

The

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Why I am an Optimist by John Mauldin, Economist

A pessimist never gets in the game. An optimist will suffer the slings and arrows of boom and inevitable bust. Cautious optimism is the correct and most rewarding path. I hope that is what you see when you read this.

The stock market doesn't compound at 10% from today's valuations. The fed is not likely to figure the perfect path in removing it's quantitative easing. We may not pursue a path of rational fiscal discipline in 2010 or sadly by 2012. I expect taxes to be much higher in the next few years and I also believe the world of our kids is going to be a far better world in 20 years.

The future is not linear. The world won't look the same as now in 20 years. We live in the most exciting time in human history. We're on the brink of discovery in so many areas of our world. It's a dance of massive collaboration on a scale the world has never witnessed that will make the world a better place in 20 years.

The world is now negatively correlated with the dollar, and as money went into the dollar and US treasuries, everything else went down. Vietnam devalues, Greece is looking increasingly risky, Russia wants to devalue some more, the world is still deleveraging, etc. Is this another repeat of 1998, when Russia and the Asian debt crisis tanked the markets?

Let's look at Dubai. It is one of the Arab Emirates; but unlike its neighbor Abu Dhabi, oil is only about 6% of the economy. While the foundations of the country were built with oil, the country has diversified into finance, real estate, tourism, trading and manufacturing. It is a small country, with less than 5 million residents, but with less than 20% natural citizens - the rest are expatriates. The gross domestic product is around US \$50 billion.

(Note: <http://www.ameinfo.com/67802.html> and then converting the currency. I found the numbers on various websites and services strangely at wide discrepancies. This seems close to a median number. The discrepancy may be people confusing the GDP for the United Arab Emirates as a whole, which includes Abu Dhabi, rather than just Dubai.)

Dubai has become a byword for thinking large. The world's tallest building, underwater hotels, the largest manmade islands (plural),

indoor snow skiing in the desert... For links to more information try this from Wikipedia: "The large-scale real estate development projects have led to the construction of some of the tallest skyscrapers and largest projects in the world, such as the Emirates Towers, the Burj Dubai, the Palm Islands and the world's second tallest and most expensive hotel, the Burj Al Arab."

UBS suggests that the \$80-90 billion in debt may not include large off-balance-sheet debt (where have we seen that one?). So, a country with a GDP of \$50 billion borrows \$100 billion. They build massive projects, which are now among the most expensive real estate in the world. The latest manmade island plans for one million people to buy property there. Talk about Field of Dreams.

Then came the credit crunch. Property values dropped by up to 50%. Sales, say the developers in understatements, have slowed. Seems there was a lot of debt used to speculate on real estate, not to mention buying Barney's, Las Vegas casinos, banks, etc. And while US banks have little exposure, it seems England has about 50% or so of the debt, with the rest of Europe having the lion's share of the remainder. Admittedly, the estimates seem to confuse the debt of Dubai with that of Abu Dhabi, so it is hard to know a reliable number, other than European banks are the most exposed

Here's the deal. Abu Dhabi has the world's largest sovereign wealth fund at over \$650 billion. Dubai has a "mere" \$15 billion. If they cared to, Abu Dhabi could write a small check and make all the problems disappear. It seems they aren't ready to do that—at least not yet. Abu Dhabi already got the world's tallest building on past debt problems.

Construction and real estate were as much as 25% of the economy. Let's see. Large leverage with maybe \$5 billion in interest in a \$50 billion economy that is 25% construction? A construction and real estate-driven economy. A real estate bubble. Sound like California, Florida, Spain? How can this be a surprise, except that everyone expected big brother Abu Dhabi to pick up the check? While Abu Dhabi advanced \$5 billion earlier, Dubai is not letting that money out of the country. There are projects to be finished, you understand. From where I sit, this is just rather hard-headed negotiations, a restructuring of who owns what and who will get

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what assets. It will all settle out. Given the massive losses that world banks have already taken, this is rather small potatoes.

Why the market reaction? Many know the potential for a serious correction is real. When anything as relatively small as Dubai spooks the market, it is a warning sign. The world has priced in 5% GDP growth for the US and much of the developed world in the equity and commodity markets. Either we have to get that or the markets are going to have to come back to the reality of what I think is going to be a much lower growth figure.

But in any event, one of the lessons to be learned is that investors should pay attention to where the leverage is. Unsustainable debt trends end in tears. They always do. Spain, Greece, Italy, Japan and the UK will all have to face major restructuring in the next decade due to leverage. We in the US will also find that we cannot grow debt at our current levels. Will we pare our debt willingly or be forced to by the market? Either way, it will make for a less than optimal economy over the coming years.

More Data Fun: Unemployment Claims Not Down

The headlines said that initial claims dropped to 466,000 here in the US, finally falling below 500,000. This was greeted with proclamations of recovery. First, let me say that 466,000 people filing for unemployment is still way too high. Lots of people are losing their jobs and when we first crossed over 450,000 a few years ago that level was seen as a sign of recession.

Second, the headline number was a seasonally adjusted number. The actual number was 543,926. What is happening is that we are coming off of wickedly high numbers in 2008 and a seasonal number that was much lower in the preceding years. It is another part of the Statistical Recovery. And this trend is likely to keep on for the rest of the quarter.

John Vogel, analyzing the unemployment numbers for me each week, shows pretty convincingly that the average for this current quarter will be over 500,000 per week on a non-seasonally adjusted basis. This is less than a 10% drop from last year for the same quarter. Job losses are continuing to mount and we are on our way to an 11%-plus unemployment number by summer.

Why I Am Optimistic About the Future

I am optimistic by nature. An entrepreneur friend of mine gave me a term that I have grown to love. She calls it "psychic income." It's that bit of hoped-for future income that is in our minds, that drives some of us, inflicted with the entrepreneurial gene, to do the next deal, make the next big plan, scheme yet another scheme to finally hit whatever counts as the big one for each of us. How much better would our life be, how our problems would go away, if only this one thing would come about! It has not yet become real income, yet we live and act as if it is almost real. We can feel it getting ready to happen. It is still in our heads, this psychic income. Yet it is in some ways real for us. For some, psychic income is not about money. It may be about the next promotion or the next big discovery. For some of us, it is just having our ideas accepted and validated in the court of human opinion. It is simply what drives us.

I graduated from seminary in the winter of 1974, entering the workforce in the hard year of 1975. We were coming off a re-

cession, about which I technically knew little. I did know jobs were tight. I was unknowingly facing another eight years of high unemployment, a tumultuous stock market, rising commodity prices, high inflation, and rising interest rates. Japan was just beginning to be a real force in the world. People were still buying bomb shelters, as Russia was a feared and powerful enemy. As the price of gold rose, there were those who told us the dollar would soon be worthless (the Fed was a problem and the deficit was out of control), and so we needed to buy yet more gold and also a year's worth of dried food.

Not the best time to start a business; yet within a year or so, I ended up starting my own print brokering business, as jobs were scarce and that is what I knew. I often get letters from readers giving me grief about my rich hedge-fund friends and our fabulous wealth, and how little we relate to the real world. And for some of my rich hedge-fund friends, that may be true (although for most of my friends that is not true). And I am sadly far from rich, although I have dreams.

I remember waking up in the late 70s at 2 AM with a knot in my stomach, because a small bank was in trouble and had called my loan (an amount which now seems so small, but at the time it was all the money in the world). How would I make payroll? Gas and food? I know what it is like to work long hours and live on a very tight budget, with some months being behind on everything, while all the while your family is growing.

It's not just me, it's tens of millions of entrepreneurs and businessmen and women in the US, and hundreds of millions worldwide, that have the same ambitions and drive. Every night we go to sleep on our psychic income, and every day we get up and try to figure out how to turn it into real income. And some of us are talented or lucky (that would be me) enough to make it happen.

Long-time readers know that I think we are in the midst of a secular bear cycle, much like 1966-82. The next decade is likely to produce less than average growth, due to structural problems and the bad choices we have made with personal and government debt. I am perfectly cognizant that unemployment will be over 10% for a protracted time. That is tragic for those unemployed and underemployed. I realize the entire developed world has huge and seemingly insurmountable pension and medical obligations over the next few decades, which we cannot possibly hope to meet. The level of angst that we will live through is huge.

The point is, we live through it. In spite of problems, we get up every day and figure out how to make it. Would it be better if we could get our act together in (pick a country) and not be forced to adjust because we have come to the end of the line? Yes, I know we will have some tumultuous times, making business and investment decisions more than a little difficult. So what? The future is never easy for all but a few of us, at least not for long. But we figure it out. And that is why in 20 years we will be better off than we are today. Each of us, all over the world, by working out our own visions of psychic income, will make the real world a better place.

The Millennium Wave

Let's look at some changes we are likely to see over the next few

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decades. We have a number of waves of change getting ready to erupt on the world stage. The combination of them is what I call the Millennium Wave, the most significant period of change in human history. And one for which most of us are not yet ready.

Some time next year, we will see the three-billionth person get access to the telecosm (phones and internet, etc.). By 2015 it will be five billion people. Within ten years, most of the world will be able to access really cheap high-speed wireless broadband at connection rates that dwarf what we now have. That is going to unleash a wave of creativity and new business that will be staggering. That heretofore hidden genius in Mumbai or Vladivostok or Kisangani will now have the ability to bring his ideas, talent, and energy to change the world in ways we can hardly imagine. When Isaac Watts was inventing the steam engine, there were a handful of engineers who could work with him. Now we throw a staggering number of scientists and engineers at trivial problems all at once, let alone the really big ones.

Because of the internet, the advances of one person soon become known and built upon in a giant dance of collaboration. It is because of this giant dance, this unplanned group effort, that we will all figure out how to make advances in so many ways. (Of course, that is hugely disruptive to businesses that don't adapt.) Ever-faster change is what is happening in medicine. None of us in 2030 will want to go back to 2010, which will then seem as barbaric and antiquated as, say, 1975. Within a few years, it will be hard to keep up with the number of human trials of gene therapy and stem cell research. Sadly for the US, most of the tests will be done outside our borders, but we will still benefit from it.

I spend some spare study time on stem cell research. We are very close to being able to start with skin cells and grow a new liver. Muscular dystrophy? There are reasons to be very encouraged. Alzheimer's disease requires somewhere between 5-7% of total US health-care costs. Defeat that and a large part of our health-care budget is fixed. And it will be first stopped and then cured. Same thing with cancers and all sorts of inflammatory diseases. There is reason to think a company may have found a generic cure for the common flu virus. A whole new industry is soon to be born. And with it new jobs and investment opportunities.

Energy problems? In less than 20 years we won't care about running out of oil. We'll be driving electric cars from power sources that are not oil-based. I run into people who are working on new forms of energy. They are literally working in their garages on new ways to produce electric power; and my venture-capital MIT PhD friend says they are for real. If I know of a handful, there are surely thousands of such people. Not to mention well-funded corporations and startups looking to be the next new thing. Will one or more make it? My bet is yes! We will find ourselves with whole new industries as we rebuild our power grids, not to mention what this will mean for the emerging markets.

What about nanotech? Robotics? Artificial intelligence? Virtual reality? There are whole new industries out there. In 1980 there were few who saw the rise of personal computers, and even fewer who envisioned the internet. Mapping the human genome? Which we can now do for an individual for a few thousand dollars? There are hundreds of new businesses that couldn't even

exist just 20 years ago. I am not sure where the new jobs will come from, but they will. Just as they did in 1975.

There is, however, one more reason I am optimistic. Sitting around the dinner table, I looked at my seven kids, five of whom are adopted. I have two Korean twins, two black kids, a blond, a (sometimes) brunette, and a redhead. They range in age from 15 to 32. It is a rather unique family. My oldest black son is married to a white girl and my middle white son is with a black girl. They both have given me grandsons this year (shades of Obama!). One of my Korean daughters is married to a white young man, and the other is dating an Hispanic. And the oldest (Tiffani) is due with my first granddaughter in less than a month. And the interesting thing? None of them think any of that is unusual. They accept it as normal. And when I am with their friends, they also see the world in a far different manner than my generation. (That is not to say the trash talk cannot get rather rough at the Mauldin household at times.)

I find great cause for optimism in that. I am not saying we are in a post-racial world. We are not. Every white man in America should have a black son. It would open your eyes to a world we do not normally see. But it is better, far better, than the world I grew up in. And it is getting still better. My boys play online video games with kids all over the world. The kids around the world get on the internet and see a much wider world than just their local neighborhoods.

Twenty years ago China was seen as a huge military threat. Now we are worried about them not buying our bonds and becoming an economic power. Niall Ferguson writes about "Chimerica" as two countries joined together in an increasingly tight bond. In 20 years, will Iran be our new best friend? I think it might be in less time than that, as an increasingly young and frustrated population demands change, just as they did 30 years ago. Will it be a smooth transition? Highly unlikely. But it could happen.

I look at my kids and their friends. They struggle. They can't get enough hours, salaries, jobs they want. They have kids, mortgages and dreams. That's cause for optimism. It's when dreams die that it's time to turn pessimistic. The world of our kids is going to be a far better world in 20 years.

Will China and the emerging world be relatively better off? Probably, but who cares? Do I really begrudge the fact that someone is making their part of the world better? In absolute terms, none of my kids will want to come back to 2009, and neither will I. Most of the doom and gloom types project a straight-line linear future. They see no progress beyond that in their own small worlds.

Even the most diehard bear among us is thinking of ways to improve his personal lot even if it is to buy more gold or guns. We all think we can figure something out. Some of us will get it right and others will not. But it is the collective individual struggle for our own versions of psychic income, the dance of massive collaboration on a scale the world has never witnessed, that will make our world a better place in 20 years.

*Reprinted with permission from "The Frontline", by John Mauldin
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