



TIME TO SUSPEND MARK TO MARKET ACCOUNTING

While the new administration is concentrating on those Americans without assets, those Americans that do have assets are hoarding them. We continue to see an enormous build up of cash by investors. This has been accomplished by not only a lack of spending but through the selling stocks and bonds.

We read an article in Forbes that we think is good enough to pass along to those who did not see it.

Why Mark-To-Market Accounting Rules Must Die

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Washington continues to toss around billions of dollars and seeing if anything sticks, while one action that could be taken is free -- putting an end to mark-to-market accounting.

Suspending mark-to-market accounting could fix major problems at no cost. Unfortunately, many people dismiss this issue without really understanding its impact on the economy.

We are economists, not accountants, or bank analysts. We really don't think a debate about how big the housing bubble was, or whether a certain bank is viable or not, is worthwhile when it comes to accounting rules.

That misses the point. Mark-to-market accounting rules affect the economy and amplify financial market problems.

The history seems clear. Mark-to-market accounting existed in the Great Depression, and according to Milton Friedman, who wrote about it just 30 years after the fact, it was responsible for the failure of many banks.

Franklin Roosevelt suspended it in 1938, and between then and 2007 there were no panics or depressions. But when FASB 157, a statement from the Federal Accounting Standards Board, went into effect in 2007, reintroducing mark-to-market accounting, look what happened.

Two things are absolutely essential when fixing financial market problems: time and growth. Time to work things out and growth to make working those things out easier must exist. Mark-to-market accounting takes both of these away.

Because these accounting rules force banks to write off losses before they even happen, we lose time. This happens because markets are forward looking. For example, the price of many securitized mortgage pools is well below their value, based on cash flows. In other words, the market is pricing in more losses than have actually, or may ever, occur. The accounting rules force banks to take artificial hits to capital without reference to the actual performance of loans.

And this affects growth. By wiping out capital, so-called "fair value" accounting rules undermine the banking system, increase the odds of asset fire sales and make markets even less liquid. As this happened in 2008, investment banks failed, and the government proposed bailouts. This drove prices down even further, which hurt the economy. And now as growth suffers, bad loans multiply. It's a vicious downward spiral.



MARCH 2009 — MARKET REPORT

In the 1980s and 1990s, there were at least as many, and probably more, bad loans in the banking system as a share of the economy. The difference was that there was no mark-to-market accounting. This gave banks time to work through the problems. At the same time, the U.S. cut marginal tax rates and raised interest rates, which helped lift economic growth. Time and growth allowed those major banking problems to be absorbed, even though roughly 3,000 banks failed, without creating an economic catastrophe.

In Japan, during the 1990s, the government allowed banks to operate without ever recognizing bad loans, which certainly bought time. However, Japan increased taxes and ran an excessively tight monetary policy, which undermined growth. This created an economic disaster. The real problem with Japan was not zombie banks; it was that there was no growth. After all, foreign banks were allowed to lend in Japan and were not in bad shape like the Japanese banks. They stayed away from Japan because the economy was not vibrant.

A final example: In the 1930s, because mark-to-market accounting existed, we limited the amount of time available to fix problems. At the same time, the U.S. raised taxes, increased spending and economic interference, and became protectionist. This hurt growth. The reason the Great Depression was so bad is that we took away time and growth.

Anyone worried about repeating the errors of Japan in the 1990s or the U.S. in the 1930s should focus on the policies that impeded recovery. Suspending mark-to-market accounting is a cost-free way to buy time. It does not allow banks to sweep bad loans under the rug. Bad loans are still bad loans, and banks cannot hide from them. Not suspending it, while at the same time interfering in the economy with massive stimulus and bank nationalization is a recipe to undermine both time and growth and therefore hurt the economy even more.

It is never too late for the Government to get this right. As the short term wealth continues to lesson, one would hope some simple and easy solutions will be utilized. If these accounting rules are dropped, the stock market could finally give a reason to investors to put some of their cash back to work by buying stocks.

Meanwhile, we have increased cash holdings waiting for the stocks to slow their retreat. Our stocks continue to decline less that the market and we will patiently wait for signs that a recovery is on the horizon.

As always, thanks you for your continued trust.