

## Do You Speak My Language? Gregory A. Naylor 5/15/2010

In 1929 the stock market crashed, and eventually the nation slipped into the Great Depression of the 1930s. In 2009 the stock market crashed, and so far the recession has not become a Depression. Why?

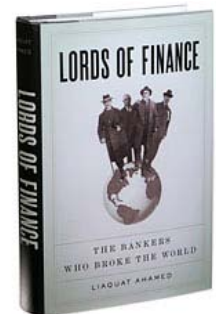
One of the fears in our national psyche is that we are not out of the woods yet. During the Great Depression, the worst of the financial storm did not hit the United States until 1932, three full years after the stock market crash. Is it possible that another Great Depression is still ahead of us?

In case you do not remember the Great Depression, here is a brief summary of America in early 1933:

*“The banking systems in twenty-eight states of the union were completely closed and in the remaining twenty partially closed. In three years, commercial bank credit had shrunk from \$50 billion to \$30 billion and a quarter of the country’s banks had collapsed. House prices had gone down by 30 percent, leaving almost half of all mortgages in default. With the contraction in credit, mines and factories across the country had to shut down. Steel mills operated at less than 12 percent of their full capacity. Automobile plants, which had once churned out twenty thousand cars a day, were now producing less than two thousand. Industrial output had fallen in half, prices had tumbled 30 percent, and national income had contracted from over \$100 billion to \$55 billion. A quarter of the workforce, 13 million in all, were without jobs. In the richest nation in the world, 34 million men, women, and children out of a total population of 120 million had no apparent source of income.”*

-Taken from *Lords of Finance*, a biography of the Great Depression by Liaquat Ahamed.

I will not argue that a similar calamity cannot befall us again. No single person controls the future or has perfect knowledge of it. We certainly have many problems now that are similar to the problems of then. House prices have collapsed, mortgages are in default, industrial production is down, and unemployment is at 10%. On the surface, our numbers are not as bad now as they were then, but things are bad nonetheless. In spite of this, I am optimistic about our future. The problems now are similar to the problems then, but the responses taken by our leaders are vastly different.



Back then, the banking system was closed and collapsed. Today, we took massive sums of money and bailed out the banking system.

Also, outgoing President Hoover and incoming President Roosevelt fought with each other and allowed the situation to get worse. Today, the outgoing president and incoming president presented a coordinated response to the crisis. Indeed, President Bush presented the first \$700 billion emergency measure before leaving office, and President Obama presented the second \$700 billion measure after taking office.

Without these responses, it is possible that we would have been plunged into another Great Depression. Of course, this does not mean that the bailout and the growing federal debt were perfect, and it does not mean that they will not also have negative consequences in the future. This is one reason that the bailout of the banks is very unpopular. To most of us, it does not make sense that wealthy bankers and Wall Street types should get massive government bailouts while you and I have to deal with the mess.

So why would anyone argue that the bailout was helpful and necessary? The answer lies in the nature of money itself. To explain the nature of money, let us look at life without it.

Humans have used barter relationships for thousands of years, and still often use barter as a way to exchange goods and services. Money is certainly not the only way for an economy to function. However, bartering can be very inefficient. If a llama farmer wants to buy a bicycle, but the bicycle dealer does not want any low-fat, delicious llama meat, then the system does not work. The llama farmer might have to spend time and energy finding something else that the bicycle dealer wants. The system gets less and less efficient as you expand geography and complexity. And inefficiency becomes much more than just a nuisance when we are talking about access to healthcare, or food, or water.

To allow goods and services to move more smoothly in an economy, we needed a standard language to communicate value, just like we use a standard language of English to communicate ideas. So we developed a 'point system' that we call 'money' to be our universal language. When you go to work, whether you are farming or manufacturing or administrating for a living, you get paid with standardized points because your work was useful. Then you can use your points to purchase goods and services from others. The dirty little secret of the U.S. dollar, the American point system, is that the points themselves are not worth anything. Never have been, never will be. The points only exist to facilitate the movement of goods and services that do have value: food, bedding, toiletries, cars, ambulances, medicine, healthcare, and video games.

The need for a universal point system is almost part of human nature. In fact, as soon as the point system collapsed in 1933, humans started to revive it. Here is a description of recovery in 1933, again taken from *Lords of Finance*:

*"To the surprise of many, Americans adapted to life without banks remarkably well – the initial reaction was not chaos but cooperation. Storekeepers liberally extended credit, while doctors, lawyers, and pharmacists continued to provide services in return for personal IOUs. Harvard University allowed its students to obtain meals on credit. Across the country in El Paso, Texas, the First Baptist Church announced that personal promissory notes would be welcome in the Sunday collection plate instead of silver. Even taxi dancers at Manhattan's Roseland dance hall on Broadway agreed to take IOUs for the 11 cents that they charged per dance – provided their customers could produce bankbooks showing evidence of funds. That prominent undergraduate newspaper, the Daily Princetonian rose to the occasion by assuming the role of central bank of Princeton and issuing \$500 of its own currency, in denominations of 25 cents, which local merchants agreed to accept – a reflection of how adaptable and elastic the notion of money can be."*

Clearly, in the absence of a universal point system, people immediately started to rebuild with other, new point systems. We need a point system almost as much as we need language. The points themselves are not intrinsically valuable, but the goods and services of daily life are very important.

Incidentally, the point system I am describing has a formal economics definition: *fiat currency*. As investors, we believe that we must always look beyond the point system to invest in the real economy, the goods and services that do have tangible value. Of course, we must also be educated in the point system, in the language of economics, because it is a real part of our world. Hence the inspiration for our company name, Fiat Wealth Management. Fiat currency is often described as 'faith-based currency,' because it does require some faith in our community and world to participate in this point system.

In 1932, not only did the real economy run into problems, but the point system itself collapsed. Through fiscal inaction by the government, and inaction by the central bank, the point system just went away. Banks were closed, and everyone had to start over. The lesson learned by economists was that abandoning our common language would not



Crowd gathering on Wall Street after the 1929 crash.

help us deal with our problems, it would only make them worse. The Great Depression taught us that our point system is important enough to our world that without it, people can go hungry, ailments can go untreated, and people can even die.

So today's leaders, politicians and economists, chose to protect the point system. They chose to protect our fiat currency, our banking system, our common language. Of course, there are, and will be, political and economic consequences of these actions, but that is for another newsletter.

*FIAT Wealth Management is located in Long Lake, Minnesota. It is a boutique financial planning company owned by Brad Gotto, Matt Stahl and Greg Naylor. We especially enjoy working with people who live within their means so that they can give back to their families and communities. We specialize in retirement income planning and asset management, and are currently taking on new clients.*

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