

How finance reshaped America

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An eventful summer and fall...



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How did we get into this mess?

“There's no question about it. Wall Street got drunk”

G.W. Bush, 7/08

CORRECTION:

The American economy got drunk.
Wall Street was just the bartender.

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Wall Street is Main Street now

- Half of US households are invested in the stock market through mutual funds and 401(k) plans
- Thanks to mortgage securitization and low interest rates, most homeowners with mortgages refinanced them during the first half of this decade
- The **personal savings rate** (employment income – spending) in the US turned **negative** in 2005 for the first time since the Great Depression
- But don't worry:
 - “The decline in an often-cited aggregate personal saving rate may not be cause for much alarm for retirement preparedness. Much of this decline can be attributed to spending triggered by **wealth increases from capital gains on housing and financial assets.**” (*Economic Report of the President 2006*)

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Due to this “wealth effect,” the housing bubble disguised weaknesses in the real economy

- Americans extracted perhaps **\$800 billion per year** in home equity from 2004-2006 – about 9% of US disposable income (Greenspan and Kennedy, 2008)
- Housing price increases fueled economic activity and job creation in retail and housing sectors
 - One-quarter of new jobs created between 2003-2006 were in housing-related industries
 - There were 400,000 mortgage brokers in 2006
 - And 1.2 million real estate agents
 - Roughly \$300B/year went for personal consumption, promoting growth in retail employment

Was the housing crash utterly unpredictable?



Figure 1. Real home price indexes for the United States 1890-2005 (Shiller 2005), Amsterdam 1628-1973 (Eichholtz 1997) and Norway 1819-1989 (Eitheim and Erlandsen 2004)

“The magnitude of the current boom is practically **unique in history**, making it difficult to predict what comes next based on historical examples... It’s notable that until the recent explosion in home prices, **real home prices in the United States were virtually unchanged from 1890 to the late 1990s.**”

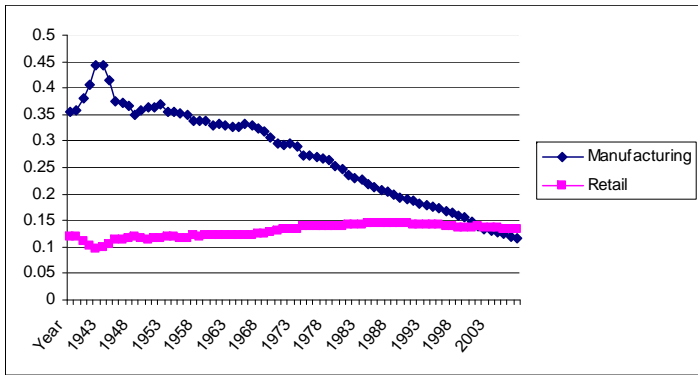
Robert Shiller, March 2006

The mortgage crisis is a symptom of a broader transition in economic institutions

- The US has shifted from an industrial to a **post-industrial economy**
- Employees are **less tied to particular employers** located in particular places
- Households are **more tied to financial markets** through college and retirement savings invested in mutual funds, credit card payments tied to LIBOR, and mortgages ultimately owned by dozens of different financial institutions

Post-industrialism (def. 1): “the majority of the labor force is no longer engaged in agriculture or manufacturing but in services” (Daniel Bell, 1973)

Manufacturing employment is increasingly rare in the US



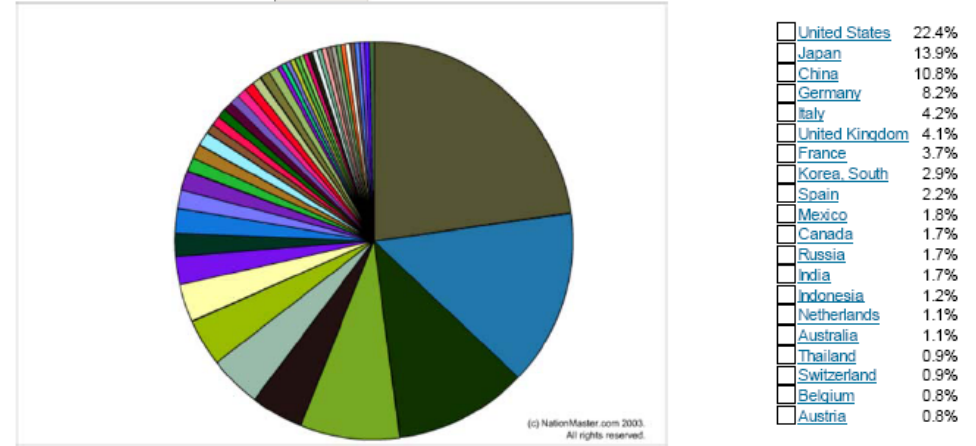
Proportion of US private labor force employed in manufacturing and retail, 1939-2008 (Source: BLS)

Since January 2001, the US has shed 4.8 million jobs in manufacturing— more than one in four

As of last month, more Americans were unemployed than were employed in manufacturing

The US still leads in manufacturing value-added...

US global share of value added in manufacturing



...it just doesn't require employees to do it (cf. agriculture)

THE WALL STREET JOURNAL
WSJ.com

CAREERS | MARCH 9, 2009

Lean Factories Find It Hard to Cut Jobs Even in a Slump

By TIMOTHY AEPPEL and JUSTIN LAHART

SPARTANBURG, S.C. -- At a factory here that churns out plastic parts for everything from spray cans to blasting caps, laying off just one worker can be more trouble than it's worth.

The plant, owned by Cleveland-based Parker Hannifin Corp., has become so lean over the past decade that many assembly lines run with only a handful of highly trained workers.

So while mass layoffs have driven the U.S. unemployment rate to its highest in 26 years, Parker and other companies like it are responding to the slump in more surgical ways, mainly by cutting hours and shedding temporary workers.

"Because of productivity gains, every one of my people carries more dollars in sales today," says Donald Washkewicz, Parker's chief executive. In 2000, the average Parker worker represented about \$125,000 a year in sales. Today, that figure tops \$200,000. "If I need to cut back, I have to cut back fewer people to achieve the same goal."

Similar trims are taking place at each of Parker's nearly 300 factories. And to varying degrees, this is happening at thousands of other large and small factories across the U.S.

The largest US employers have shifted from manufacturing to retail and other services

10 Largest US Corporate Employers, 1960-2009

1960	1980	2009
GM	AT&T	WAL-MART
AT&T	GM	TARGET
FORD	FORD	UPS
GE	GE	KROGER
US STEEL	SEARS	SEARS HLDGS
SEARS	IBM	"AT&T"
A&P	ITT	HOME DEPOT
EXXON	KMART	WALGREEN
BETH. STEEL	MOBIL	VERIZON
ITT	GTE	SUPERVALU

Manufacturing Oil Services

Wal-Mart now employs roughly as many Americans as the 20 largest manufacturers combined

Ten industries with most-tenured employees

<u>Industry</u>	<u>Tenure</u>	<u>Age</u>	<u>%</u>
Agriculture	14	47	1.6
Utilities	13	45	0.9
Petroleum and coal products mfg	11	45	0.1
Forestry, logging, fishing, hunting	10	44	0.2
Electrical equipment, appliance mfg	10	46	0.3
Public administration	9	45	4.9
Transportation equipment manufacturing	8	44	1.4
Beverage and tobacco products	8	38.5	0.1
Paper and printing	8	43	0.9
Primary metals and fabricated metal prods.	7	43	1.4

Ten industries with least-tenured employees

<u>Industry</u>	<u>Avg tenure</u>	<u>Age</u>	<u>%</u>
Internet publishing and broadcasting	0.5	42.5	0.0
Food services and drinking places	1.5	26	5.0
Private households	2	40	0.6
Retail trade	3	38	11.9
Motion picture and sound recording	3	34	0.3
Rental and leasing services	3	36	0.4
Administrative and support services	3	40	3.3
Social assistance	3	41	2.2
Arts, entertainment, and recreation	3	38	1.8
Accommodation	3.5	40	1.3

Ties between companies and employees have frayed

“The whole labor force of the modern corporation is, insofar as possible, turned into a **corps of lifetime employees**, with great emphasis on stability of employment,” and thus “membership in the modern corporation becomes the single strongest social force shaping its career members...”

Carl Kaysen, 1956

“If there's one thing you'll learn—and dot-coms have learned it in the last year—is **no one can guarantee lifetime employment...** You can give lifetime *employability* by training people, by making them adaptable, making them mobile to go other places to do other things. But you can't guarantee lifetime employment.”

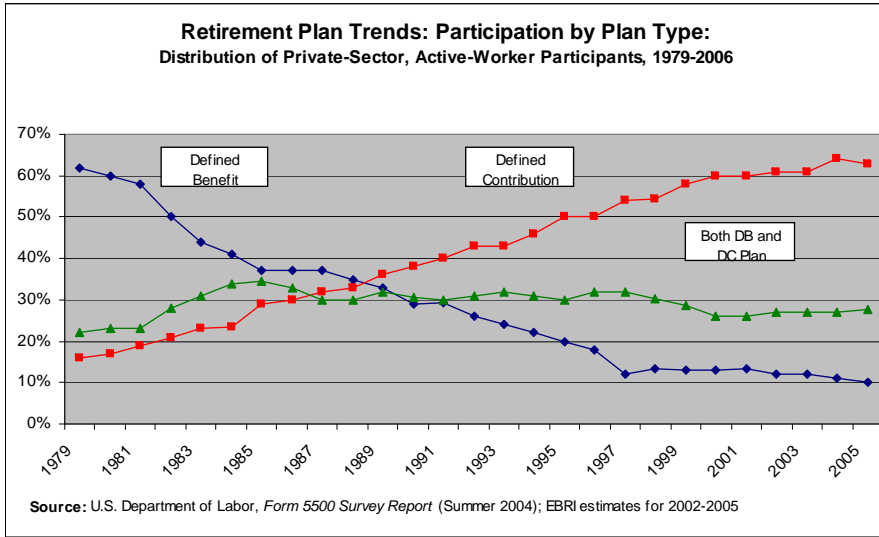
Jack Welch, 2001

Long-term attachments to employees can be costly...

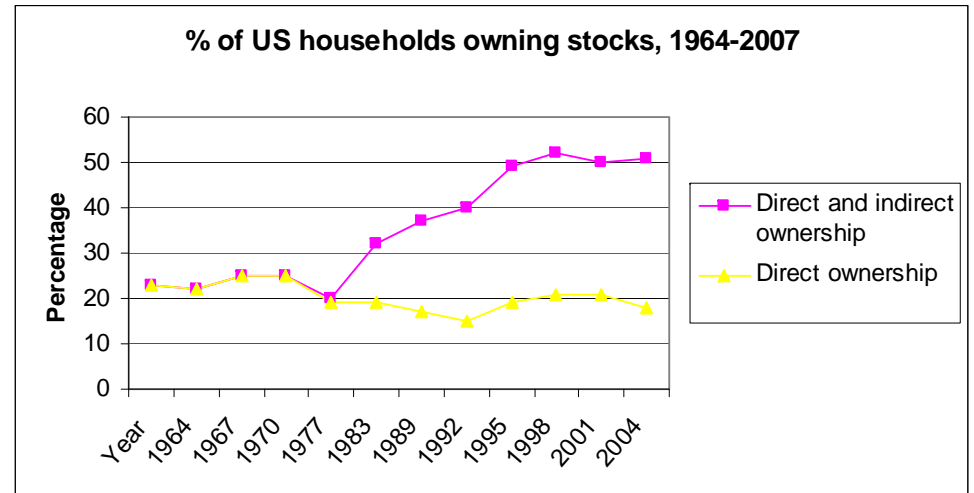
“Our legacy costs in pensions and health care are an area of significant competitive disadvantage for us... We're now subject to global competition. We're running against people who do not have these costs, because they are funded by the government.”

Rick Wagoner, CEO of GM, Feb. 2006

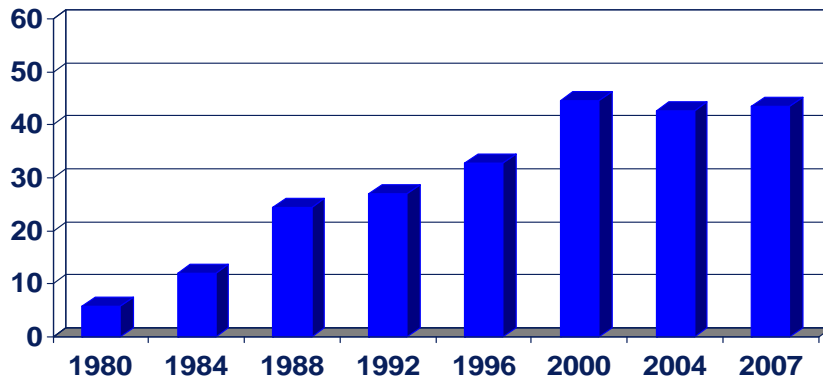
...so most employers have abandoned traditional company pensions in favor of relatively portable 401(k) plans



As a result, households became increasingly invested in the stock market during the 1980s and 1990s

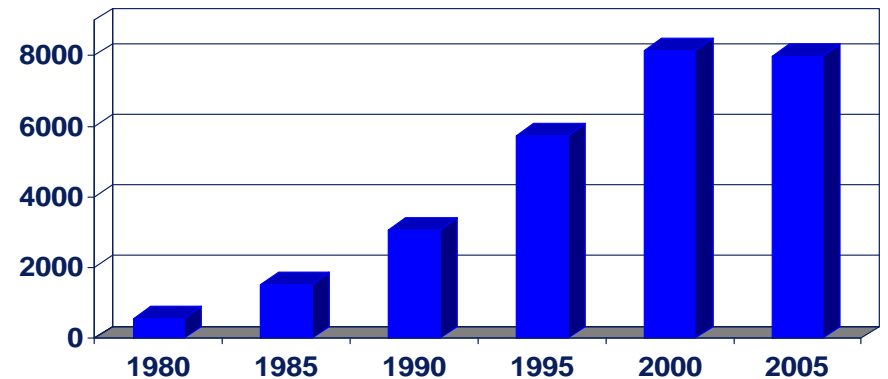


Specifically: investors in mutual funds



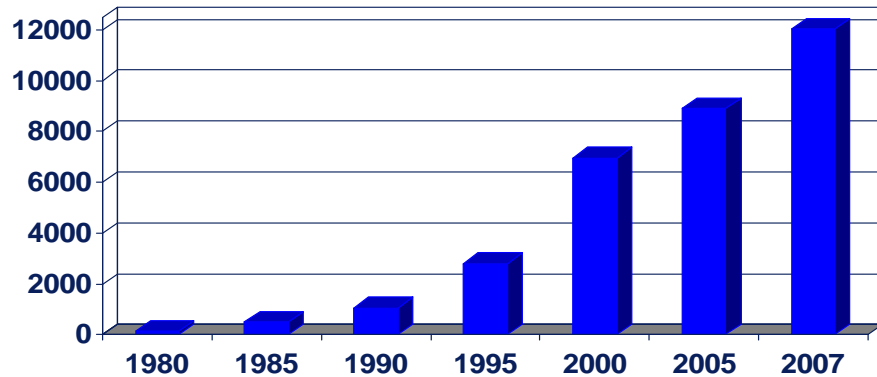
Proportion of households allegedly owning mutual funds

There are many more US mutual funds now



Number of US mutual funds

And they gathered a lot of assets

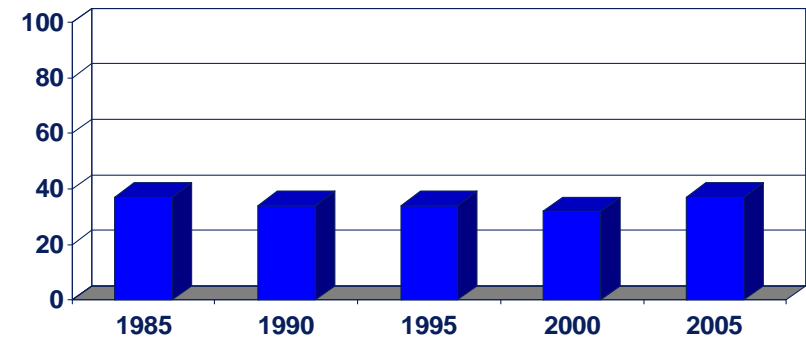


Billions of dollars in assets held by US mutual funds

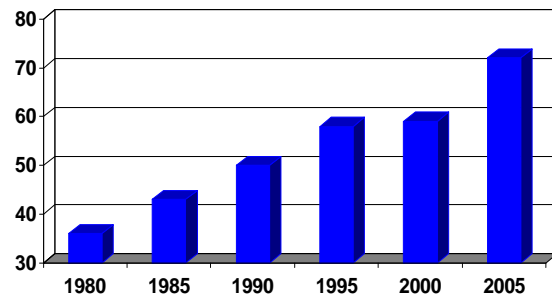
But 'name brand' funds got most of the benefit



Market share of top 5 fund families



Leaving US corporate ownership largely 'intermediated' by a few mutual funds



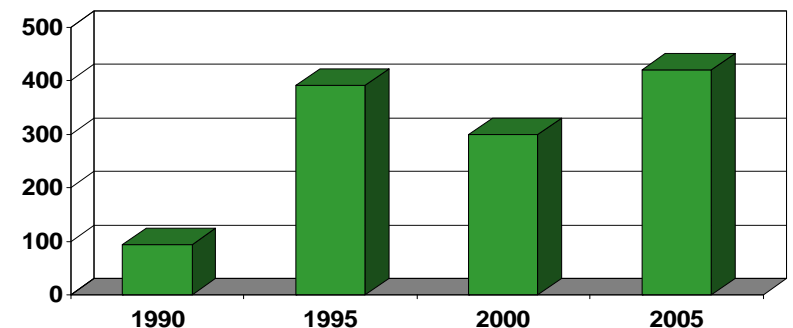
Mean ownership by institutional investors of 1000 largest corporations

Corporate ownership by mutual funds

- 1950: 3%
- 1990: 8%
- 2005: 28%

Fidelity is now the largest shareholder of one in ten US corporations

Number of US-listed firms in which Fidelity is largest shareholder



of listed firms in US

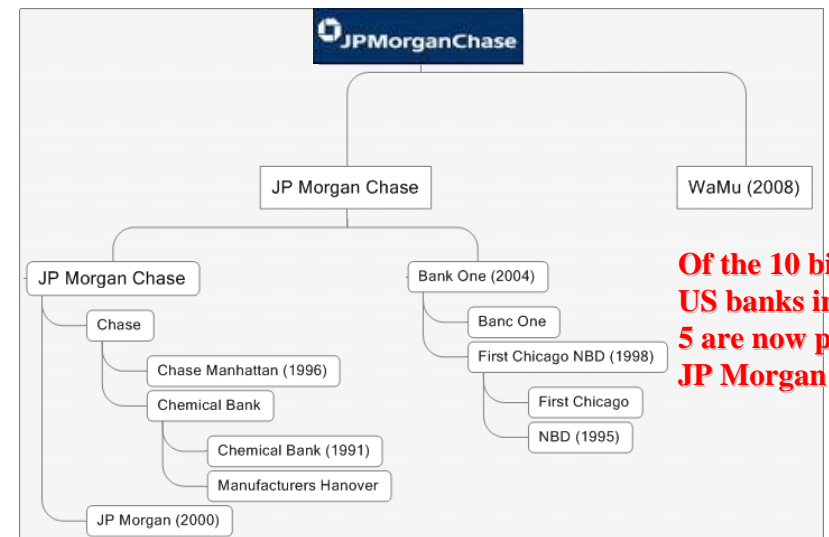
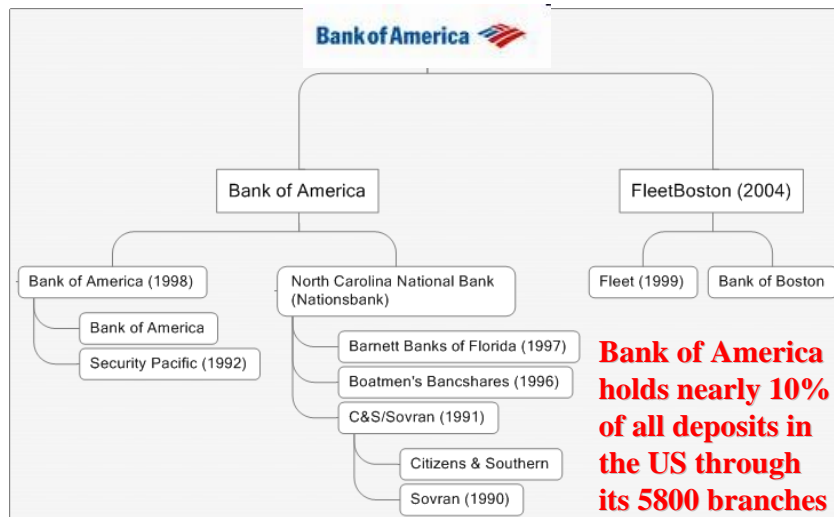
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Q: If household savings have moved to mutual funds, what happened to the banks?

A: They got acquired by Bank of America or JP Morgan Chase

How North Carolina National Bank became Bank of America

How (almost) every New York-based commercial bank became JP Morgan Chase



The surprising new geography of banking

Ten largest US-based traditional commercial banks

Bank	Location
JP Morgan Chase	New York
Bank of America	Charlotte, NC
Citibank	New York
Wells Fargo	San Francisco
State Street	Boston
PNC/National City	Pittsburgh
US Bank	Minneapolis
Bank of NY/Mellon	New York
Suntrust	Atlanta
Regions Bank	Birmingham, AL

7 of the 10 largest US cities no longer have a major local commercial bank.

The basic business of banking has changed



“No, but you . . . you . . . you’re thinking of this place all wrong. As if I had the money back in a safe. The money’s not here. Your money’s in Joe’s house . . . right next to yours. And in the Kennedy house, and Mrs. Macklin’s house, and a hundred others. Why, you’re lending them the money to build, and then, they’re going to pay it back to you as best they can. Now what are you going to do? Foreclose on them?”

Securitization: or, What can be bundled together and sold as bonds?

- Mortgages
- Auto loans
- Student loans
- Corporate loans
- Credit card receivables
- Business receivables (even in distress)
- Settlements of tobacco lawsuits
- David Bowie’s royalties
- Blends of the above (CDOs)
- Your neighbors’ life insurance policies

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Life Settlement: Selling Your Life Insurance

Whether term or whole life, you could get cash for your life insurance policy. Don't leave money in a sock drawer - **85% of all life insurance policies never pay a death benefit**¹ and life settlements provide 300% of the cash surrender value on average.² Many people don't realize that there are options to giving up a policy or getting only the cash surrender value.

Done  Internet 

Thanks to securitization, a US bank today is often a façade—a portal to financial markets



A Copernican shift in American society



From a corporate-centered society...



...to a market-centered society...