And Now… The Greatest Bust in U.S. History!

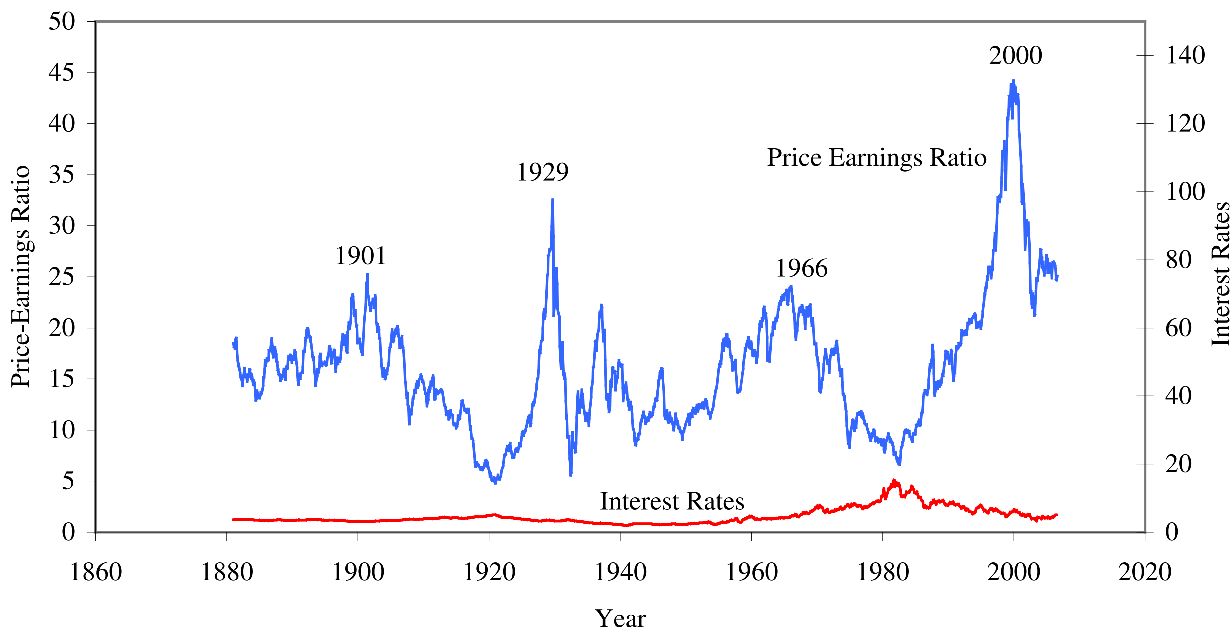
We experienced the greatest **stock market bubble** in U.S. history during the late 90's followed by the greatest **commodity, bond, and real estate bubbles** in U.S. history. Since the stock market has largely re-inflated, the bond bubble is at its peak, and the real estate bubble is just past its peak, they have collectively encouraged the most egregious **borrowing** and **spending excesses** in the ***history of the Republic.*** As a result we will experience:

- ***The "Greatest Bust in U.S. History"!***
- ***A series of dollar and market collapses soon (2008-2010), then rebalancing for approx. 8-10 years!***

The most common characterization those in power utilize describing the U.S. economy today is the well rehearsed and spun declaration that: **"The Economy is Strong!"** Metrics sited to buttress this assertion include low unemployment, continuing growth in Gross Domestic Product (GDP) and productivity, strong wage increases, high asset valuations (including real estate, debt securities, and equities), and record company profits and sales. Metrics that are suspiciously missing are the magnitude of the bubbles and imbalances in all financial assets (debt securities, equities, derivatives, currency holdings, etc.), real estate and international trade. Metrics are also missing that may describe the misallocation of resources that are performing work in market unjustified industries under which artificially suppressed interest rates have provided morally hazardous crutches. Unfortunately, when the noted bubbles begin popping in a big way, the weight of their force will easily trump any central bank or government effort to disguise the correction process with yet another illusory papering effort. I anticipate this "major bust" will commence between now and 2010 as the initial critical mass of Boomers begin to leave the work force and task (cash-in on) their perceived financial wealth. Further, it will require approx. 8-10 years to painfully correct the most extraordinary imbalances in the history of our Republic.

The Greatest Stock Market Bubble of All Time

The stock market bubble in the late 90's blew away any prior U.S. equity bubble in magnitude! Whether measured in Price relative to earnings, sales, or book value, the 90's bubble made the bubble preceding the Great Depression look like a tea party. Robert Shiller's work presented in Irrational Exuberance revealed data of the S&P 500 index Price relative to its prior 10-year Average Earnings in an effort to smooth the extraordinary earnings volatility resulting from short-term earnings cycles aggravated by macro money and credit manipulation. The first graph below indicates the P/E ratio trend since 1881 clearly validating the relative magnitude of the "2000 Bubble" to the "1929 Bubble". His second graph below (Figure 1) demonstrates again the unprecedented peak in year 2000 (solid black line) of the noted P/E ratio, which marked the beginning of the current secular bear market. Comparative P/E ratio trends following the start of all other U.S. secular bear markets since 1881 are indicated as well.



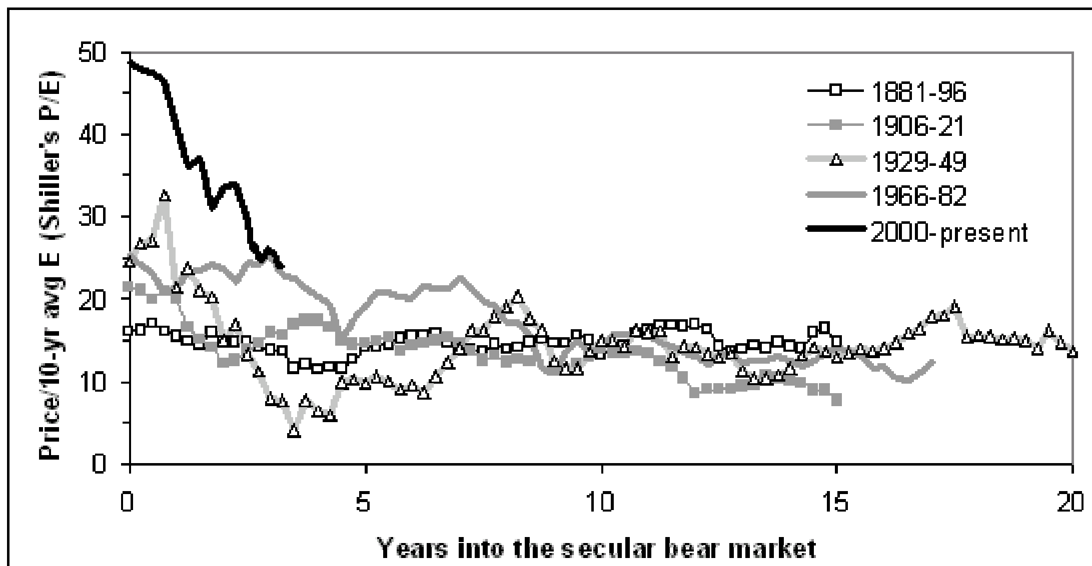


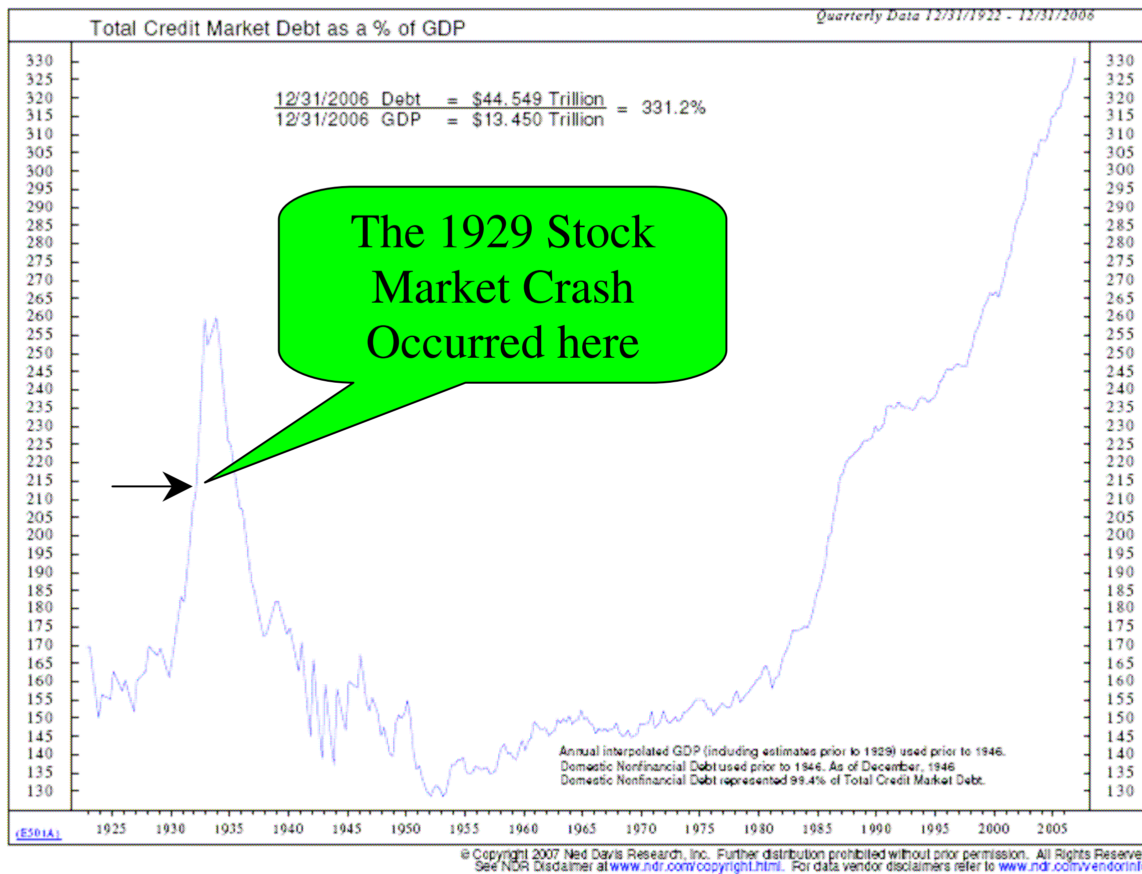
Figure 1 Shiller's P/E during secular bear markets [(1)]

Most economists refer to the 2000-2002-equity bust as the "Tech Market Bust". In fact, the "Tech Market" was more excessively overvalued than the rest of the market, **but** the rest of the market was also in an extraordinary bubble of its own. The illusion created by referring only to the "Tech Bust" leads one to believe that the balance of the market was at rational justified levels in year 2000 and the whack that non-tech stocks took for the next 3 years was largely un-justified. NOT TRUE. Bubbles were everywhere in nearly all stocks. You can see my graph of the entire equity market here: http://www.austrianenginomics.com/id10.html (second graph) depicts the gap between market and fundamental valuations where the market *only partially corrected* before the bubble blowing continued in earnest from 2003 onward.

The Greatest Bond Bubble of All Time

Once the inevitable stock market semi-bust started rolling full speed in 2000, our well-greased central bank and Treasury department anticipated the fallout by launching one of the greatest tax cuts and arguably the greatest liquidity injection in the history of the Republic during 2001-6 period. Further, by gradually raising interest rates in baby steps, ¼ point at a time, they remained a giant step behind the global financial cartel's ability to expand credit faster than the central banks were willing to restrain it. The most creative and confusing financial securities and associated derivatives (CDO's, CDO's squared, CDO's cubed, MBS's, SIV's, CDS's, etc.) grew exponentially to enable the final parabolic expansion of the greatest aggregate bond bubble in the history of the Republic. This overwhelming credit market bubble is in its infancy of popping. The "popping" will manifest itself through anything from Sub-Prime mortgage loan blow-ups and their derivatives to major banks (read Citigroup) and companies (read General Motors) going bankrupt or breaking up to dissolve their debt obligations.

The graph on the following page by Ned Davis Research, Inc. is a bone-chilling depiction of how the aggregate Credit markets have grown relative to Output (GDP). I have logically argued in numerous missives that the increase in total "real" debt obligations that will be repaid cannot be greater than the increase in Output. Hence, the line in the graph should be nearly flat hovering around 100-130 on the chart!! By that logic the illusory wealth in the Credit Markets today is over $30 trillion. i.e. there is a total disconnect between those holding the credit securities (Treasury Debt, State Debt, Municipal Debt, City Debt, Corporate Debt, Individual Debt, etc.) and those who are expected to pay them. This multi-generational credit cycle is by far the most dangerous of bubbles. We have far exceeded the level prior to the Great Depression. Note: The spike in the graph **after** the 1929 market crash was due to the catastrophic reduction in GDP; not a further increase in debt!



Next, The Greatest Real Estate Bubble of All Time

Real Estate in aggregate does not appreciate in real terms! One cannot "will" wealth into existence by owning a home. Houses do not create wealth! At best, they may only facilitate the *transfer of wealth* via renting.

Land is not nearly as scarce as other critical major commodities. Hence, the fundamental relative value of land associated with the home or commercial building structure will increase at a lower rate than oil, natural gas, water, copper, gold, silver, etc. That means houses should DECREASE ever so slightly over time relative to all other real wealth on the market. Just click on the "Houses Do Not Appreciate in Real Terms" article here… http://www.austrianenginomics.com/id7.html to learn the fundamental drivers of real estate appreciation.

This most extraordinary illusion of real estate valuations in the history of the Republic is not surprising considering the extremes of the equity and bond bubbled assets. The central bank easy-money policies following the stock market bust of 2000-2003 exacerbated the real estate bubble. Robert Shiller again highlighted the historic perspective of the most recent real estate bubble in the graph below. The mainstream economists and pundits always claimed, "there is no more land", and "we must house a growing population" to justify the repeated insane valuation bubbles throughout history highlighted in the graph. One can intuitively deduct that we did not suddenly run out of land in 1977, 1985, or 1996 to prompt the subsequent valuation spikes from a dearth of land supply.

A sad irony is that Dr. Alan Greenspan actually encouraged use of the seductive ARM and sub-prime loans!
In April 2005, Greenspan said:

"Innovation has brought about a multitude of new products, such as subprime loans and niche credit programs for immigrants . . . With these advances in technology, lenders have taken advantage of credit scoring models and other techniques for efficiently extending credit to a broader spectrum of consumers . . . Where once more marginal applicants would simply have been denied credit, lenders are now able to quite efficiently judge the risk posed by individual applicants and to price that risk appropriately. These improvements have led to rapid growth in subprime mortgage lending . . . fostering constructive innovation that is both responsive to market demand and beneficial to consumers." *(from Jim Willie)*

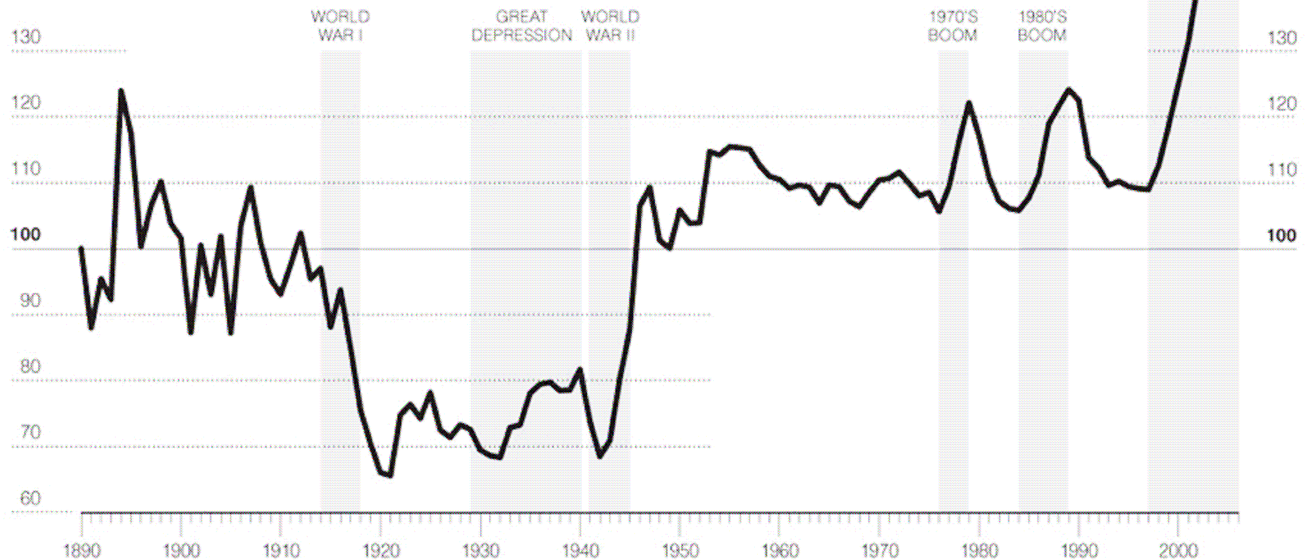
A History of Home Values

The Yale economist Robert J. Shiller created an index of American housing prices going back to 1890. It is based on sale prices of standard existing houses, not new construction, to track the value of housing as an investment over time. It presents housing values in consistent terms over 116 years, factoring out the effects of inflation.

The 1890 benchmark is 100 on the chart. If a standard house sold in 1890 for $100,000 (inflation- adjusted to today's dollars), an equivalent standard house would have sold for $66,000 in 1920 (66 on the index scale) and $199,000 in 2006 (199 on the index scale, or 99 percent higher than 1890).

DECLINE AND RUN-UP Prices dropped as mass production techniques appeared early in the 20th century. Prices spiked with post-war housing demand.

BOOM TIMES Two gains in recent decades were followed by returns to levels consistent since the late 1950's. Since 1997, the index has risen about 83 percent.



Source: "Irrational Exuberance," 2nd Edition, 2006, by Robert J. Shiller   Bill Marsh/The New York Times

Why Haven't the Bubbles Popped?

Central Banks and governments have become much more linked globally. Hence, as the modern financial chicanery that violates fundamental economics becomes more pervasive across the globe, then the more inclined are bubbles to continue growing for the same reasons they grew in their infancy. Blowing bubbles is politically irresistible. 99 of 100 people perceive they have actually gained real wealth from these asset illusions. A scant 1 of 100 know that they are in fact illusions that will inevitably diffuse when tasked (cashed in). As long as the collective bubbles keep growing from central bank easy monetary policies around the world and creating ever-larger illusions of wealth, they will continue…

Conclusion

Why would you not expect the greatest bust of all time after the greatest asset bubbles of all time? Unfortunately, when the illusions of wealth are discovered as the first wave of Boomers retire in 2008-2010, and they attempt to cash in on the illusions, it will "disrobe the emperors" in central banks and governments as all markets experience a series of crashes and false recoveries. People tend to move quickly when motivated by fear to change buying habits and seek real money (e.g. gold, silver, etc.) to preserve their dwindling perceived wealth. Unfortunately, the series of panics will feed upon themselves relentlessly as we endure the Second Great Depression lasting 8-10 years!

References:
(1) Shiller, Robert (2005-03-17). "Irrational Exuberance, Second Edition". Princeton University Press. Retrieved on 2007-02-03. http://www.irrationalexuberance.com/index.htm

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