

## **1932 AGAIN**

### **WEB BUZZ 2009.06.15**

The size of the U.S. economy as measured by the nominal GDP is approximately 15 trillion dollars. There are, of course, many factors that determine its success or failure. Some of these—such as population, education, innovation, and incentives—are matters which are largely unseen and not reported upon on a daily basis. There are no public markets for these items, which appear and are discussed on television and newspapers ad nauseum.

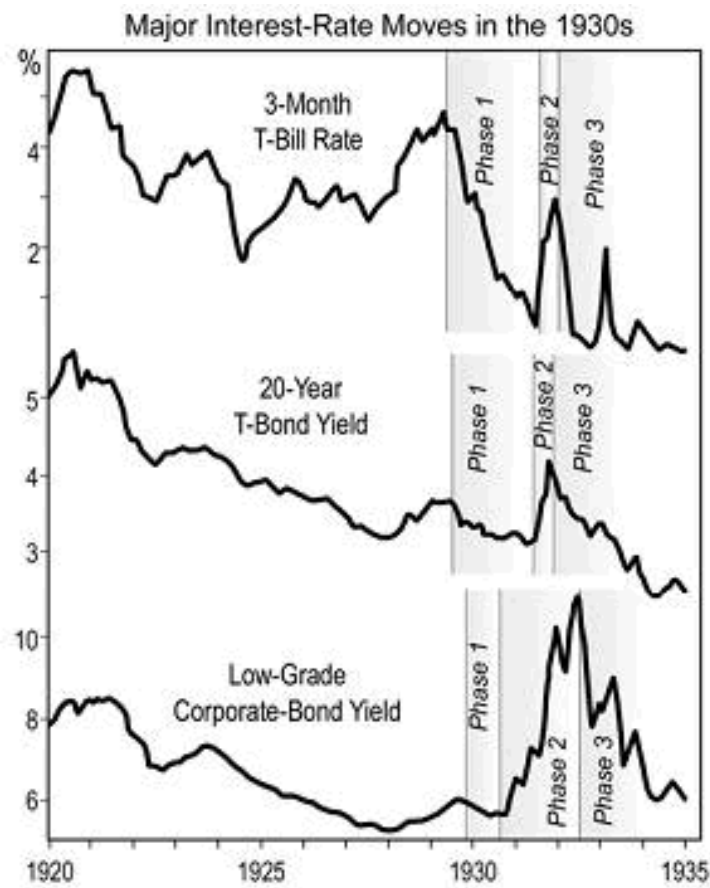
On the other hand, there is a huge marketplace for such financial assets as stocks and bonds, which also have an influence on the real economy—and, as mentioned above, amounts to about \$15 trillion. For example, there is approximately \$500 billion a day that is traded in U.S. government bonds. In 30 trading days, the dollar size of these trades equals the size of the entire nominal GDP. On average, three billion shares of common stock are traded each day. This amounts to approximately \$60 billion, or the equivalent of the nominal GDP every 250 days. For every buyer there is a seller, and, with the exception of new offerings, it's a zero-sum game. With the exception of the level of long-term interest rates as set by the daily bond marketplace, much of this activity has little to do with the size and shape of the real economy. However, on a fundamental basis it is the size and shape of the *real* economy that determines the ultimate long-term value of the financial markets.

In the trade, we call most of this day-to-day financial market activity “noise”. It has absolutely no bearing on what the final value of a bond or stock might be, yet its daily ups and downs draw the immediate attention of investors and causes most—as all studies of individual investor behavior indicate—to make unwise decisions. As a valued client mentioned to us one day, “Volatility is a killer.”

Why this interim market update? The bond market has gone against us over the last three months, just as it has in other periods over the last 18+ years. However, the

fundamentals of the economy have not changed, and they will determine the value of our portfolio in the longer term. Traders such as the Wall Street investment houses have returned to the market in a big way. Washington has propped them up to a point where they can borrow at practically 0%, which allows them to buy or sell short at virtually no cost, then spend the rest of the day on CNBC touting their position. In a single week last May, one major Wall Street firm traded for their own account seven times what they did for their customers.

In 1932, there was an upward spike in long government bond rates, which adversely affected the real economy and led to much lower rates later on (please note the chart below). That, in our opinion, is taking place again right now. Such noise must be cast aside if one is to obtain the good results that one deserves. It's hard to do as it goes against human nature, but it is very much a winning decision to make.



Adapted from SafeHaven.com