



# Capital Drain

Rick's investment opinion newsletter

Occupy Wall Street special, 2011

v.7 no.5



Before printing, think about the environment

Hi Readers,

Starting in September, we've been reading about the Occupy Wall Street (OWS) demonstrations. The movement spread quickly to other cities, and to other countries. Today is the three-month anniversary of the start.

Depending on your choices of news sources, you may have heard almost nothing about them, or a lot (but prejudicially wrong), or a lot but confusing.

What was it about? Does it matter? Is it rational, or nonsense?

I certainly don't have a comprehensive answer. We can leave that for the historians. The issues OWS raised are not solely or even primarily political, but socioeconomic. Their input may change the investing climate in the US. I would like to offer you a quick ad hoc discussion of the Occupy movements as I understand them.

## Executive Summary:

- What are they?
  - Mostly middle-class progressives.
  - To their great surprise, a part of Time Magazine's Person of the Year.
- What are they *not* ?
  - Commies, hippies, moochers, violent, stupid, anti-capitalists, stooges, punks, anti-business, confused, mislead, whiners, elitists, going away.
- What do they want?
  - An economic system more balanced toward the middle class and supporting the working poor.
- Is that possible?
  - Most assuredly. You betcha. We used to have ALL that, in my lifetime and for most of you readers, in yours.

## The Details:

Part of what made OWS noteworthy was the lack of designated leaders. It started with minimal organization, and became less centralized as it grew. One of the favorite comments of its detractors was “We don't know what they stand for or what they want.”

"It is difficult to get a man to understand something, when his salary depends upon his not understanding it."

– Upton Sinclair

Not everyone is puzzled.

"All over the world, the protesters of 2011 share a belief that their countries' political systems and economies have grown dysfunctional and corrupt-- sham democracies rigged to favor the rich and powerful and prevent significant change. They are fervent small-d democrats. Two decades after the final failure and abandonment of communism, they believe they're experiencing the failure of hell-bent megascaled crony hypercapitalism and pine for some third way, a new social contract."<sup>1</sup>

—Kurt Andersen, TIME Magazine

"...Wall Street wrecked the economy three years ago and nobody's held responsible for that. Not a single person's been indicted or convicted for destroying twenty percent of our national net worth accumulated over two centuries. They're upset about the fact that Wall Street has iron control over the economic policies of this country, and that one party is a wholly owned subsidiary of Wall Street, and the other party caters to them as well.

[They] think that we should not have 24 million people in this country who can't find a full time job, that we should not have 50 million people in this country who can't see a doctor when they're sick, that we shouldn't have 47 million people in this country who need government help to feed themselves, and we shouldn't have 15 million families who owe more on their mortgage than the value of their home."<sup>2</sup>

-- former Florida Representative Alan Grayson



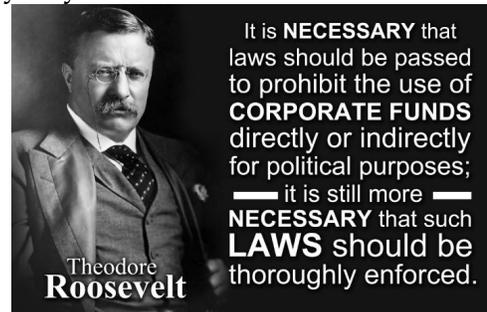
- 1 Kurt Andersen, “The Protester,” TIME Magazine, 14 Dec 2011, Time Inc., 14 Dec 2011 <[http://www.time.com/time/specials/packages/article/0,28804,2101745\\_2102132\\_2102373,00.html](http://www.time.com/time/specials/packages/article/0,28804,2101745_2102132_2102373,00.html)>.
- 2 “Real Time with Bill Maher”, Home Box Office, 7 Oct 2011, Time Warner, 11 Dec 2011 <<http://www.youtube.com/watch?v=mQnSu0DG3Oo>>.

What should we make of all that? Obviously, the recession puts everyone on edge. This is not a “fat, dumb, and happy” time for working people in the US, Europe, or anywhere.

As Congressman Grayson described, the government's response to the housing bubble and crash was a big factor. We can see that de-regulation of the financial industry has not produced a better outcome than the regulated era before it. Further, we saw that Congress is unable to bring itself to re-regulate in any meaningful way. The people are wondering, “Whose Congress is it, anyway?”

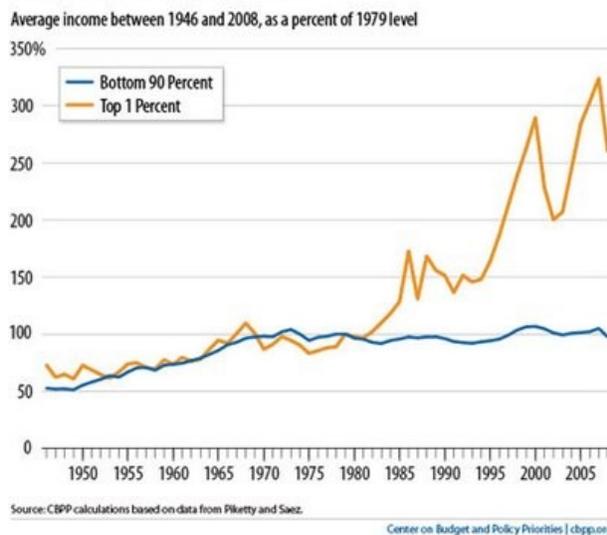
The Supreme Court may have supplied the answer, unwittingly. The ruling in Citizens United v. Federal Election Commission overturned a century of prior rulings to give corporations the same free speech rights as people. The Court had already, years ago, ruled that money was (effectively equivalent to) speech.

In a contest of money, the human citizens feel overpowered and under-represented.



Next, the Great Recession has made the citizens look at the division of the economic pie. “Trickle-down” has failed. A rising tide has not lifted all boats. The very rich are not creating jobs-- in America, anyway. Decreased taxes have not created prosperity, but have impoverished the nation's capacity for collective action through the government. We may assume that the Supply Siders were sincere. It's time for them to recognize that they were mistaken.

**Uneven Distribution of Gains Contrasts with Earlier Era, When Growth Was Widely Shared**



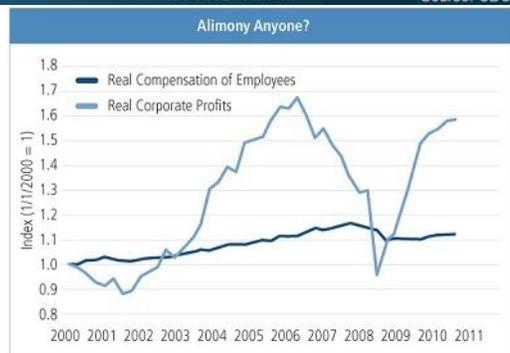
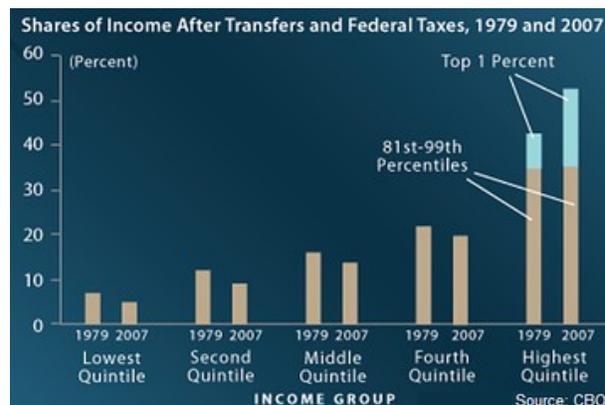
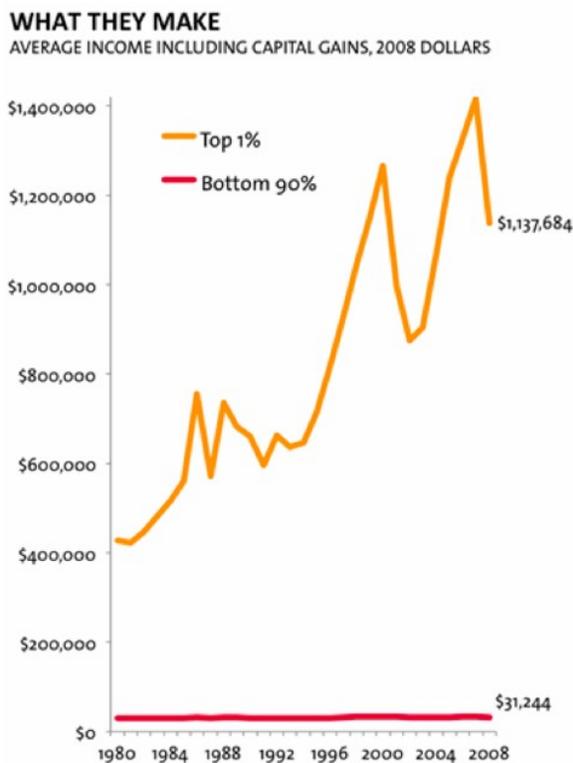
"The great enemy of the truth is very often not the lie-- deliberate, contrived and dishonest-- but the myth, persistent, persuasive and unrealistic. Belief in myths allows the comfort of opinion without the discomfort of thought"

-- John F. Kennedy

“In the aughts, Republicans held more power for longer than at any time since the twenties, yet the result was the weakest and least broadly shared economic expansion since World War II, followed by an economic crash and prolonged slump.”<sup>3</sup>

3 David Frum, “When Did the GOP Lose Touch With Reality?”, New York Magazine, 20 Nov 2011, New York Media LLC, 11 Dec 2011 <<http://nymag.com/news/politics/conservatives-david-frum-2011-11/>>.

Income inequality in the US is not simply a fact of nature. It used to be better, and specific laws have made it worse. Those laws can and should be reversed.



This is not a trivial question of envy or of “Class Warfare.” The more equal division of the economic pie from the end of WWII to the first Reagan tax cuts created far more prosperity overall than the era that has followed.

The reason is simple enough: 2/3 of the economy is consumer spending, and consumers can only spend when they have money. Duh, right? Yet the consumers have been squeezed, and for a while used cash-out refinancing and other debt to keep up their accustomed living standards. Taking on debt for consumption is a bad idea, but all the talking heads and advertisers were recommending it, and people believed.

Meanwhile, the slice of the pie that went to the wealthiest very few-- not even 1% really, but a tenth or a hundredth of 1%-- went into savings and investments. This is where the “job creator” / “supply side” paradigm really fell apart.

The macroeconomic theoretical need for more investment (job creators) is only true when the economy is running full speed, if then. With all the bubbles we've seen, it is very difficult to argue that there's any shortage of investment capital. In particular, lower capital gains taxes encouraged saving/invest over consumption. The goal was never (publicly) to encourage investing over labor, yet that's what happened. Leaving more money in the pockets of workers could have boosted the economy more through the older, proven “demand side” economics.

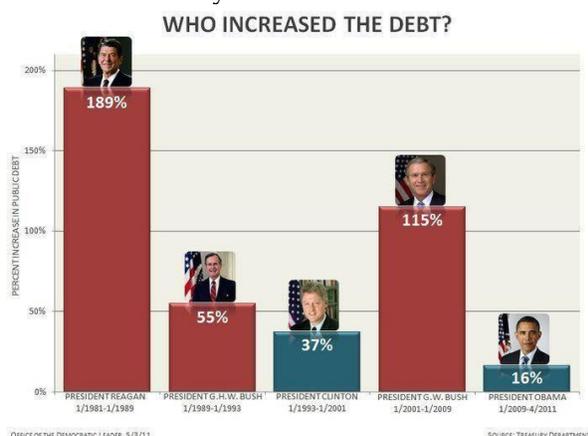
“But growth, while necessary, is insufficient by itself, given today’s high unemployment and the extent to which income and wealth inequalities have increased. Hence the third dynamic: the West is being challenged to deliver not just growth, but “inclusive growth,” which, most critically, involves greater “social justice.”

Indeed, there is a deep sense that capitalism in the West has become unfair. Certain players, led by big banks, extracted huge profits during the boom, and avoided the deep losses that they deserved during the bust. Citizens no longer accept the argument that this unfortunate outcome reflects the banks’ special economic role. And why should they, given that record bailouts have not revived growth and employment?

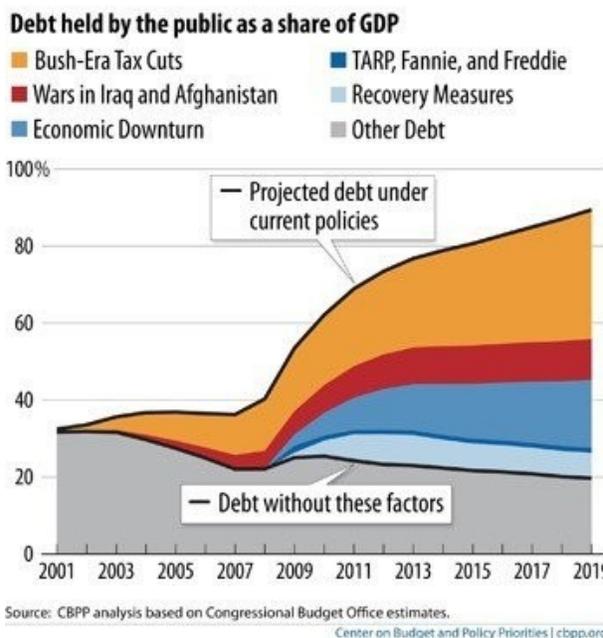
Calls for a fairer system will not go away. If anything, they will spread and grow louder. The West has no choice but to strike a better balance – between capital and labor, between current and future generations, and between the financial sector and the real economy.”<sup>4</sup>

--Mohamed A. El-Erian, CEO and co-CIO of PIMCO

Another disturbing (and motivating to OWS) aspect of the tax and income shift is the way it has left the US government less able to help the mass of the public when they need help. The public was reasonably willing to allow the government to help the banks when the banks were in big trouble, because crashing the banking system would be bad for everyone.



### Tax Cuts, Wars Account For Nearly Half Of Public Debt By 2019

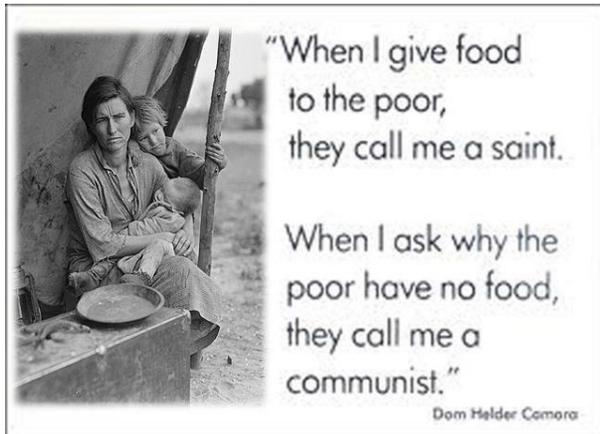


The mirror case has not been true. The banks and the wealthiest investors have been extremely hostile to the idea of helping the public more. They cite government deficits as a barrier to more social spending. The money was there for the banks, but it is being denied to the middle and working class. Why are there deficits? Supply-side cuts.

4 Mohamed A. El-Erian, “The Anatomy of Global Economic Uncertainty,” Project Syndicate, 18 Nov 2011, 18 Dec 2011 <<http://www.project-syndicate.org/commentary/elerian11/English>>

The middle class and the working poor really need help. This has been, as you've heard for years, the deepest and now longest recession since the Great Depression.

Jobs are gone, savings are gone. The public watched a bank rescue, ongoing, and wonder why it's deemed impossible to help the people, the workers, the citizens.



Source: Labor Department

'Yet to return to my initial criticism of cyclically finance-based as opposed to structural policy solutions, almost all remedies proposed by global authorities to date have approached the problem from the standpoint of favoring capital as opposed to labor. If the banks could just be stabilized, if the "markets" could just be elevated back in the direction of peak 401(k) levels, if interest rates could just be lower so that borrowers would inevitably take the bait, then labor - job creation - would inevitably follow. It has not. The explanation for why not must at least include the rationale that Wall Street and Main Street are symbiotically connected and if one benefits at the expense of the other, then both ultimately can falter.

...

Even conservatives must acknowledge that return on capital investment, and the liquid stocks and bonds that mimic it, are ultimately dependent on returns to labor in the form of jobs and real wage gains. If Main Street is unemployed and undercompensated, capital can only travel so far down Prosperity Road.

...

Ultimately, however, both labor and capital suffer as a deleveraging household sector in the throes of a jobless recovery refuses - if only through fear and consumptive exhaustion - to play their historic role in the capitalistic system. This "labor trap" phenomenon - in which consumers stop spending out of fear of unemployment or perhaps negative real wages, shrinking home prices or an overall loss of faith in the American Dream - is what markets or "capital" should now begin to

recognize. Long-term profits cannot ultimately grow unless they are partnered with near equal benefits for labor.

...

[Marx] might also have added, "Investors/policymakers of the world wake up - you're killing the proletariat goose that lays your golden eggs."<sup>5</sup>

– William H. Gross, Managing Director, PIMCO

Still reading? Good for you.

There's one more aspect of the ongoing OWS episode that urgently needs mention-- the excessive police violence & media hostility that have "greeted" their peaceful assemblies.



"We're seeing widespread violations of fundamental First Amendment and Fourth Amendment rights," said Mara Verheyden-Hilliard, co-chair of a National Lawyers Guild committee, which has sent hundreds of volunteers to provide legal representation to Occupations across the nation.

"The demonstrations are treated as if they're presumptively criminal," she said. "Instead of looking at free speech activity as an honored and cherished right that should be supported and facilitated, the reaction of local authorities and police is very frequently to look at it as a crime scene."<sup>6</sup>

If you think the complaints about the police have been exaggerations, read this and watch the videos (Not appropriate for children.):

[Caught on Camera: 10 Shockingly Violent Police Assaults on Occupy Protesters](#)<sup>7</sup>

OWS is not going to go away, despite the colder weather and the pause to regroup. The protesters have found their voice, discovered the heft of their numbers, and seen how widely their message has resonated. Even Redwood City, arguably the

5 William H. Gross, "Six Pac(k)in' ," PIMCO, Oct 2011, Allianz, 18 Dec 2011  
<<http://www.pimco.com/EN/Insights/Pages/SixPackin.aspx>>.

6 Dan Froomkin, "U.N. Envoy: U.S. Isn't Protecting Occupy Protesters' Rights," The Huffington Post, 2 Dec 2011, TheHuffingtonPost.com Inc. <[http://www.huffingtonpost.com/2011/12/02/occupy-wall-street-un-envoy\\_n\\_1125860.html?ref=fb&src=sp&comm\\_ref=false](http://www.huffingtonpost.com/2011/12/02/occupy-wall-street-un-envoy_n_1125860.html?ref=fb&src=sp&comm_ref=false)>.

7 Joshua Holland, "Caught on Camera: 10 Shockingly Violent Police Assaults on Occupy Protesters," AlterNet, 18 Nov 2011, 18 Dec 2011  
<[http://www.alternet.org/story/153134/caught\\_on\\_camera:\\_10\\_shockingly\\_violent\\_police\\_assaults\\_on\\_occupy\\_protesters/?page=entire](http://www.alternet.org/story/153134/caught_on_camera:_10_shockingly_violent_police_assaults_on_occupy_protesters/?page=entire)>.

Mayberry R.F.D. of the Bay Area, has had its own Occupy protests, emceed by The Raging Grannies. Don't mess with The Raging Grannies.



We'll be back to our customary fare of investment opinion in the next letter.

If you have any questions, please write or phone. If you want to read more, the company [web site](#) has archived editions of this letter, lots of charts, and links to other interesting sites. There's also a [web log](#) where I discuss the process and progress of starting the mutual fund, along with occasional economic or investing thoughts..

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Take care,

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"Our doubts are traitors,  
And make us lose the good that we oft might win,  
By fearing to attempt."  
--W. Shakespeare



A collection of fine industrial Boilerplate, but true:

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