Cursing the Loss of Purchasing Power

By The Mogambo Guru

04/14/08 The Mogambo has a problem with the government's Plunge Protection Team: either it exists and is massively operating to intervene in the markets, or that people are truly idiots. Or maybe delightful little fairies guard our dreams and protect us in life!

Thomas G. Donlan's new essay in Barron's is titled "Lands of Waste and Debt" with the subhead "The states send signals that it will not be a happy Spring", which makes me ask the obvious question "It won't be happy for who?", as I am all in gold, silver and oil, and I am dead-bang sure that I will be VERY happy for a long, long time because I know what happens to those particular items when a moronic, corrupt government teams up with a central bank, especially one utilizing some bizarre computer models to determine monetary policy; inflation that screams your death knell!

So maybe it won't be a happy time for some working people having their death knells screamed at them, or their families screaming at them because things cost so much and they whine, whine, whine about it all the damned time until you want to scream a death knell of your own, as the latest employment report showed that 80,000 jobs were lost in March, which does not even account for the fact that the two previous month's job losses were each revised upward by 76,000! In two months, 152,000 more jobs were lost? Yow!

And these are only the reported job losses, and I've even seen estimates as high as 400,000 jobs lost!

And people with houses to sell are not going to be too happy, either, as Bill Bonner here at The Daily Reckoning reports, "So far, U.S. homeowners have lost probably about 12% of the wealth they thought they had in their houses. The total capital value of the residential housing market is about $20 trillion. So, a 12% loss is equal to about $2.4 trillion."

Apparently, Mr. Bonner recognizes the look of horror on my face and the way I am gasping for breath at the prospect of a country with a GDP of $15 trillion losing $2.4 trillion in wealth. To make me feel better, perhaps, he added, "A few foreign housing markets have been hit harder – Ireland, Spain and Iceland, for example." Yikes!

Back here in America, the National Association of REALTORS reports, "the median price of an existing single-family home dropped 8.7 percent in February from a year earlier, the most in four decades of record keeping."

And it is not just first mortgages that are in trouble, as Ed Steer of GATA sent the International Herald Tribune article "U.S. Equity Loans Are Next Round In Credit Crisis", which contains the chilling statistic "Americans owe a staggering $1.1 trillion on home equity loans – and banks are increasingly worried they may not get some of that money back."

And they should worry, as, "In December, 5.7 percent of home equity lines of credit were delinquent or in default, up from 4.5 percent in 2006, according to Moody's Economy.com", and "In places like California, Nevada, Arizona and Florida, where home prices have fallen significantly, second-lien holders can be left with little or nothing once first mortgages are paid."

To make sure that they get their money back, "many lenders are taking the extraordinary step of preventing some people from selling their homes or refinancing their mortgages unless they pay off all or part of their home equity loans first." What makes this all the more worrisome is that "In the past, when home prices were not falling, lenders did not resort to these measures." Cue ominous soundtrack, with wolves howling and banshees wailing.

And it won't be happy for those guys holding stocks of the S&P500, as that index had earnings sliding again, this time to $66.18. In case you were wondering, less than 6 months ago, the earnings of the S&P500 were almost $86.00! It's amazing that the stock market HASN'T collapsed in the face of an earnings slowdown of 23%!! Earnings are slashed by almost a quarter, but the underlying stocks haven't sold off, but actually seem to rise? Wow!

This amazing phenomenon proves either that the government's Plunge Protection Team exists and is massively operating to intervene in the markets, or that people are truly idiots. Or maybe delightful little fairies guard our dreams and protect us in life! Something.

Either way, the earnings yield of the S&P500 is a miniscule 4.83%, which is the lowest since sometime in '04. Nice "growth" there, dudes!

And it won't be happy for many shareholders at all, as Jack Willoughby in Barron's reports, "The average U.S. diversified stock fund lost 10.11% in the opening quarter, slightly more than the Standard and Poor's 500 index's drop of 9.44% over the same span."

It also looks like all the other stock funds, (big cap, low cap, high growth, blue chip) had losses, too, ranging 7% to 15% in the first quarter, with the exception of everybody's favorite, the gold funds, which gained 5.22%, and some short funds that were up 11.93%.

And the news is not any better in bonds, and Ty Andros of TraderView.com has been looking at the gigantic bubble in bonds. He says that bond prices "have been this high, and rates this low, ONLY one other time in over 50 years, and that was the 2nd quarter 2003."

Wow! 50 years! Then, since he knows what a drudge I am about inflation, innocently asks, "How about purchasing power? Let's use the rule of 72 to figure out what type of purchasing power losses these holders are about to face. 72 divided by inflation of (I will be kind) 9 percent."

The results are that, "In the case of the 10-year note, it will lose half its value over the next 8 years, and in terms of the 5-year, a 31% loss of purchasing power will be seen between now and redemption time." My God! These are staggering losses, considering the sheer tonnage of bonds that are already extant in the freaking world!

And why will bond investors face purchasing power losses? Easy! Mr. Andros says, "MZM (money with zero maturity) is expanding at 30 percent, and reconstructed M3 is running at over a 17% growth rate." I am stunned! In short, the Federal Reserve is creating money seemingly as fast as it possibly can, which devalues all the existing currency by just that little bit more!

On the other hand, he says, "As long as they create fiat currency and credit as they are, stocks can NEVER be expected to decline for long. They will just rise to reflect their re-pricing in the currency in which they are denominated (currencies don't float they just decline at different rates) with nominal gains to reflect the loss of purchasing power, not to be confused with REAL gains as measured in gold."

And to prove it, look at Zimbabwe, where a single cigarette now costs over Zim$750,000; their stock market shows the biggest gains of all the stock markets in the world!

Too bad the entire capitalization of the Zimbabwe stock market is roughly equal to a used Chevrolet with bald tires! Ugh.

Until next week,

The Mogambo Guru
for *The Daily Reckoning*
April 14, 2008

The Mogambo Sez: If I was ever a bull on gold, silver and oil, I was but a novice, as I am much, much more so now.

And so should you be.