



The Party's Over: Stop Spending, Start Saving!

By: David Bach

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

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". I was recently at the World Finance and Economy Summit and Alan Greenspan said what we're seeing with this global credit crisis is a once in a century event. I've stopped to wonder if this time it is different.

I will say, I've 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 either. It's actually much worse than most people realize.

Can you explain in layman terms, what's happened in the housing market?

Absolutely, the story goes like this: Once upon a time, there was a housing market that hadn't 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 in value. Year after year, banks offered loans without down payments, feeling they were secure and foreclosures were rare. 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, why don't I pull this money out and go buy 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 other countries rich. These countries looked for a place to spend the revenue received from us, so they invested back in our bonds (the loans on our houses). This allowed lenders to keep selling more mortgages. In turn, it allowed people to keep buying more and bigger houses. This created more equity in our homes which we then pulled out and used to buy more stuff from abroad!

This cycle continued until late 2005 to 2006, when the cracks started to show. Beginning about two years ago, housing prices stopped going up and 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. Many people bought homes with bad mortgages and then they couldn't afford the payments.

In essence, we lived off our homes as though they were piggy banks instead of treating them as the ultimate security blankets that they are.

Now our piggy bank is empty and so we have to save money again before we can buy more stuff. With the current credit crisis we can't borrow money to buy stuff, so we really need to save money. 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's 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're in a recession since last year. Technically, we may not yet be in 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." 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're 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're about to see that happen.

The real question is how long will we spend less, and how dramatically will we cut back? My prediction is that we're not even at the mid-point of this recession yet, because the average American hasn't 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 I left the store. Everyone in line 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 2010 is when we'll really start to see people cutting-back on their purchases, when the ultimate hangover from over-spending will hit.

Why do 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, is a self-made millionaire from the depression era. She taught me an incredibly simple phrase as a child: "If you don't have the cash, you can't afford to buy it."

The concept of having money before you buy something is no longer something we hold as a value in this country.

We now teach and promote the opposite. The government creates “economic stimulus programs” meaning: “We’re sending you \$500. Go out now and buy an IPOD because your check is in the mail”. Our moral values on spending are just nuts. We’re a country that has a lobster lifestyle on a tuna fish budget. And we’ve created, as a result of easy money with credit cards, young people who are now drowning in debt and may never get out from under it.

Is there any good news in any of this?

Absolutely, here’s the good news: This too will pass and we’ll learn and grow from it. This country is about to return “back-to-basics”. If you talk to your grandparents about the depression, they remember it vividly. It shaped their 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 lifetimes. We’ll begin to spend less, and, most importantly, we’ll begin to save more. Americans are ultimately smart and driven people and we’ll rebuild from this. It may take years for us to recover, but during that time we’ll get back in touch with what really matters; giving love to the people who matter most in our lives. I predict we’ll spend more time with family and friends and there will be a true return to family values. Less time will be spent “shopping”. It will ultimately be a great thing for the psyche of the American family.

You claim, “America is on sale”. Can you explain this for our readers?

The stock markets have traditionally traded at 15 times earnings (known as PE ratio). Today, give or take, 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’ve 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 discount prices.

I can’t tell you when the bottom will hit, and picking it is next to impossible. But I doubt we’ll see these markets go below 7,000 this year—and that means we’re 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 that will more than likely produce more than any other asset class.

What about the housing market? For two decades you’ve been a huge advocate of buying a home, stating it’s the best investment you can make in your lifetime. Do you still feel this way?

Without a doubt, the best investment you’ll make in your lifetime is the home you buy and live in. As long as you’re alive, you need 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, or 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 serve as your shelter and your safety. But if you return to why homes make great investments, the simple answer is that they force you to save. When you pay your mortgage you pay down your home. But more than that, you can leverage your home as an asset, and homes go up in value in the 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, *The Automatic Millionaire Homeowner*, I predicted the upcoming real estate meltdown offering advice on how 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 throughout the book was financing. I have always said that in real estate the old axiom, “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’ll lose it, and this is very much what has come to pass.

For millions of Americans, the recent downturn in the real estate market is actually creating the best opportunity in decades for people to buy their first home. And for smart investors, there’s 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’re a huge advocate and crusader of the environment, your latest bestseller being, *Go Green, Live Rich*. Can you share with readers 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’s cleaner and healthier than the planet I grew up on. 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 all 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 ultimately believe a greater awareness of the environment and living in a planet-friendly way is going to be what turns around our economy and country.

I believe we’re going to finally become advocates for cleaner energy and 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 entirely new economy that will lead us to our next great economic boom—one that will someday be regarded as a “Green Economic Boom”.

Any last words of advice to our readers?

I think the most important truth I can tell you is this: Worrying about the economy is a waste of time. You need to control your own economy. This starts with thinking about what you spend money on, and how you spend it. Now is the time to cut back 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 need to have a real savings plan and most people don't. Don't buy into the myth that someone other than yourself is going to save you. 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. Your greatest opportunity to build wealth could in fact, be right now. Build your fortune now.

To do this, you can't keep doing what you've 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).