

ARISTA

INVESTMENT ADVISORS, LTD

Registered Investment Advisor

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You think...?

David Brooks had an op-ed piece in the NYT on 2-13-09 entitled “The Worst-Case Scenario,” in which he imagined the unfolding of the economy over the next two years. Perhaps you read it. His primary thesis is that the current plans and packages coming from President Obama and Congress are not addressing the central issue, which, he claims, is that we are not in an economic crisis, but a psychological crisis.

You think...?

Each day I have an impulse to comment on some big economic or financial development. I’ve started to write many times, only to be overtaken by issue after issue. I’ve also been cautious not to overwhelm all of you with constant commentary. Too much is already swirling around us, much of it is either misleading, untrue or simply without context. In this “Darwinian” market environment, investors are on strike and the field has been left to the speculators and traders. In the ecology of the markets there is a place for speculators and traders. In a more normal environment these market species play a useful role in mediating risk. In a market where fear has been used as a blunt tool by so many in power, the environment for new capital has been abandoned and only the speculators remain. This is true at market peaks as well as troughs. At peaks, “average” investors don’t see themselves as speculators, but they are. In troughs, however, it’s the professionals that rule.

Rather than addressing the daily flood of what passes as news, I would like to approach the situation from an unusual direction.

When so much is in doubt and leaders, old and new, seem to so confidently lack a clear plan, what is one to do? I go back to a process of thought, exemplified by thinkers and philosophers for ages: seek some, at least apparently, irreducible point and build from there.

A good example of this process, that may be familiar to many of us, comes from the Meditations on First Philosophy, by Renee Descartes, the 17th century French philosopher and mathematician.

It was Descartes who authored the still famous observation, “*Cogito, ergo sum*,” often translated as “I think, therefore I am.” Descartes was attempting to find that “reality” or fundamental principle, from which he could reconstruct his knowledge and understanding of the world. He set out to eliminate any idea that could be doubted. Ultimately he arrived at what was, for him, the bedrock of all knowledge: that there is the immediate consciousness of thinking and, therefore, existence.

Let’s leave the deeper examination of Descartes for another time. For now, let’s seek to identify that irreducible principle on which we can build an understanding of the economic and financial world. Perhaps this irreducible principle might give us a foundation on which to build our confidence in *a*, if not, *the*, likely future.

255 Washington Avenue Extension, Albany, NY 12205

Telephone (518) 464-0319 Facsimile (518) 464-5004 Hawaii Telephone (808) 531-5665

E-mail: aristaadv1@aol.com www.aristaadv.com

Here is my irreducible principle:

Human beings inexorably seek to improve their material circumstances and respond to opportunity and incentive.

That we go to excess, have a questionable sense of entitlement and ownership, experience loss, even temporary loss, more intensely than gain, are more inclined to be fearful and have very short term memories, have been demonstrated repeatedly, even during the course of a single lifetime.

But the one given that I cannot escape, that seems to override even the current horrendous financial and economic experience, is that billions, yes, billions of people all over the world want and will continue to strive for a better material life. This force, this massive demographic reality and the transformational outcome, is, for better or worse, in my opinion, irresistible and undeniable, in short, inevitable.

In light of the pervasive doom and gloom, a force, at the core of our human aspiration and striving, is irreversibly moving ahead. This human force will create enterprise, business, growth, profit (the quotient of creativity, industrious labor and risk taking) and prosperity. The more significant question is not whether we and future generations will have improved material prosperity, but toward what human purpose it will be applied? The failure of our current model is that it has no purpose, other than to create more of itself. If we cannot or will not identify a purpose beyond our own needs and wants, we will, at some point, permanently lose our way and doom this civilization to dis-integration.

Human beings and the culture we create, are teleological. We are purposeful and seek meaning. To pursue more and more, without any larger purpose, except to perpetuate ourselves, is not, in my opinion, a sustainable impulse. Without the recognition of a higher purpose we are reduced to our biology. Do you really believe this is all we are? I don't.

Work, labor, creativity, saving and investing are expressions of a deep inner sense that we have the potential for an elevated life and future, individually, for our children and collectively as a species.

If this seems too abstract, then mark this observation and make a note on a calendar one year and two years and three years from now to ask yourself, when those dates arrive and you are reminded of this exercise, what the then current state of the world is. I expect that you will not only be surprised by what has been rebuilt and revalued, but you will be very surprised at how little you remember about what will then be a distant experience with little immediacy. You will remember about it, especially when prompted, but it will be difficult to conjure up the emotional immediacy of the period. For better or worse, we have a powerful tendency to revert to our previous acquisitive behavior and expectations.

Of course this isn't exact, but it does describe what you and I have already experienced time after time. We simply are too intent on the present and the future to consciously carry the past along. This memory loss results in our dealing with each event as if it were the first of its kind and, therefore, unique. Mass media, polarized politics and concentrations of opaque institutional and private wealth, all undermine respectful discourse about our lives, futures and shared purposes. Mass anxiety opens us to manipulation and a loss of confidence in our own ability to direct our lives toward what we understand as our highest good. What we are now experiencing is not unique. It recurs, although the magnitude of the cycles varies. The amplitude of this cycle is larger than most and the rate of change has been severely compressed. While it's unlikely that the market recovery will be as rapid as the decline, we can expect some very intense periods of higher market values.

Ironically, the fear induced by the betrayal by the financial services industry and sadly, polarized politics, has resulted in a very significant rise in the personal savings rate. The hitherto low savings rate was regularly criticized and highlighted as a major weakness in our economy and in the American character. The fear that has been created has reversed this trend very quickly and in a major way. What else would anyone expect? If you (Wall St. and Washington) are supposed to know and you say the sky is falling, then you will be believed and changed behavior will follow. The unintended consequence of this reversal is that individual spending has declined or been frozen and businesses, in anticipation of and response to this slowdown in demand, cut back on spending, employment and investment. The layoffs and fear of layoffs induces more fear and the cycle repeats. If we allow this to continue, we will be driven to helplessness.

Plato, in his work, The Republic, describes what he (through Socrates) describes as the natural cycle of governing principles, both within each of us and “writ large” in the community, the *polis*, the city-state or community. In brief, he says that as part of the larger cycle of governing principles, the natural tendency of democracy is to decline into anarchy, with each out only for themselves. Anarchy becomes intolerable and cultivates the conditions for tyranny. In other words, the rise of the tyrant is precipitated by a lack of self-knowledge and self-discipline, which ignore the common good or common wealth, in short the harmony and well being of the community.

This brings me to...

The Political Imperative or The NyQuil Effect

One great human quest has been to find the cure for the common cold. Of course there are many viruses that cause colds and no single solution has been identified. What have been developed are remedies for the symptoms of colds, not a cure for the virus itself. We are able to moderate the experience, even as the cold virus, virtually unaffected, runs its course through our system. Given a reasonably healthy immune system, we deal with the discomfort and over a period of a week or so, we recover.

The massive leveraging of our individual lives, amplified by the even greater leverage by the institutional crowd, coupled with the complicity of our political leaders, of both parties, is a like a virus experienced within our national character and economy. This is a particularly intense virus and is testing the entire financial system. We have believed that the Wall St. and Washington “doctors” have a cure. They don’t. They have a remedy to deal with the symptoms. The cure must go much deeper, into our national psyche and our understanding of the purpose of our economic lives. The Washington “cure” is to overwhelm the patient with manufactured money until the virus leaves in its own good time.

The “cure” will make us feel a bit better along the way, but it won’t come close to directly affecting this particularly nasty virus. However, feeling better is important, particularly if you want to acquire and retain power. Interestingly, the life span of the virus fits nicely into the time frame before the next congressional election cycle. If the remedy is not at least palatable, we may choose a new medical team. If we feel better, then we will likely retain our team. So, the political imperative will trump the deeper economic and financial remedies, which require deeper psychological changes. This “hair of the dog” remedy gives us temporary relief, but keeps us vulnerable, in remission and still addicted to the behaviors that put us at risk in the first place. The virus loves it, since it does its stealth damage while we think we are healthy...at least until the next “unique” crisis.

Will it work? I have mixed feelings. On the surface, I think it will work. The key is restoring confidence, not directly solving financial problems. At the moment the effort is not creating confidence, but the sheer scale of it all, coupled with the inevitable desire for a more “normal” time, will eventually shift the balance toward growth.

I believe we all want good health and harmony. I believe our national immune system is adequate to protect us. The remedy will appear to work, since the toxic condition will work its way through the system anyway. The political imperative will ride in the wake of the irreducible principle I discussed above: Human beings inexorably seek to improve their material circumstances and respond to opportunity and incentive.

It would have been much better, in my opinion, to be given a placebo and let the psychological dynamic work its magic. Confidence in ourselves and in the future, while living conscious, principled, purposeful lives, is far more desirable than simply treating the symptoms of self induced excess.

As I wrote to President Obama (and implicitly to his predecessors and successors) two weeks ago, “Fear and blame are never lasting or authentic motivators.”

This too will pass. The billions of people who still want to live as we do, even in our current condition, will insure that we continue to produce economic prosperity. I only hope that we will be better able to use this productive capacity, and the gifts it provides, as instruments toward a higher purpose and not as an end in itself.

As ever, here's to y(our) Good Wealth!

Jerry!

Posted 3/3/09 also at www.Aristaadv.com