

STATESIDE



VANESSA DRUCKER
Fund Strategy's American editor in New York

'Not since the Great Depression...'

This year America's main television networks have compared the country's economy today to the big slump of the 1930s more than 200 times. But do the parallels really bear examination?

Students of history

It must be the most the hackneyed hyperbole of 2008. The phrase punctuates every financial article, while photos of breadlines hint at a dire future. Just try Googling "not since the Great Depression" and you will strike gold. But, says Jim Grant, the editor of the trenchant Grant's Interest Rate Observer: "Those glib comparisons ignore the reality of the economic backdrops. In the thirties, nominal GDP was sawed in half, while today it is down less than a percentage point."

I ran into Grant at the Museum of American Finance on Wall Street, which houses a diverting collection of financial artefacts. If you have a few minutes to spare, check out the antique stock and bond certificates, cash registers, bank notes and an original Edison light bulb. Note especially that the front page editions of the October 20, 1987 Wall Street Journal and New York Times explicitly state that the previous day's crash is not an echo of the 1929 plunge. My favourite display is a typed note dated November 8, 1929 from Matt, a Wall Street worker. He writes to a girlfriend that the sight of a woman jumping from a window has destroyed his appetite for his lunch.

In any case, during the week of the 1929 crash, positive daily news stories surprisingly outnumbered negative reports by four to one. From March 13 to March 19 this year, as Bear Stearns crumbled, coverage on the main American television networks was six to one negative, according to a study by the

conservative-leaning Business & Media Institute. The networks compared today's economy to the Depression 70 times in the first six months of 2008 and a further 157 times from July to October. Time magazine featured Franklin D Roosevelt (FDR) on its October 27 cover. Despite FDR's New Deal, it was only World War II that finally revived the American economy.

The rear mirror

Grant concedes that some of these parallels may have a point. "It's understandable that people are harking back to yesterday. It's not every cycle that AIG becomes a ward of the state."

We are seeing, after all, an end to the banking system as a more or less privately run enterprise. People are disorientated that the familiar markers of the post-war period have teetered or toppled or lost their haloes. Yet the differences between then and now are stark: the federal government now represents 20% of the economy, not 3% as in 1929, and its spending acts as a stabiliser. Consider that from 1929 to 1933 real output fell by 30%, real consumption by 20% and investment by about 90%. And even by 1940 unemployment still hovered around 15%.

Yet Grant's comment caused me to ponder how far analysts during previous recessions had carried comparisons with the Depression. There have been 10 recessions since the second world war. The worst two began in 1973 and 1981, and each lasted 16 months, with unemployment hitting 9.0% and 10.8%

respectively. So I turned to Howard Sherman, an old-timer who joined Lehman Brothers in 1958, and has survived several bear markets. Sherman, currently chief investment officer at Ruggie Wealth Management, in Tavares, Florida, recalls the gloomy environment in 1975. Then, too, the press and his own demoralised clients often referred to the Great Depression.

The economy had stagnated, with no growth in volumes. Only price increases were driving earnings. Inflation and tax rates were sky-high. President Nixon was about to be impeached. "My clients all said, why invest when I can get 15% in money markets? So they kept selling stocks," Sherman recalls.

Yet he does not regard today's references to the 1930s as wholly overblown, nor does he blame the media for its breathless coverage. "A few weeks ago, we were steps from the abyss," he says. "It could have been worse than the Depression!"

A common thread

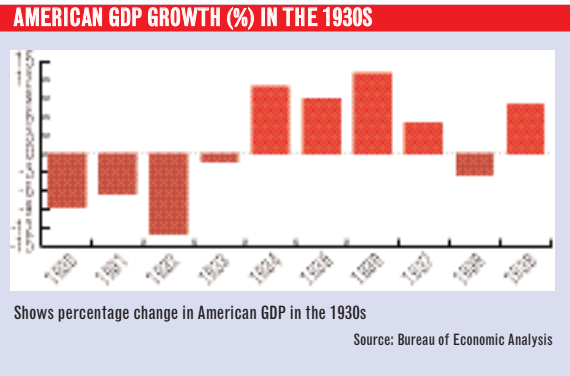
Aside from the calamitous market outcomes, there is at least one distinct common root cause between then and now. Bob McTamane, chairman of the corporate law department at Carter Ledyard & Milburn, traces both crises to excessive wealth disparities. In the 1920s, assembly lines and mechanisation had led to explosive increases in productivity, yet workers still earned pitifully low wages and 30% of Americans eked out an existence below the poverty line. The top 5% of the pop-

ulation was enjoying a third of all income, and low wages were keeping a lid on consumer demand. Flash forward to the 1990s, when the internet was the catalyst for productivity surges around the world. Once again, the wealth drifted disproportionately to the higher end of the spectrum.

"If you can't make money by going to work every day, you look for different ways to do it, by relying on other assets for your future," says McTamane. In 2000, real estate began to plug that gap. In August 2006 homeowners counted on an

anticipated escalation in house prices for repaying subprime mortgages. Property prices started to head south. Speculators who could not sell at inflated prices found themselves in a trap similar to 1929, when investors were buying stocks on 10% margins. Then a sudden and modest dip in the equity markets set off a call on margin loans, forcing them to sell out, which caused a further depressing effect and accelerated the spiral.

Those who cannot learn from history are doomed to repeat it, warned the philosopher George Santayana. In this case, excess credit and leverage, regulatory errors and borrowing by those who did not have the wherewithal to repay their debts, led to terrible dislocations. But before we draw too many parallels between very different epochs, add one more Santayana quotation: history is a pack of lies about events that never happened told by people who weren't there.



"It's not every cycle that AIG becomes a ward of the state"