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Mutual fund exposure sets Americans up for slaughter

by Richard Freeman

Increasing numbers of Americans are investing in stock market equities and mutual funds. In hopes of making a killing, American families are shifting money from bank accounts into mutual funds, which then plow the money into the stock market bubble.

The lure of the market is making Americans crazy, distorting their grasp of economic and strategic reality. Encouraged by stories in magazines and newspapers, tips from hot-shot newsletters and "insider" investment advisers, and talk-show gossip, Americans are betting their shirts on the market. So far, the Dow Jones Industrial Average is trading around the 7,000 mark, and other stock market indices are rising.

But this is untenable: these Americans are setting themselves up to be slaughtered.

Economist Lyndon LaRouche warned in a Feb. 5 interview with the "EIR Talks" radio program:

"The only thing I can say is that the persons—and there are about 40 million Americans, I think, who are exposed to this—who are betting that they have a pension, and a future invested in mutual funds, the stock market, or some plan of that sort, if they stay, they're going to be slaughtered. They'll lose everything.

Mutual fund mania

Mutual fund mania—reporting on the "hottest" funds, the highest yields, and the shortest path to making the most money—is a major topic of public conversation, and is shamelessly promoted by the nation's business and financial magazines.

Although it never actually reported what was going on in the economy, *BusinessWeek* magazine, for example, used to have cover stories on the U.S. steel, machine tool, and construction industries—that is, real production. No more. The Feb. 3 cover story of *BusinessWeek* is "The Best Mutual Funds," with sub-headlines: "Building a Winning Fund Portfolio," "Up-and-Coming Funds To Watch," and "New Improved Performance Guide." One article is entitled "Virtuoso Returns: In a Thrilling Year, These Funds Make the Sweetest Music."

The Aug. 26, 1996 issue of *Fortune* magazine, which presented its "1996 Mutual Fund Survey," featured an article entitled "Gambling with Mutual Funds." It said, "Never mind investing—you want to be on the stock market's direction. Here's how you can use mutual funds for rank speculation."

Leading the way in mutual fund investment is the Boston Brahmin-run Fidelity group of mutual funds, which is the world's largest, with more than $700 billion under management. During the 1960s, Bernie Cornfeld's organized crime offshore mutual fund empire, Investors Overseas Services, used Fidelity funds to invest and launder its dirty money. *—R. Freeman*

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People watch the moving sign of stock quotations in Boston, on Oct. 20, 1987, the day after "Black Monday." (Inset) The bull and the bear outside the "Borse," the Frankfurt stock exchange. The hogs (i.e., those who stay in the market, desperately hoping for a profit), LaRouche warns, will be slaughtered.

"Because, as I've said before, and I'll say it again. It's worth repeating, because I hate to see Americans get suckered this way, partly by their own greed: that on the financial market, bears can make money, bulls can make money, but, hogs are always slaughtered. The fellow who says, 'I don't want to get out of the market today; what if I lose a profit I could get tomorrow?' *That* is the guy who is accident-prone. He's going to be slaughtered. And, people who are ordinary Americans, should not keep their money in these things. It's going to go. The exact date, we don't know. . . . You won't be told in advance, most of you. It will come by surprise, and you'll lose everything."

Most Americans refuse to face reality. During the period 1990 to the present, the real physical economy of the United States contracted at the rate of 2% per annum. In this same time frame, the Dow Jones Industrial Average rose from 2,810 on Jan. 1, 1990, to 6,858 on Feb. 11, 1997—growing 240% larger. Thus, it is strictly true to say that there is *less* than nothing backing the market up.

EIR is now studying the individual household's exposure to the stock market today, compared with 1929 and with 15 years ago. Although we are still compiling the figures, the broad picture is clear. Fifteen years ago, Americans placed most of their money into savings and loan institutions and commercial banks; today most of their money is in the stock market.

The chief conveyor for this investment today is the mutual fund. Individual investors buy shares in a fund, which is an investment vehicle, steered by City of London and Wall Street "managers." The mutual fund pools people's money, investing it in stocks, commercial paper, Treasury securities, corporate and municipal bonds, and so on. Although stocks are not the only thing that a mutual fund invests in, the mutual fund business is a major conveyor, channeling suckers' money into the stock market.

Figure 1 shows the asset size of mutual funds, and the portion of the assets invested in stocks.

Notice that through 1978, the size of mutual fund assets was minor. It grew from 1978 through 1984, but still stayed below $500 billion, reaching $496 billion in 1985. Then it exploded, jumping to more than $3.5 trillion by 1996. The amount of mutual funds assets in stocks went from $246 billion in 1990, to $1.752 trillion in 1996; that is, it had increased by more than $1.5 trillion. In fact, mutual funds assets in equities (stocks) grew by $483 billion just from 1995 to 1996. By 1996, one-half of all mutual fund assets were invested in the stock market. This fed the stock bubble, drawing households deeper into the mess.

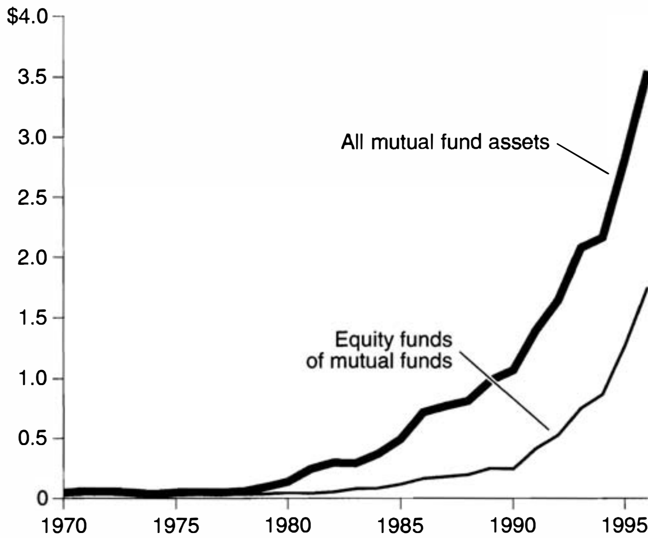
Mutual fund assets rival bank deposits

Over the past 15 to 20 years, U.S. households, as well as corporations, have shifted their assets and holdings out of savings and loan institutions, commercial banks, and credit unions, placing them instead in mutual funds. As a result, mutual fund assets are now almost as large as the total deposits of the entire U.S. commercial banking system (this

FIGURE 1

Rise in mutual fund assets

(trillions $ of assets)

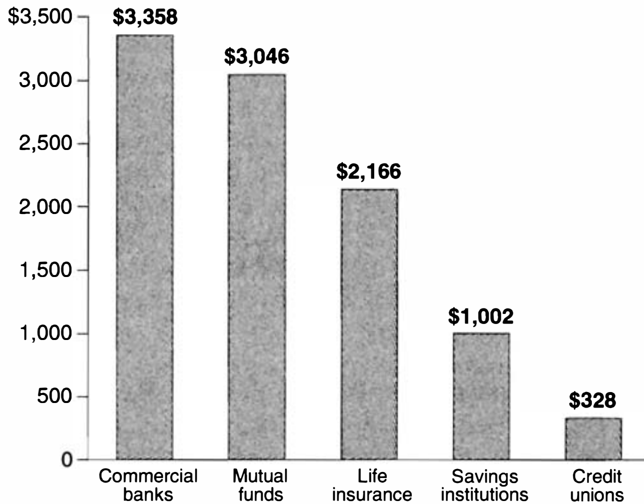


Source: Investment Company Institute, *Mutual Fund Fact Book,* 1996.

FIGURE 2

Total deposits and assets of the largest financial institutions, second quarter of 1996

(billions $)

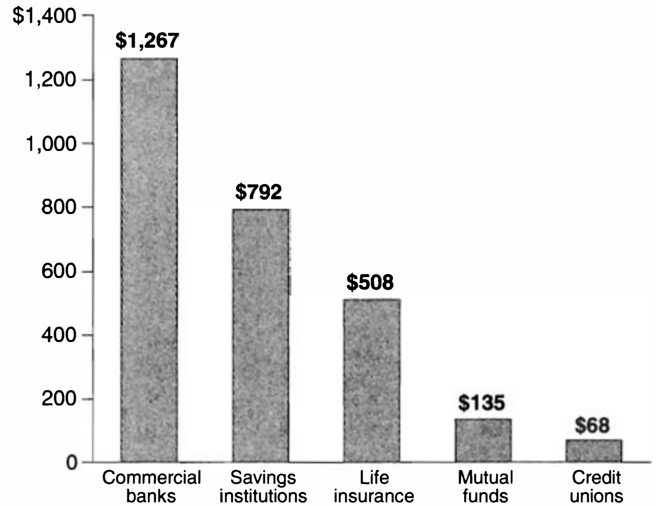


Source: Federal Reserve Board of Governors, "Flow of Funds Accounts."

FIGURE 3

Total deposits and assets of the largest financial institutions, 1980

(billions $)

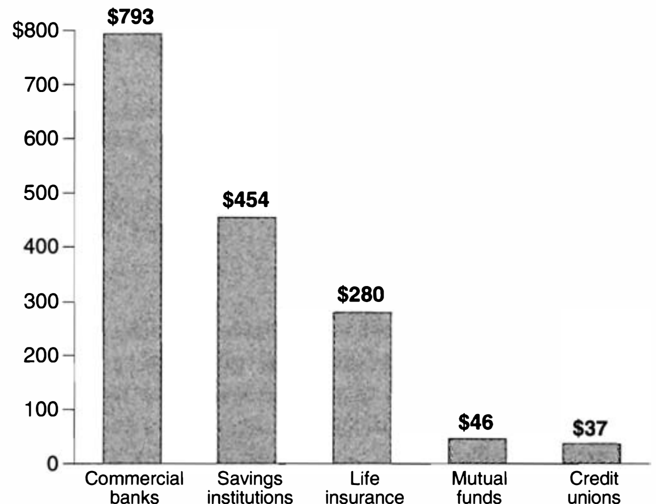


Source: Federal Reserve Board of Governors, "Flow of Funds Accounts."

FIGURE 4

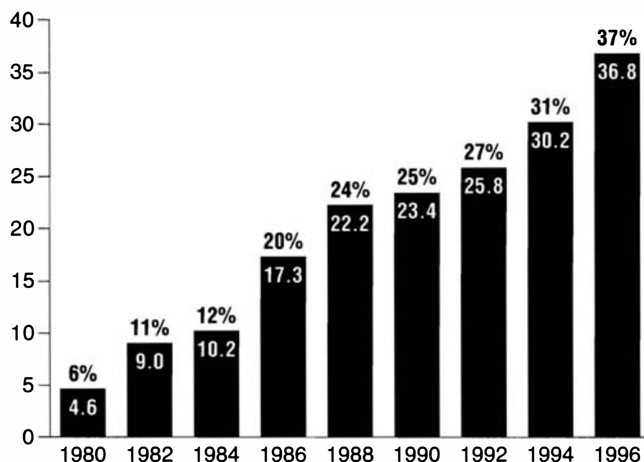
Total deposits and assets of the largest financial institutions, 1975

(billions $)



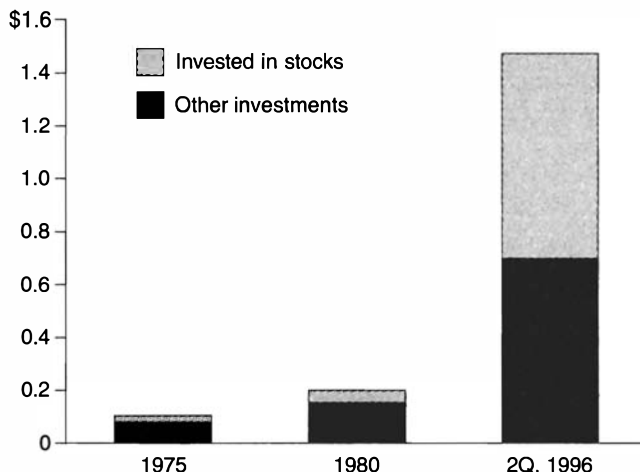
Source: Federal Reserve Board of Governors, "Flow of Funds Accounts."

FIGURE 5
Ownership of mutual funds by U.S. households, 1980-96
(bars: millions of households; above: percent of all households)



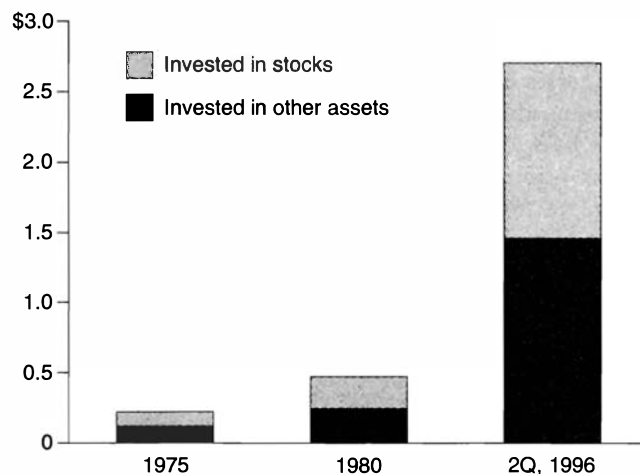
Source: Investment Company Institute.

FIGURE 6
State and local retirement fund assets, showing portion invested in stocks
(trillions $)



Source: Federal Reserve Board of Governors, "Flow of Funds Accounts."

FIGURE 7
Private pension fund assets, showing portion invested in stocks
(trillions $)



Source: Federal Reserve Board of Governors, "Flow of Funds Accounts."

comprises only U.S. chartered banks, not foreign banks). **Figures 2, 3,** and **4** depict the story. (Figure 2 employs second quarter 1996 figures. For mutual funds, *EIR* has figures for the entire year, but for the other institutions figures extend only through the second quarter 1996. To make the comparison consistent, *EIR* here reports only second quarter figures.)

In 1980, mutual funds assets were a fraction of their current size, and in 1975, they were merely a blip. Two post-industrial society measures spurred the shift of individual investors away from traditional financial institutions and into the speculative stock market: first, the move by Federal Reserve Board chairman Paul Volcker to implement a policy of "controlled disintegration" of the economy, by sending interest rates into the stratosphere in October 1979; and second, the 1982 banking deregulation pushed through by Vice President George Bush, as well as Sen. Jake Garn and Rep. Fernand St Germain, among others. These measures also contributed to the accelerated growth of derivatives, starting in 1987.

How much are households exposed?

The exposure of the individual household is still to be fully determined, but here are the initial indicative markers:

Figure 5 shows the number of households that have invested in mutual funds, and the percentage of all households that these investing households represent. (This includes mutual funds that a household owns through Individual Retirement Accounts [IRAs] and Keogh plans).

In 1980, only 4.6 million households owned mutual funds, constituting 6% of all households. Today, 36.8 million households own mutual funds, constituting nearly 40% of all households.

A study titled "Family Finances in the U.S.: Recent

Evidence from the Survey of Consumer Finances," appearing in the January 1997 *Federal Reserve Bulletin* (published by the Federal Reserve Board of Governors), reports that in 1989, some 19.6% of all American household financial assets were in either stocks or non-money-market mutual funds (which is primarily stocks). In 1995, this figure had reached 31.2% of all American household financial assets. This represents stock "acquired" either through direct purchase, or through purchase of mutual funds (but does not include stock 'acquired' through participation in pension and retirement plans).

There is also a poll conducted by John Zogby International for Reuters, completed Jan. 25-29, which surveyed 1,008 registered voters. Zogby reports that of registered voters in America, 54% own stocks or mutual funds, and 39% of those polled, who claimed an annual income of $15,000 to $25,000, were invested in the stock market. (Nonvoters in the same income bracket would have a lower investment level in the stock market.) Of all respondents, 58% of whites, 35% of Hispanics, and 28% of blacks were invested in the market.

Pension funds also heavily in the market

In addition to mutual funds, there are other forms of stock ownership through direct purchase (we will discuss this in a future issue), and through participation in a private pension plan or state and local government retirement plans. These latter plans invest a portion of their proceeds into stocks, in addition to other financial instruments.

Figures 6 and **7** show that the pension and retirement plans are very significantly exposed to the stock market bubble. Both private pension and government retirement plans have grown dramatically in size over the last 15 years. In the second quarter of 1996, state and local government retirement plans held $789 billion in corporate equities—that is, in stocks—out of their $1.499 trillion in assets. In the second quarter of 1996, private pension plans held $1.258 trillion in stocks, out of their $2.742 trillion in assets. Together, private pension and public retirement plans held more than $2 trillion in stock market investments. This $2 trillion represents approximately one-quarter of all the money invested in the stock market.

Some of these retirement and pension plans are also invested into highly dangerous derivatives.

Readers who think that their pension is safe and will come to them automatically when they retire, should think again.

The multiple levels by which Americans are exposed to the stock market indicates a vulnerability that was not there 15 years ago, and that far exceeds that which existed in 1929. When the financial system's final phase of disintegration comes, the loss of stock value will create an existential crisis for tens of millions of "average" households. The American population, while celebrating the market's rise today, has set itself up for the slaughter.

Deregulation: the illness, not the cure

by John Hoefle

According to conventional wisdom, one cure for a hangover is to take another drink, as if imbibing additional alcohol were a solution to a drinking problem. This observation comes to mind, when looking at the renewed push in Congress for further deregulation of the banking system.

On Feb. 11 and 12, the House Banking Committee's Financial Institutions Subcommittee, held hearings on what subcommittee chairman Marge Roukema (R-N.J.), in her opening statement, called "financial modernization in general, and the Depository Affiliation and Thrift Charter Conversion Act, H.R. 268, in specific." H.R. 268 is one of several banking bills currently under consideration, all of which will only make a disastrous situation worse.

That "financial modernization" is the latest euphemism for deregulation, was made clear by Roukema's statement that her intent is to "replace the outdated Glass-Steagall Act of the 1930s." "Glass-Steagall did its part in its day, but the financial world has changed," Roukema said, noting that "technology and market forces have broken down the barriers between insurance, securities and banking. Our current statutory framework has remained stuck in the '30s."

"In the absence of congressional action," Roukema continued, "federal agencies and the industry have been forced to find loopholes and novel interpretations to allow financial institutions to adopt to an ever-changing marketplace."

Roukema's admission that banks and their regulators have been "forced" to find ways around U.S. law, is a curious position for a regulator to take, and says volumes about the incestuous relationship between the international financier oligarchy and their supposed overseers. At minimum, it raises the question: What is Glass-Steagall, and why are the bankers so determined to repeal it?

The drive to reverse Glass-Steagall

For years, bankers and regulators, including Federal Reserve Board Chairman Alan Greenspan, Senate Banking Committee Chairman Alfonse D'Amato (R-N.Y.), and House Banking Committee Chairman Jim Leach (R-Iowa), have demanded the repeal of the Banking Act of 1933, commonly known as the Glass-Steagall Act. The Glass-Steagall Act was passed in 1933, during the depths of the Depression, to correct widespread cheating of customers by banks. The National City Bank (known today as Citicorp), for example, had packaged bad Ibero-American loans as bonds, then sold those