

From the Expert

Recession?

David Bach Explores Our Current Economic State



David Bach is the bestselling author of the [Finish Rich series](#) and the [Automatic Millionaire series](#). He is a guest on *The Oprah Winfrey Show*, the *Today Show*, the *Early Show*, and is a columnist for Yahoo! Finance. He is best known for his common-sense strategies for living and retiring rich. His most recent book is [Go Green, Live Rich](#), which combines the principles of living with an eco-consciousness and reaping the financial benefits.

David, you have been in the financial service business since the early 90's. First you were a senior vice president of Morgan Stanley and over the last decade you have authored nine books on personal finance, with seven New York Times bestsellers to your credit and over five million copies of your FinishRich Series in print. What can you share about these difficult markets that we now see ourselves in?

As Yogi Berra once said, "It's déjà vu all over again". Markets go up and markets go down—and then they go back up again, and then they go back down. Every decade, whether it's an up or down cycle, people always believe that "this time it's different". Last week I was at the World Finance and Economy Summit and Alan Greenspan said that what we are seeing with this global credit crisis is a once in a century event. So you almost have to stop and wonder if this time it is different. I will say that I have never seen anything like this in my lifetime and most people I know who really know and understand the markets have nothing to compare this to—it's actually much worse than most people realize.

Can you explain what has happened in this market in layman terms?

Absolutely—it really goes like this: once upon a time, there was a housing market that had not declined nationally for fifty years! That housing market was the U.S. housing market. And the idea, up until 2005, was that housing was safe because nationally houses never declined year over year. And what was even better was that people rarely lost their homes to foreclosures. So, over time, the banks said, we really don't need a down payment; houses go up in value, people don't lose their homes—so the loans are secure. Americans in turn said, "You know what, I have all this equity in my house now because it's gone up so much in value so why don't I pull this money out and go buy some stuff?"

What's ironic is that we went out and bought lots of stuff from abroad (China, India, gas from the Middle East) and we made all these other countries rich. They in turn needed to do something with the money so they invested back in our bonds (our loans on our homes). That allowed the lenders to keep selling more mortgages and people to keep buying bigger homes and more homes (which also created more equity in our homes) which we then pulled out and used to buy more stuff from abroad! And the cycle continued--until late 2005 to 2006, when the cracks started to show.

Beginning about two years ago, housing prices stopped going up—and then they started coming down. Millions of people had zero equity in their homes because they had pulled it out to buy stuff—and they started walking away from their houses. But not everyone is losing their homes today because they pulled their equity out. Many people bought homes with bad mortgages and now can't afford them.

In essence, what happened is we lived off our homes as though they were piggy banks instead of treating our homes like the ultimate security blanket. Now our piggy bank is empty and so we have to save money again before we can buy more stuff. And with the current credit crisis we can't borrow money to buy stuff—so we really need to save money. And to save money we have to spend less. And that, my friends, is called a recession. And because our piggy banks are so empty, it is going to take at least a few years to fill them back up to go buy more stuff.

What do you see happening in the economy in the near future? Are we in a recession and how long will it last?

I've been saying we are in a recession since last year. Technically, we may not yet be a recession—but at this point basically everyone accepts that we are. People are spending less money, and that creates a recession. It's incredibly simple. First you watch your friend lose his job and you think, "Bob just lost his job, poor guy, maybe we should spend less." You spend a little less, and you talk a lot about poor Bob. Then your buddy Mike loses his job, and you say, "Poor Mike--maybe we should spend a little less." Again you talk about poor Mike and maybe spend a little less. Then you lose *your* job and you don't have money to spend, but you have credit cards to use—so you spend a little less. Then your credit cards become maxed out and you are broke and you really spend less. This last part of the cycle is just starting to hit. We haven't yet really seen Americans dramatically cut back on their spending, but we are about to see that happen—and it will be the biggest decline in spending during the holidays in probably a decade. The real question is how long will we spend less, and how dramatically will we cut back.

My prediction is that we are not even at the mid point of this recession yet, because the average American has not yet truly slammed on the spending brakes. I was at Toys R Us the other day with my son Jack and we wanted to buy a new game for our Wii. The line was literally 25 deep, and after fifteen minutes with a five year old I put down \$150 worth of video games and decided instead to buy them later. The entire line of people was holding stacks of these games—and again it was 25 people deep, so I'm not seeing a cut-back in spending yet. The stores in Manhattan are mobbed, the restaurants are packed, and the bars are standing room only. In terms of spending, we're still at the party—having our last "round" before the bar closes. I think next

year is when we will really start to see people cutting-back on their purchases and going through the ultimate hangover from all of our over-spending.

Why is it that we spend more money than we make year in and year out?

For better or worse, the last two decades have truly been about consumption in this country. Give me more, give me better, give me faster—and give it to me now. The entire concept of earning it before you buy it has gone out the window. My Grandmother Bach, to whom I dedicated *Smart Women Finish Rich*, was from the depression era and she became a self-made millionaire. She had a phrase and a belief that she taught me as a child that was incredibly simple, and it was this: “IF YOU DON’T HAVE THE CASH—YOU CAN’T AFFORD TO BUY IT.” This concept—of having money before you buy something—has totally gone out of our value system in this country. We now teach and promote the opposite. The government creates “economic stimulus programs” that amount to: “*We’re sending you \$500—go out now and buy an IPOD because your check is coming*”. It’s utterly insane what we teach society today.

Our moral values on spending are just nuts. We are a country that has a “LOBSTER LIFESTYLE ON A TUNA FISH BUDGET”. And we have created, as a result of easy money with credit cards, an entire age group of young people who are now drowning in debt and may never get out from under it.

Is there any good news in all of this?

Absolutely—here’s the good news. This too will pass and we will learn and grow from it. This country is about to return to a “back-to-basics” time. If you talk to your grandparents about the depression, they remember it vividly. It shaped their entire thinking and spending for the rest of their lives. This recession, involving a national real estate decline and stock market crash, will be remembered for our life times. We will begin to spend less, and, most importantly, we will begin to save more. Americans are ultimately a smart and driven people—and we will rebuild from this. It may take years for us to recover—but during that time we will get back in touch with what really matters, which is giving love to the people who matter most in our lives. We will spend more time with family and friends—and there will be a true return to family values and less time “shopping”. It will ultimately be a great thing for the psyche of the American family.

What about our 401(k) plans? With the markets down so much what should we do?

First and foremost you have to use your 401(k) plan at work---because you have to PAY YOURSELF FIRST. My #1 bestselling book *The Automatic Millionaire* is the book I am probably best-known for and it’s an easy read (you can read it in an hour). It teaches the simple formula for building wealth, which is this: Save one hour a day of your income automatically for life and pay yourself first! Don’t budget. Don’t use discipline. Make your savings automatic and let them grow. Your 401(k) plan is the best place to make your savings automatic and it’s the best place to pay yourself first because your money is going into savings before you pay taxes.

The biggest problem we have at home is we don't save enough money. The average American saves less than 4% in their 401(k) plan, so my best advice today is this: Look at your 401(k) plan and get your savings up to 10% at least. Ideally get your savings up to 15%--and then take a hard look at your investment options. Review them and make sure you are using the best funds and best asset allocation for your situation. And, if you don't know which investment choices would be best for your particular needs and circumstances, then ask! Get some financial education and get some coaching.

Whatever you do, don't stop saving. That is the biggest mistake we are seeing people make right now. They are shutting off their 401(k) plans and postponing saving "until this blows over." The stock markets will ultimately go back up—even if it takes a decade. And if it takes a decade to recover (which I don't think it will) then buying into the markets for a decade while they are low and then having them bounce up would make you wealthy. The truth is that right now America is on sale.

You say America is on sale? Explain that please for our readers.

The stock markets have traditionally traded at 15 times earnings (known as PE ratio). Today for all intents and purposes the S&P 500 is at 10 to 11 times earnings. When you go back and look at this in terms of history—the stock market is as cheap as we have seen in 30 years! This is ultimately going to be looked back on as a once-in-a-lifetime opportunity to buy great companies at a discount price. I can't tell you when the bottom will hit and picking it is next to impossible. But I doubt we will see these markets go below 7,000 this year—and that means we are close to a bottom now. Stocks will ultimately return to historical averages, so if we head back to them, the stock market will return to over 10,000 sooner rather than later. And if it takes two months or five years to get back to 10,000, from where we are now—that's a solid return--one will more than likely produce more than any other asset class.

What about the housing market? For two decades you have been a huge advocate of buying a home as the best investment you can make in your life time—do you still feel this way?

Without a doubt—without any question in my mind—the best investment you will make in your lifetime is the home you buy and live in. As long as you are alive, you have to live somewhere. And if the recent downturn in the stock market proves anything it's that housing is your best investment. Why? First of all you can't live in a stock, mutual fund, bond, treasury, money market account etc. When you buy a home you get to live in it! Your home is your castle. It's where you love and live with your family—it's where your memories are made. Homes are much more than investments, they are your shelter and your safety. But if you return to why homes make great investments—the simple answer is that they are forced savings (when you pay your mortgage you pay down your home) and they ultimately are leverage and they go up in value long term. I promise you a decade from now most housing markets will be higher than where they are today.

In my book on homeownership titled, *The Automatic Millionaire Homeowner*, I discussed the coming real estate melt down and what you can do to protect yourself. The last chapter is "How

to “Bubble Proof” Your Real Estate Plan—and Survive a Downturn. The book was written in 2005 and the advice, while timeless, was also critical. I still suggest people read this book because their home is still more than likely their biggest investment. One of the issues I hammered on in this book was financing. I have always said that in Real Estate the old axiom that it’s “location, location, location” is false. In fact, it’s “financing, financing, financing”. You can buy the best piece of real estate, but if you get the financing wrong you will lose it—and this is very much what has happened unfortunately.

For millions of Americans, the recent downturn in the real estate market is actually creating the best opportunity in decades for them to buy their first home. And for smart investors, there is simply going to be a fortune to be made in the next two years. Every downturn creates opportunities and this downturn will ultimately create fortunes for those who take advantage of it.

You are a huge advocate and crusader now for the environment—your latest bestseller being, *Go Green, Live Rich*. Tell us why you think this issue is so important?

At the end of the day, our planet is our home and if we don’t take care of it we won’t have any place to live. I want my son Jack to have a planet and place to live that is cleaner and healthier than the planet I grew up on—and I certainly don’t want it to be worse. So it comes down to caring about the Earth for our kids and their kids and their kids. My contribution to this issue was to help people realize that they can “go green”, live a healthier lifestyle, and save money at the same time. *Go Green, Live Rich* was revolutionary when it came out this year because it showed people 50 simple ways to save the earth and get rich trying. People have been really excited to learn that they can save thousands of dollars a year and help the planet and improve their families’ health at the same time. I also ultimately believe that a greater awareness of the environment and living in a planet-friendly way is going to be what turns around our country and economy. I believe we are going to finally become advocates for cleaner energy and that the next administration will create green economic zones and green tax incentives to encourage a revolution in energy. This will create a new generation of “green collar workers” and an entire new economy that will lead us to our next great economic boom—one that will someday be looked at as a “Green Economic Boom”.

Any last words of advice to our readers?

We are fortunately almost done with this election cycle, and, after two years, I’m sure most of us are ready for it to end. I think the most important truth I can tell you is this: it’s irrelevant who wins this election in terms of your family’s own economy. Neither candidate is going to fix your financial situation, and, candidly, worrying about the economy is a waste of time. You need to control your own economy. And that starts with what thinking about what you spend money on and how you spend it. The fastest thing you can control is your own spending, and now is the time to cut back on it significantly. I suggest you look at how you can cut your spending 10% to 20% right now—today. No more saying, “We should do this”—it’s time to get serious and get going.

Second, it's time to save money. That's why you have to cut your spending, because you need to save money! So get saving! Social security isn't going to be your answer. You have to have a real savings plan and most Americans don't. Again, the myth of the Presidential election every four years is that some guy or gal will "save us". You are your savior. No one is going to do this for you. So get out and get going. More millionaires will be created during this recession and meltdown than any other time in our lifetime. There will be fortunes made—and this could be your greatest opportunity to build your wealth. But to do that you can't keep doing what you have always done. You need to have new ideas, new thinking and new education. And if ever there was a time to get smarter about money, it's now! I would start by reading *Start Late, Finish Rich* and *The Automatic Millionaire* (if you haven't read them yet).