

# **The Recession of 2005**

America: An Argentina  
In the Making

By Ray Mullaney

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**THE RECESSION OF 2005**  
*AMERICA, AN ARGENTINA IN THE MAKING*

This report explains why US consumer and federal spending must decline and why most stocks, real estate, and US bonds will decline as well.

**The Four Reasons for These Conclusions**

**1. The Trade Deficit** - Most economists agree, the World Bank, the IMF, even Greenspan, that the US trade deficit is unsustainable. Americans are told (by Wall Street and politicians) that to remedy the trade deficit, the exchange value of the US dollar must fall. While this is true, a falling US dollar presents its own set of serious problems (addressed later). To correct America's weakened trade posture, it must change its root cause. The US trade deficit is the direct result of the loss of competitiveness of US businesses and workers. America's wealth is in decline while her spending has increased. This is a colossal problem; its remedy requires sweeping policy and behavioral (social) changes.

Over the past twenty years Japan, China, Canada and all major European countries have outperformed the US in manufacturing. In response, America has not changed at all. This is not simply because of cheaper labor. The productive powers (and historical advantages) that made America the richest country in the world have effectively disappeared. This is why our trade deficit has ballooned.

A decline of the US dollar will not restore US competitiveness. It will, however, raise the costs of imports (reducing America's standard of living) and force foreign nations to lower prices, which will precipitate trade skirmishes or possibly much worse.

The chart to the left shows the dramatic and rapid decline of US productive competitiveness in the early 1990's.

Fair (and unfair) international competition, always has and always will determine winners and losers. Thirty years ago America was the greatest creditor nation on earth. It possessed great wealth; average American families were self-sufficient. From 1945 through 1975 America became increasingly efficient and profitable, exporting goods and services.

What will America do? Borrow and spend more; spend until no one will loan them more money, like Argentina. This will not produce greater competitiveness or greater national wealth. This approach is unsustainable. Taxes will rise; federal and state deficits will expand.

It will be bad for US stocks and bonds.

China and Japan alone hold nearly \$1 trillion in US government bonds. Foreign leaders may have a change of heart; they may demand higher interest rates on these loans. Then what?

When Americans buy Chinese Christmas tree lights, Japanese Toyotas and Saudi oil (by going deeper into debt) they reduce not only their economic freedoms, they also jeopardize their political freedoms as well. If foreigners disagree with US military or trade policies they may sell their US

bonds or simply refuse to loan the US government more cash. The US government would collapse were it not for loans from foreign countries (not all are US friends and allies). Is the US reliance on foreign debt a sign of great economic strength? If foreigners decide to sell US bonds, raise their rates or simply refuse to loan the US government more cash, will Americans file a legal complaint with the "world court" or UN?

The US trade deficit is an extremely serious US problem. It will not be remedied easily or quickly. The dollar may drop dramatically, that would change trading trends quickly. However, as the dollar falls, foreign imports will be more expensive; food, clothing and even shelter will cost more. That may be inflationary, that could force Americans to spend less. That is recessionary. This is not good for stocks or bonds.

**2. Social Security, Medicare & Medicaid** - According to the Office of Management and Budget under the Clinton Administration in 1999: "These [trust fund] balances are available to finance future benefit payments and other trust fund expenditures--but only in a bookkeeping sense. These funds are not set up to be pension funds, like the funds of private pension plans. They do not consist of real economic assets that can be drawn down in the future to fund benefits. Instead, they are claims on the Treasury, that, when redeemed, will have to be financed by raising taxes, borrowing from the public, or reducing benefits or other expenditures."

Before American baby boomers retire, they must accelerate their savings or face poverty at retirement. Will foreigners support them? If or when they begin saving, they will consume far less. Since, consumption accounts for about 70% of the US gross domestic product; when Americans save more and spend less, corporate profits will decline so will taxes and jobs. If they do not save more, the government must borrow more to support them. This will not be good for the dollar, interest rates or stocks.

My parents contributed about \$25,000 to the system. To date, they have received over \$500,000, and it's still coming (mom, 93, in a nursing home) The US social security system is as rational a system as fishing in your own swimming pool. Analysts that I respect, estimate this fix to the SS problem to be in the range of \$20 to \$40 trillion dollars. It is not possible for taxes to support the benefits promised. This "system" will implode.

**3. The Federal Debt Burden** - How will US taxpayers pay off the federal debt? Debt reduction comes from three sources, 1) increased taxes, 2) a reduction in federal spending, or 3) printing more cash. The first two choices will result in lower disposable incomes, a slower economy, lower corporate earnings, reduced employment and finally, further reduce tax revenues. If they print more money, interest rates will rise and the dollar will fall, even more.

The Bush administration and Wall Street believe that as the GDP expands, tax revenues will accelerate. They will temporarily. However, since so much of the GDP is financed with debt, not earnings, and since US citizens must begin to save more, US spending must slow down. This will drag down the overall US economy. GDP growth, alone, will not close the twin deficits.

The present Bush budget requires both greater federal spending and taxes that are an increasing share of the GDP. This strategy will be recessionary. While the US government may attempt to continue deficit spending and avoid any real cuts in spending (they know spending cuts may cause a recession) interest rates are certain to rise and the dollar will fall further. This will eventually

cause a recession.

**4. American Culture** - "The Rulers Syndrome" - From 1875 until 1975, immigrants to America (with no welfare, or tax credits for the rich) built the strongest and wealthiest nation on earth; the US ruled. Today's Americans fail to understand that commerce, the production and sales of goods and services, is the source of all wealth. They ignore the fact that great wealth is derived from great international trade surpluses and that great trade deficits result in inevitable economic decline. Americans believe that government is the mother of wealth.

Of the 2.5 billion people of China, India and Russia, hundreds of thousands have now been trained in the best US universities. Increasingly, new, profoundly more aggressive and powerful foreign businesses will compete with US workers and businesses. Is the US prepared for greater competitive international challenges? The Rulers Syndrome is the unwarranted confidence that a nation's past supremacy assures it a great future, that its future domination is a birthright, and that its heritage and size (its borrowing capacity) will provide its citizens a free and comfortable life. Clearly, many Americans and all of their politicians suffer from this delusional syndrome.

In each of the past three decades, Americans have spent significantly and increasingly more than they produced. Many Americans accept little responsibility (nor prepare) for life's inevitable challenges, like the loss of a job or sickness. They demand that government (their neighbors) provide for them.

Americans do not understand that competition determines economic winners and losers, they believe politicians do! Americans are consuming more and more; yet, they produce less and work far fewer hours than all past generations. In 2000, 40 million Americans paid \$40 per month for cable TV, yet contributed nothing to IRAs! Many of these same people refuse to purchase health insurance and demand it for free. Democrats and Republicans pander to this sort of "thinking". Wall Street and violent criminals demoralize and cause citizen's great suffering, yet Americans sympathize with these criminals rather than seriously punish criminals. In all aspects of life, Americans have simply gone soft.

Many Americans demand higher taxes on their neighbors, the neighbors who work two jobs, sacrifice and save and generally live more responsibly. This vocal and growing minority insists that government must provide all that they need, with little sacrifice or hard work on their part. The US economy is being destroyed by sloth and the religion of socialism. America is now a welfare state, financed with foreign debt. Ultimately ordinary citizens, not politicians or government employees, will pay for this profligacy.

Currently, the least productive US citizens enjoy a lifestyle that is 10 to 20 times greater than workers in the countries that produce the goods Americans consume. This trend will reverse, just watch. Capitalism, raw and vicious, abject poverty, and unbridled greed made America the richest nation on earth. But the rich went too far. The exploited demanded a larger piece of the American pie; labor laws, unions and vital reforms followed. What began as a civil progress became institutionalized welfare for all. The media persuades Americans that the past was dreadful and the utopian Promised Land (socialism) is only a matter of a few more worthy social programs. The rich produce little, so workers want a free ride too. Immigrants still work hard in the US, but few else do.

The Declaration of Independence has been grossly perverted: "the Pursuit of Happiness" has become the "Right to Happiness". Americans demand that their government provide for all their consumption indulges. They don't work hard enough to support their spending, so they continue to increase the debts that their children will inherit.

### **THE BUSH ADMINISTRATION'S ECONOMIC ERROR**

Current Treasury estimates assume that the US economy will grow and that growing tax revenues will balance the US budget, someday. Taxes do rise when the GDP grows. However, the administration's forecasts of higher GDP growth and higher tax revenues are seriously flawed for the following three reasons:

The US still remains uncompetitive; therefore, the use of debt is accelerating (rather than reduce the living standard).

Since today's "economic growth" occurs only when Americans go deeper into debt, and since debt must be repaid (debts can only be repaid by reduced spending), the economy will slow down.

Since nearly half of all Americans have no savings for retirement, they must increase savings. They must decrease spending to increase savings. Economic growth will contract or become negative.

### **SUMMARY**

The US is not earning the standard of living it consumes, it borrows to live.

The US trade deficit arose from more committed and effective foreign competition.

The Ruler Syndrome prevents Americans from realizing that they have lost the international economic competition.

They must work much harder/smarter, accept a far lower standard of living, or go bankrupt. Government deficit spending stems from sloth and pandering politicians that encourage spending to get votes.

Social Insurance programs and "low taxes" are bankrupting the US. Going deeper into debt, tax cuts, fiscal stimulation, and low interest rates are not long term economic solutions.

America is a nation where the greediest capitalists and the "lazy class" own Congress. America has neither the will nor the know how to (safely) change its policies.

The US trade and federal spending deficits will continue; an economic crisis will result.

We cannot predict when a crisis will occur, but the fact is, America's increasing dependence on debt, foreign debt, proves that the US is growing weaker and weaker; America is going broke. Without major changes, a dramatic drop in the US standard of living and in the US markets, is certain to occur.

Raymond M. Mullaney, President

Throughout this report we have used information and graphics produced by Michael W. Hodges. Mr. Hodges is not responsible for any errors, judgments or interpretation contained herein. I thank him for his outstanding work. Visit Michael W. Hodges excellent website: <http://mwhodges.home.att.net/>

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