

The Political Forum

*A review of social and political trends and events
impacting the world's financial markets*

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THEY SAID IT

*No! I am not Prince Hamlet, nor was meant to be;
Am an attendant lord, one that will do
To swell a progress, start a scene or two,
Advise the prince; no doubt, an easy tool,
Deferential, glad to be of use,
Politic, cautious, and meticulous;
Full of high sentence, but a bit obtuse;
At times, indeed, almost ridiculous—
Almost, at times, the Fool.*

The Love Song of J. Alfred Prufrock, T.S. Eliot

GEORGE W. PRUFROCK: LET US GO THEN, YOU AND I. Some years ago I used to go to Atlantic City and play poker for hours on end. The stakes were high enough to make it interesting, which meant that the regulars at the table were pretty good, not professionals like you run into in Las Vegas, but retired guys who play every day like some people play golf.

I thought about those pokers games the other day as I watched President Bush discuss the horrible terrorist attack that took place at Hebrew University. He looked like a bad poker player looks when he has a mediocre hand and doesn't know what to do with it. He looked like a loser, a "mark," one of those guys that the regulars at poker tables in Atlantic City and Las Vegas welcome with open arms; the nervous guy who wants to go up against the pros with the skills he learned playing penny ante around the kitchen table.

Bush tried hard to appear both resolute and "furious," but his expressions went from sincere, to worried, to "aw shucks," to tough, to nervous, and back to sincere again. He reminded me of one of those big Black Forest clocks where little wooden figures with funny faces keep popping in and out of windows with jingly music in the background.

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In truth, Bush should be the strong guy in the game. He's young, healthy, alert, and has a lot of money. Add a bit of patience and a smidgeon of guts and he'd have a reasonable chance against the old fat guys with the bad hearts, sore backs, and small retirement nest eggs that have to last them until they die and the kids get the condo.

But Bush looked like the guy at the table with lots of money who is afraid to lose any of it. He looked like the kind who would lose with a full house to the grungy fellow with a low pair; the guy with the big turquoise ring, the dirty cowboy shirt, the doughy face, and a look that tells you he could lose all his cash, and the ring too, and walk out without changing his expression.

But what is Bush to do? He's against terrorism. He really is against terrorism. Really. I mean, he isn't just against it a little bit. He really and truly is against it a lot. In fact, he's "furious" about it. He said he was. And he's against terrorists too. He really is against them. Really!

But. Well. You know. Some of his best friends are terrorists. Or at least they are friends with and financial supporters of terrorists. Why the Bush family has been "close" to the Saudi "Royal Family" for years. And then there's that other King, the little guy, you know the other one they call "His Royal Majesty." His dad was a King too, you know. How about that? I mean he's called "His Royal Majesty," for goodness sake. What are you gonna do? These guys are Kings and stuff. Like in the storybooks. And did you know that if they hang in there and die as "martyrs" they get a shot at 70 virgins some day. All with sacks over their heads. What can Bush offer against a deal like that?

As I said in an article entitled "Choosing Sides" in the first issue of this newsletter dated April 2, 2002, I think Bush needs to do what he asked every other nation in the world to do after September 11, namely, choose sides. A lot of nations did it. Pakistan did it. Russia did it. Even America's "friends" in Europe kind of did it. And it wasn't easy for some of them. But they did it. Now it's Bush's turn. He needs to stop pretending that there are some good murderers somewhere who want "peace," if only he could find them.

Hamas chose sides. That crowd of cutthroats did it a long time ago. They don't have particularly good cards. But they're good poker players. They've sized up Bush and they think he'll fold as the stakes get higher. "You want to stay in this game, 'W'?" I'll see your last tough speech and raise you five dead Americans. The stakes may be too high for you, kid. Why don't you go back to the penny ante games around the kitchen table at the ranch? Things could get pretty tough later this evening when we go to table stakes."

"What if the Saudis get 'furious?' And what about the little King, 'His Majesty' Whatisname? What if he gets 'furious' too? What if the guy with the turquoise ring has a pair to backup the three nine's he showing? Then what good is a high straight? What if the guy has two clubs down to go with the three on top? What good are three queens then? What if? Do I dare disturb the universe? In a minute there is time for decisions and revisions which a minute will reverse. ... So how should I presume? ... Do I dare eat a peach?"

The only thing that Bush said in his remarks following the Hebrew University massacre that I applauded was when he looked straight into the camera and said: “I take the loss of American lives seriously and I will act to revenge the deaths of these five innocent people by expeditiously searching out and destroying the murderous swine who did this act, beginning with the two heads of snake that is Hamas, Sheikh Ahmed Yassin and Mousa Abu Marzook.”

What? Excuse me? Oh. You mean he didn’t say that? Well, if he had it would have been the only thing he said that I applauded.

As I said in that aforementioned article, the escalation in the war between Israel and militant Islam that has occurred since September 11 should not have come as a surprise to anyone. A child could have figured out that if America declared war against militant Islam, militant Islam would do all it could to bring Israel into the conflict in an effort to bring its fellow “moderate” Arabs into the fray. What’s to know?

There are not two wars going on here. There is one war against one enemy, being fought on numerous fronts, some of which are more advantageous to America than others. The front in Afghanistan carries little geopolitical risk. It is a backwater, nothing nation. The front in and around Israel carries a great deal of geopolitical risk. Probably more than any one can imagine. But it’s the same war, against the same enemy, and it is unlikely, whether Bush likes it or not, that this enemy is going to agree to fight the entire battle in the mountains of Afghanistan where America has the advantage.

If Bush has trouble remembering that this is one war against one enemy, he should review the clips of Arafat’s Palestinians joyously celebrating in the streets on September 11 after several thousand Americans died at the hands of men these people think of as heroes.

So far as I can tell, Bush has only two choices. He can vigorously engage the enemy on all fronts, including those where the geopolitical risks are high, thus raising the stakes enough to make everyone at the table as nervous as he is. Or he can fold his cards and leave a loser.

I hope he stays at the table, and gets tougher as the game wears on into the night. I’ve seen that happen to “marks” during some long nights in the poker rooms in Atlantic City and Las Vegas.

THIS NEW BROOM WON’T SWEEP CLEAN. I have been warning about the threat to capitalism from corruption for some six years now. So it pleases me to see a gaggle of corporate crooks get carted off in handcuffs. If the charges against these men hold up, then they are greedy, sleazy people, who have betrayed their families, friends, employees and country. And there is no question that their public humiliation, and the eventual incarceration of some, will have a positive effect on other executives who might be tempted by riches to go astray.

I must say though that I have several reservations about the long-term efficacy of this high profile campaign against executive scofflaws. For starters, while this initiative does indeed address the problem of commonplace, blatantly illegal, corporate malfeasance, it is silent as to the related, more insidious problem of collusion, both legal and illegal, between the criminals in corporations and the criminals in Washington. Thus, it is my fear that this initiative will give

Americans the false impression that Washington has done something about the money-driven corruption that permeates the American political system today, which, I believe, threatens the very foundations of American democracy.

Congress has no problem with carting corporate crooks off to jail. In fact, if the politicians are to be believed, the entire exercise was driven by “outrage.” But where, one wonders, is the “outrage” over their own role in helping to make the theft possible, or in skimming off a share of the proceeds of these ill-gotten gains.

It is true that this corporate governance legislation was not intended to address the cronyism between large corporations and politicians that is so commonplace in Washington today. That, theoretically, was handled in the “campaign finance reform legislation,” which was passed several months ago, although that initiative was largely a joke and everyone involved knew it except, apparently, John McCain, the poor muddle head who acted as its champion.

But one would think that this corporate reform legislation would at least acknowledge some of the most obvious connections between the riches gained by the corporate fat cats and the payoffs made by these guys to their political friends in Washington. Or to put it another way, a modest effort to demonstrate some “outrage” at the most blatant of the crooks among their own ranks would have made their “outrage” a little more convincing. It would have been better yet, if they had had a few of their own carted off in handcuffs before the television cameras. And while they were at it, they might have taken a peek at the rampant corruption that continues non-stop in the murky relationships between organized labor and their political supporters in Washington.

A place to start, in my opinion, would have been Bill’s pal Terry McAuliffe, the guy whom Bill made Chairman of the Democratic National Committee just before he and Mrs. Clinton absquatulated from the White House with the silver.

McAuliffe has been involved in one ethically shabby deal after another since appearing on the political scene. And he doesn’t play favorites. Sometimes he sleazes with labor bosses and sometimes he sleazes with corporate big shots. But it doesn’t appear that he ever misses a chance to sleaze a little. The following paragraphs from a July 16 article by Byron York in *National Review Online* provides some of the flavor of his enterprises. (The complete story can be found at: <http://www.nationalreview.com/york/york071602.asp>.)

In the late 1990s, some of McAuliffe's business ventures came under investigation by the U.S. Department of Labor, which filed suit against two labor-union officials, both of them with the International Brotherhood of Electrical Workers pension fund, for entering into questionable business arrangements with McAuliffe. Both officials later agreed to pay hundreds of thousands of dollars in penalties for their actions, and the union itself had to reimburse its pension fund by nearly \$5 million.

In one deal, McAuliffe and the fund officials created a partnership to buy a large block of commercial real estate in Florida. McAuliffe put up \$100 for the purchase, while the pension fund put up \$39 million. Yet McAuliffe got a 50-percent interest in the deal; he eventually walked away with \$2.45 million from his original \$100 investment. In

another instance, the pension fund loaned McAuliffe more than \$6 million for a real-estate development, only to find that McAuliffe was unable to make payments for nearly five years. In the end, the pension fund lost some of its money, McAuliffe moved on to his next deal, and fund officials found themselves facing the Labor Department's questions.

But the kicker was McAuliffe's "work" for Global Crossings, whose CEO Gary Winnick recently won top honors on the *Financial Times*' "Barrons of Bankruptcy" list, having amassed some \$512 million while his company went down the drain. The following comes from a www.newsmax.com article dated February 1, 2002, and entitled "McAuliffe: Bankrupt Donor Hired Me For 'Political Action'."

Though he insists now that his relationship with bankrupt telecommunications giant Global Crossing was strictly business, Democratic National Committee Chairman Terry McAuliffe admitted in 1999 that he once worked for Global CEO Gary Winnick, who, McAuliffe said, hired him to "help him work on deals" because Winnick "was looking for a little political action."

After President Clinton's reelection to a second term, the top Clinton fundraiser began "operating out of an office in downtown Washington that belonged to Mr. Winnick's Pacific Capital Group, a billion-dollar operation based in Beverly Hills," the *New York Times* reported in Dec. 1999. Winnick had retained Mr. McAuliffe as a "consultant," the paper said.

The DNC chief told the *Times*, "Gary (Winnick) likes the action. He wanted a stable of people around him with great contacts" to "help him work on deals." Though McAuliffe insisted that his work for Global Crossing had nothing to do with politics, in the next breath he told the paper he was hired because, "Winnick was looking for a little political action."

The bankrupt ex-billionaire seems to have gotten what he wanted. Not only did Winnick's company win a \$400 million Pentagon contract with the help of the Clinton White House, but he managed to get a public endorsement from the president himself.

"Gary Winnick has been a friend of mine for some time now and I'm quite thrilled by the success that Global Crossing has had," then-President Clinton told a California fundraiser in Nov. 1999.

On Thursday the *Washington Times* reported that Global Crossing and its CEO "have been major political donors - bigger than Enron - with a majority of those funds going to Democrats."

In 1999, after McAuliffe arranged a golfing meeting between Winnick and Clinton, the businessman donated \$1 million to Clinton's presidential library. That same year, McAuliffe cashed in his Global Crossing stock for an astonishing \$18,000,000 profit.

Winnick's company went belly up on Monday, wiping out investors and costing thousands of employees their jobs.

A second reservation that I have about the long-term impact of Washington's high profile campaign against corporate crooks is that it provides ammunition to the both the enemies of capitalism and those who would smother it in "help" from Washington, two groups that are virtually indistinguishable. This concern is more complicated than the first, and it may be that it will turn out to be unfounded. But it still worries me.

It centers around an observation that Russell Kirk, who had a magnificent way of packaging profound thoughts in simple sentences, once made about the stock market crash in 1929, namely that it opened the way "for terrible simplifiers to rally an immense following."

He was referring, of course, to the fact that the crash and subsequent depression opened the door widely for a crowd of left-wing "intellectuals" to usher in an era of socialist "reforms," which in turn paved the way for the hordes of bureaucrats who F.A. Hayek was later to refer to darkly as "the planners." A discussion of this movement is far beyond the scope of this article, but Paul Johnson hinted at it in his wonderful history *Modern Times*.

"Edmund Wilson, whose Depression articles were collected as 'The American Jitters' (1932), eschewed the rhetoric but powerfully reflected the growing anti-enterprise sentiment which was overwhelming the country He recognized shrewdly that a good time — or rather an influential time — for intellectuals had come: especially for the younger ones 'who had grown up in the Big Business era and had always resented its barbarism, its crowding-out of everything they cared about'. For them, 'these years were not depressing but stimulating. One couldn't help being exhilarated at the sudden, unexpected collapse of the stupid gigantic fraud. It gave us a new sense of freedom; and it gave us a new sense of power.

This time around there is, of course, no cadre of left-wing intellectuals to welcome the "collapse of capitalism" and hail the dawn of a new collectivist utopia. The likes of John Dos Passos, Edmund Wilson, Lincoln Steffens, Sidney Hook, Upton Sinclair, and George Bernard Shaw have been replaced by a nameless, faceless crowd of liberal politicians, technocrats, and bureaucrats, as well as their boosters in the mainstream media. Collectively, these folks are the antithesis of intellectuals, but their agenda is the same as that of their predecessors, which is to use the present "crises in capitalism" to further harness the enormous power and money of corporate America to the will of Washington.

Indeed, these new "terrible simplifiers" are no less dangerous with their shallow assurances that the solution to the problem of corporate malfeasance lies in more laws, more regulations, more bureaucrats, and more government control and collusion with the private enterprise.

The message they and their efforts send was recognized by Irving Babbitt many years ago in his great book *Democracy and Leadership*. "The multitude of laws we are passing is one of many proofs that we are growing increasingly lawless.

LETTERS TO THE EDITOR. This week I am introducing a new feature to the newsletter, one that I had not included before because I have never had a letter to the editor before. I used to get letters all the time when I was at Prudential Securities. Most were of the kind that obliquely raised questions about whether my parents were married when I was born, and some requested in rather strong terms that perhaps my employers might consider showing me the door, which they eventually did. My favorite was one that said “Why don’t you keep your stupids (sic) ideas to yourself?” Anyway, here’s one I liked from an old friend, who is quite clearly wise beyond his years.

Dear Mark:

My favorite time of the week is becoming Tuesday morning. I get my latest piece from Melcher, go to the gym, ride a recumbent stationary bike, and read til my heart’s content. I also know when it’s a great article because I return to my office and think. If it’s really a good piece, I change my mind. Today, I thought til it hurt, and I may have changed my mind.

What provoked my “thinking attack” was your comment about the President needing to be friendly to the stock market. I believe the process of becoming market friendly began to evolve under Clinton. I also believe Clinton’s economic advisors understood what it meant to be market friendly. When Clinton was first elected, I remember saying to [my wife], “If he wants to be successful, he must bring down long term interest rates, and install policies that move the government toward fiscal balance.” Since the principal mover of the stock market under most conditions is interest rates, if macro policies are in place that support lower long term rates, the market will respond positively. Clinton did two things that enhanced investors’ belief in the long-term downward movement of interest rates. He presided over very small increases in domestic spending, and decreases in military spending, and, consequently, a steady decline in the government’s deficit. The increasing Price/Earnings ratios of the late 1990’s were not an accident. They were a calculated response to a decreasing demand by the federal government on private sector capital.

Normally, I am fully invested. But, now, [my firm] is almost half cash. I’ve been wondering why I’ve done this, because I do believe the economy’s coming along fine, and we will soon be booming again. Of course, increased political and corporate risk are issues, but I also think we’re nearing the end of their impact. It’s just possible that investors as a psychic class are underrated. They know the President has to be concerned with the market. They also know this President has no over all market friendly strategy. They also know there is little he can do except an occasional photo op. His position on steel tariffs and his inability to hold the fiscal line tells the market his driving concern is political, not economic. If he were concerned with the economic issues, he sure wouldn’t have Mitch Daniels as his OMB Director. This means his response to market concerns will be ad hoc, or sector-by-sector, not strategic. The consequence of this is that the Fed, by trying to help out, will likely keep interest rates low too long; will keep the monetary base expanding too fast, too long, (it’s up 11 % year over year), our fiscal policy likely will continue to deteriorate until the deficit hits

\$ 300 to \$ 400 billion, and investors will see a booming economy, but also increasing inflation and much higher interest rates. Since interest rates are the best predictors of the market, it's easy statistically to invert the formula, and determine what interest rate investors are now projecting for future market values. Discounting the risk issues, which I think are currently important, the market is currently treating corporate earnings as though the long bond were at 8.05% instead of its actual 5.4%. If, in fact, this is a conscious process, which I'm not sure it is, then the market is saying exactly what you said in your article. Bush has no strategic economic vision, he is likely to simply respond to Congressional financial demands, the bureaucratic machine will continue to grow, and the federal deficit will become surprisingly large. All this in the next 2-3 years. It makes sense under this scenario to hold cash.

One way to test this theory is to look at cash holdings versus the market. I went back to early 2000, and added up all funds in demand type accounts (MZM). This includes savings, checking, and money market accounts. They totaled then about \$ 5.1 trillion. Since the stock market then was worth a little over \$16 trillion, we had about \$3 in market value for each \$1 in cash. Now, with the market worth about \$9 trillion, I added up MZM for last week. It was \$6.7 trillion. So, now there is only about \$1.34 in market value for each \$1 in cash. Mark, this could be a very clear vote of no confidence on the part of investors, and an effort to establish the strong cash positions needed to get through high interest rate periods, when cash becomes king.

See what you've done, Mark? I've spent much of my morning thinking about your thoughts. You may have saved me millions, though, because now that you've forced me to think about what I've been doing, I think I understand it better, have better data to support it, and probably more conviction going forward. I will still stay in the market, because earnings will be excellent over time, but PE ratios will probably not return to late 1990's levels, and consequently, the market will not move ahead as fast as earnings. It should still do well though. The key issue here is to stay away from any fixed income securities until the long bond reaches at least 7 %. The bond market could be as bad in the next few years as the stock market has been in the last few. Over 7%, though, the bond market could be a great long-term buy.

Best Wishes,

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