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# An era of illusions

By Joe Nocera

Back in his mid-1980s heyday, Peter Lynch used to hate Mondays.Monday, you see, was the day the stock market was most likely to go down; according to research Lynch had compiled, between 1955 and 1985, it dropped by a cumulative 1,500 points just on that one day.

Lynch, who for 12 years ran the Magellan Fund at Fidelity Investments with spectacular results, had a simple theory as to why this was the case: negative thinking.

"On the weekend," he once told me, "everyone becomes an amateur economist." Investors, he believed, would read the weekend newspapers, filled with their articles of doom and gloom, and become filled with doom and gloom themselves. Naturally, after stewing over the weekend, their first instinct when the market finally opened Monday was to sell.

Sigh. This is a weekend newspaper, and I'm about to write a pretty gloomy column. Sorry. On the other hand, I don't see how you can avoid a certain amount of gloom given the week we've just had - and its implications for the future. Yes, things calmed down Thursday and Friday, but the early part of the week was just awful. On Monday, U.S. markets were closed for the Martin Luther King Jr. holiday, but all over the world, stock markets were in free fall. On Tuesday, the Dow Jones industrial average dropped 464 points at the opening and closed with a loss of 128 points. On Wednesday we had the so-called whipsaw rally - from a 300-point morning deficit, the market swung to a nearly 300-point gain. Even with the gain, a 600-point swing does not exactly inspire confidence. It inspires fear.

Meanwhile, the Federal Reserve announced an emergency rate cut of three-quarters of a point, a move that smelled an awful lot like panic. Economists were debating whether the U.S. economy was nearing a recession or already in one. Société Générale revealed that a rogue trader had cost it €4.9 billion, or $7 billion. The New York State Insurance superintendent sought a bailout plan for the major bond insurers, fearing disaster if they failed. Housing prices continued to drop. All the things that the bears have been predicting were suddenly coming to pass.

"This is nothing like I've ever seen," said Peter Bernstein, author of several best-selling books on business and financial markets - and a man who has pretty much seen it all.

Normally, he said, bear markets are triggered when stock values get out of hand, as was the case when the technology-stock bubble burst in 2000. But not this time. The market is in trouble because the larger economy is in trouble. "The collapse of credit is what is driving this recession," he said.

Daniel Alpert, the managing director of Westwood Capital, wrote: "In past debt debacles, and other market crises, the affected assets have been things like commercial real estate, farmland, tech stocks and bank shares. This time around, along with the stock market, it is people's homes, the repricing of which literally hits us where we live."
Stephen Roach, Morgan Stanley's former chief economist - he is now in charge of Asia for the firm - told me that private consumption in recent years amounted to 72 percent of gross domestic product, far higher than the 66 percent it had been just a few years before.

David Rosenberg, the North American economist for Merrill Lynch, and the author of a devastating report on the state of the economy, said that "when you look at private sector debt that was over and above what can be explained by GDP, you are talking about $6.5 trillion beyond the economy's capacity to handle that debt." That debt will have to be either written off or paid back. People will have to stop spending, he said; they'll have no other choice. Since their homes are decreasing in value, they can no longer borrow against them.

And as they spend less, corporate earnings will fall, and that will inevitably cause the stock market to continue falling. "The problems are deep, widespread and intense," he said. He said he didn't expect a rebound anytime soon.
Is that gloom and doom enough for you? More to the point, are you - are all of us - ready to face a world in which your two biggest assets, your savings and your home, don't automatically go up?