is uncertain. But one thing for sure is that it is highly likely the long term benefits from government sponsored insurance will be less. Those who have taken matters into their own hands will most likely be affected least. The long term care industry has seen many changes. Earlier this year I was shocked as a client brought in a quote I gave him over ten years ago for long term care coverage. Not only was the benefit far better than anything that could be bought today, but the price was substantially lower. The trend I’ve seen in the long term care insurance industry is a consolidation of good carriers, increasing prices and a decrease of benefits especially with the duration of care. If you are in your mid 40’s and most certainly your 50’s or older then I’d consider reviewing and possibly buying into a long term care policy sooner than later.

14) Life insurance

Life insurance is a staple protection carried by many families to cover a catastrophic event that they are not yet capable of handling on their own. I’ve seen too many cases where families had insufficient coverage and it left the remaining spouse and children in a very tough position.

When comparing coverage I’d concentrate mostly between term and universal type policies. Universal comes in two forms, one where you have investment discretion and one that you don’t.

Term is pretty straightforward in the sense that you buy a policy to cover the risk from a particular event happening. For example, if you have children ages ten and above and you
want to be sure that you could get them through college even if you passed away then you might consider a 15 year term policy. Be sure to shop price and go with a well funded insurance carrier.

With permanent cash value insurance (universal life) pay a great deal of attention to the underlying costs of insurance, and don’t get wrapped up by the illustration projections of future cash value potential. Some insurance policies allow you control over how the money is invested. Be sure to keep an active management approach to the cash value of the policy (if it is a variable policy and carries different individual investment choices). Too often people buy into these policies, pay lots of money as premium and do no review or make changes to the policy for a decade or more. Because the cash value is used to pay ongoing internal operating and insurances costs I would consider an even more conservative investment approach to the cash value in the policy than you might consider inside your 401k or other long term investments.
Remain Logical and Prepare Appropriately

Just because you have more information on the financial condition we’re in doesn’t mean that a collapse will suddenly happen tomorrow. It might be that the unraveling has already begun. Or maybe we borrow time and delay the reckoning for many years as we continue to prop up the economy. It is also possible collapse doesn’t happen at all. Maybe the resolve of our country is so great that we can grow our way out of this mess. I think it more likely that we do experience a correction, but that it is our resolve that will eventually build us back from the rubble.

Debt is leverage and leverage magnifies an outcome. Debt can help propel a good idea into a great one, but it can also bring an idea to market that never should have been.

It takes longer to buy things without using debt. Most people wouldn’t be able to afford a home if they couldn’t obtain a mortgage to help reduce the amount needed to move in. All businesses need some level of start up capital. More often than not people don’t have sufficient funds to pay for a business, especially a capital intensive business, without borrowing money. Unfortunately we moved away from using debt as a strategic advantage and used it for just about everything, even small tangible items that depreciate in value faster than the time it takes to pay the debt that bought them. Too much debt can be the death of a good idea and can bring a system to its knees. Recovery from such an event can take a very long time, especially if false fixes along the way only delay the natural efficiency of a real fix. No matter the short term swings or current events, be sure you are financially ready to handle the hardship and/or opportunities that arise.

This summer I was on a vacation with my boys in my hometown of Manistique when I got word that the paper mill shut down. The paper mill has been the rock of that community and the devastation of losing an employer like that ripples through a city to the point that it might not ever be the same. The community acted quickly, and within days had organized back to back workshops for those who just 72 hours ago were happily employed. Ronnie Dunn has a song, Cost of Livin’ that describes the situation well.

I spoke at the events and was honored to talk with many of the displaced workers. These were people who just wanted to work. They don’t want welfare, they don’t want a handout, they just want a job where they can do their part and build security for their family.

The paper mill had a revolving line of credit that renewed like clockwork year after year – up until this one. And just like that, when there isn’t the money to function then an economy shuts down. Management at the mill worked day and night to try and rectify things, Governor Snyder visited the mill and the people who had worked there and others did what they could to try and keep this engine going. They were able to work out a temporary arrangement with another bank, and the mill slowly began ramping up their operations. But the conditions are steep, let alone the challenges of renewing their supply and customer chains when just a few weeks back they had to leave them hanging.
It’s a window into the harsh view of what can happen, and how quickly things change when the numbers can no longer be supported. Listening to the November 9th 2011 Republican debate on CNBC it was evident that many there recognized the stark reality we’re in. But amidst the battle cry of renewed growth none denied the possibility of a collapse of sorts before things could finally get back on proper track. The warning signs are blatant enough that it’s time to take heed and prepare for what this country does best; dig deep and achieve a renewed “American Dream.”

James Studinger, Financial Planner
www.jspstudinger.com
Author of Wealth Is a Choice
248-643-6550
James@jspudinger.com

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100 W. Long Lake Road, Suite 120
Bloomfield Hills, MI 48304
T) 248-643-6550 F) 248-928-7044

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