

Taking people at their “Word” Value

Trying to make sense of so many moving pieces in today’s economic and financial worlds is a challenging task. In the process of catching up on my reading during our school’s winter break, I came across the following quotes.

"Whatever words we utter should be chosen with care for people will hear them and be influenced by them for good or ill." Attributed to Gautama Buddha [563-483 BC].

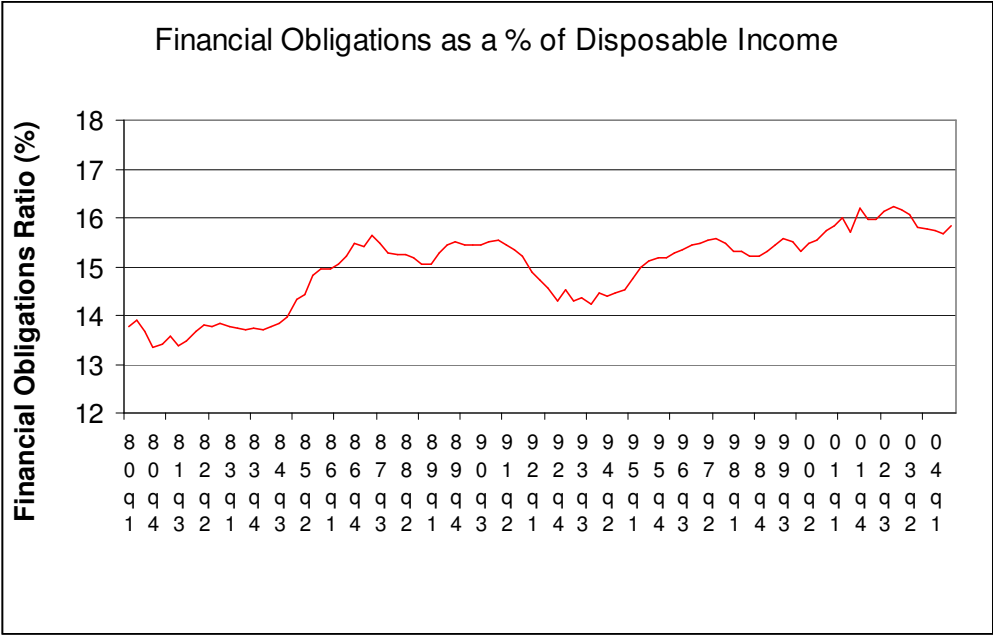
"Only the suppressed word is dangerous." Karl Ludwig Börne, German journalist (1786-1837)

Thus, rather than taking people at “word value” it is worthwhile to pay attention to the choice of words used by the community, and the words that are suppressed.

1. Social (In)Security. The issue of Social Security, and its proposed privatization has garnered a lot of press lately. Mr. Greenspan and the politicians portray a looming sense of insecurity regarding the solvency of Social Security. However, the [Social Security Administration](#) trustees indicate that under their “intermediate” assumptions the combined (OASI and DI) Trust Funds are projected to become exhausted in 2042. For the 75-year projection period, the actuarial deficit is 1.89 percent of taxable payroll, 0.03 percentage point smaller than in last year’s report. So, when Alan Greenspan said that the country will face "abrupt and painful" choices if Congress does not move quickly to trim the Social Security and Medicare benefits that have been promised to the baby boom generation, he does not mention the above SSA numbers or allude to the fact that a 1.89% increase in payroll taxes ensures the solvency through the projection period with the current benefits. President Bush, during a Press Conference on December 20 said, “ In 2040, it will require two workers per employee to meet the promises. And when the system was set up and designed, I think it was, like, 15 or more workers per employee. That is a problem. The system goes into the red. In other words, there's more money going out than coming in, in 2018.” He chose *not to mention* that during 2003 total benefits paid were \$471 billion while Income was \$632 billion, and assets held in special issue U.S. Treasury securities grew to \$1.5 trillion. Curiously enough the “intermediate” assumptions of the SSA trustees include a productivity growth rate of 1.6% and a CPI increase of 2.8%. From a macro perspective it is difficult to figure out how to justify the S&P 500’s current P/E ratio that’s greater than 16 based on these assumptions! If Greenspan has his way, we would be using the new *chain-weighted* CPI that gives lower inflation readings instead of relying on the Consumer Price Index. A couple of extra words, and inflation is reduced!
2. The Ownership Society. Making America an “ownership” society is currently a key issue on the economic and political agenda. Wall Street is trying to get policy makers to enact legislation to allow workers to have a “personal savings account.” The President, in a recent press conference said (sic) “Now, the benefits, as far as I'm concerned, of the personal savings account, is, one, it encourages an ownership society.” He also added that “the younger worker would gain a rate of return, which

would be more substantial than the rate of return of the money now being earned in the Social Security trust.” Note that the fact that this comes at an *increased risk to Security is consciously omitted*, perpetuating the myth that investing in the market is a sure-fire way to wealth.

3. The US homeownership rate reached a record 69.2 percent in the second quarter of 2004, according to the Administration, which touts it, as more evidence of the “ownership” society. However it does not mention that according to the Federal Reserve’s Statistical Release, total Consumer debt in October 2004 exceeded \$2 trillion dollars, and Household financial obligations as a percentage of disposable personal income, seasonally adjusted, stood at 15.83% at end of Q3. Further the trend in the Financial Obligations Ratio is depicted below.



* Data from Federal Reserve

Compared to historical numbers the FOR is fairly high and was last seen at these levels during the 1987-1991 period. What makes it more challenging this time is the extent of the ARMs in a period of rising interest rates and an uncertain employment outlook. CPI was reported at 3.9% for the three months ending November 2004, while earnings growth for production and supervisory workers was in the 2.4% to 2.5% range, resulting in a decline in real earnings. Clearly a rise in interest rates not only increases the interest payments on the mortgages but also increases the risk of lowering property values but not the loan amounts. Which brings us back to the meaning of the word “ownership.” Once upon a time ownership meant possessing an entity without anyone else having claims to it. Clearly ‘owning’ a home with an outstanding mortgage nullifies this archaic view of ownership..

4. Kmart and Sears. Back on June 30 Kmart Holding Co. announced that it will sell up to 54 of its stores to Sears, Roebuck and Co. for up to \$621 million. Its stock rose \$3.58 to \$71.80. Then on November 17 Kmart announced that it would be merging with (i.e. acquiring) Sears in a stock and cash deal. This sent its stock up \$7.78 to \$109. So the

stores made a round trip back to Kmart, and Eddie Lampert, Kmart Chairman, and other managers have done pretty well for themselves. Now analysts are touting retailers like Saks as a “Kmart” story with undervalued real estate!

In this context, looking up the words ‘invest’ and ‘gamble’ in the Merriam-Webster dictionary reveals the following:

Invest: to commit (money) in order to earn a financial return, or to make use of for future benefits or advantages

Gamble: to bet on an uncertain outcome to play a game for money or property

It is noteworthy that all discussions involving the privatization of Social Security or home ownership use the word “investment” but not “gamble.” As always, *caveat emptor* prevails!