Going Postal on Inflation

By The Mogambo Guru

05/21/07 **The Daily Reckoning PRESENTS:** Well dear reader, it appears we are backed into a corner. Once again inflation is the bully in the schoolyard, and we are the little guy who doesn't want to give up our lunch money. Our only hope is that the mighty Mogambo makes it in time to stop him – or at least offer some amusing insights onto why this bully is so ridiculous. Read on…

GOING POSTAL ON INFLATION

An unseen hand slips a piece of paper under my door, and then I hear footsteps hurrying off. Curious, I walk over and pick up the paper, and see that it is a Bloomberg.com news item about the Labor Department reporting, "Prices paid to factories, farmers and other producers rose 0.7 percent after a 1.0 percent gain in March." No wonder they hurried away, as I feel those old feelings welling up inside me, wanting to lash out in anger, and all I need is a target!

Even worse, as Bloomberg writes, "Today's report showed food prices rose 0.4 percent in April, after the previous month's 1.4 percent increase."

Beads of sweat broke out on my forehead as I realized that more of the same is on the way, as "Costs of intermediate goods, those used in earlier stages of production, rose 0.9 percent last month, after rising 1 percent the prior month."

Inflation is everywhere! I can't even afford to write my stupid Congresspersons ("Dear Morons, You let the Federal Reserve destroy our money by creating so much of it!") as first-class postage is going from 39 cents to 41 cents, which is an increase of 5.1%. In case you were wondering, other classes of mail will have newly altered rates, too, and the average rate is going up 7.6%.

This comes on top of (if you remember) the increase in postal rates that took effect in January of 2006, with first-class postage going from 37 cents to 39 cents, a 5.4% increase.

An interesting note to the ugly news was that there is a new restriction on the Post Office, as future rate increases in postage cannot exceed inflation, as determined by the Consumer Price Index! Hahaha! That'll teach them!

The Post Office is quoted as saying that this would be "extremely challenging" to them, as "Significant portions of our costs – such as fuel and employee retirement and health benefits – routinely exceed the consumer price index."

Hahaha! You, too? Hahaha! Relax, letter-carriers of America; your own government says that you are wrong, and that prices are not going up! You're all just a big bunch of stupid poopie-heads about inflation, just like The Mogambo! Hahaha!

If you want to measure inflation, then perhaps the Post Office should read, “Dow Jones Plus 13000 – No Big Deal”, an essay at gold-eagle.com by independent analyst Mark J. Lundeen. In it he wrestles with the problems of measuring inflation, and writes, “as an investor I must come up with a rate of inflation that is real world and easily determined, or risk losing purchasing power, over time, due to inflation’s erosion on the dollar.”

Looking at alternatives, he compares the rise in various costs, expenses and indexes to the rise in the Dow Jones Industrial Average since 2000, and concludes that the annual increase of his property tax can be accurately used “as the yearly inflation benchmark to determine if I am making an inflation proof return on my capital.”

Even better, “the calculation is very easy as we only have to do it once a year and our county officials will make sure we have all the information we need”! How handy! Thanks, Mark!

And how much did his property tax increase from 2000 to 2007? About 6.7 times as much as the Dow increased!

Now that the housing market is in obvious distress, perhaps you would be interested in knowing exactly who is going to eat those mortgages going bust. In his book Financial Armageddon, Michael Panzner reveals that the Bank for International Settlements (BIS) figures, “more than half of all U.S. residential mortgages were incorporated into mortgage-backed securities in 2006.”

A mortgage-backed security, in case you were wondering, is when a bank bundles up a lot of mortgages altogether into a unit, slices and dices the bunch into various pieces, or “tranches” which vary according to what the piece yields, pays or promises, and the pieces are then sold to various buyers, who buy them for various reasons.

The very, very interesting part is that “the yield of each tranche would vary, with the overall average working out to less than what the underlying mortgagees were paying.” Hahahaha! So, as stupid as the banks were to make these risky-but-low-yield loans, the average of the “investors” who bought the mortgage-backed securities from them is even more stupid, as he got, on average, a still-risky-but-even-lower-yielding “investment”! Hahaha!

And, even worse, the last tranche was the “equity tranche”, which apparently doesn’t get any payments at all, but that “Anything left over after making good on loan losses would go to the equity tranche holders!” Hahaha!

A voice calls out from the back of the audience, asking “Hey! Stupid Mogambo Jerk (SMJ)! If all the pieces and tranches of the mortgage-backed security add up to less than the whole thing, where did the money go? Did you steal it, you Filthy, Stinking Crook (FSC)?”

I was, of course, livid at the insult. I could plainly see my rude and insulting adversary smirking at me from the back of the room, and I quickly realized that striding back there, grabbing that little snot by his geeky little neck and repeatedly slapping his nasty little face was the only Appropriate Mogambo Response (AMR).

So I say to Mr. Panzner, “Take over for me, will ya?” and I start striding downstage to get my hands on my little nemesis. But I was stopped mid-stride when Mr. Panzner provided my alibi when he explained that the difference went not to the slimy Mogambo, but “to cover the fees of those involved in the securitization and later sale to investors, as well as any legal and administrative costs.”

Until next week,

The Mogambo Guru
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**** Mogambo sez: I am astonished that gold and silver are not leaping in price to heady new highs, and grateful that they are not. So should you be, as it allows you to get rid of some more overvalued dollars by exchanging them for gold and silver while they are still cheap. One day it will not be so!