PART I

AFTERSHOCK

CHAPTER 1

Bubblequake and Aftershock—A Quick Review of How We Got Here and What's Next

WHY READ THIS BOOK? BECAUSE WE WERE RIGHT, NOW YOU CAN BE RIGHT, TOO

We are not Ben Bernanke, chairman of the Federal Reserve. We are not economic Nobel Prize winners, like Paul Krugman. We don't run huge investment firms, such as Goldman Sachs or Merrill Lynch. *But they were all wrong, and we were right.* That is why this book is worth reading. We don't have a crystal ball—no one does. But we do have something even more reliable over the long term: the *correct* macroeconomic view of what is occurring and what's coming next. Once you have this correct Big Picture too, you can be just as right as we have been. With this book, you and your family and associates will likely have a better chance than most to cover your assets, protect yourself, and perhaps even find profits in the coming Aftershock.

The purpose of this book is to move you closer to that with every page.

Please note: If you have not yet read any of our previous books, the rest of this chapter will serve as your quick executive summary. **If you have already read *Aftershock*, Second Edition, you could just skip ahead to Chapter 2**, which offers a brief update since our 2011 book. However, you may want to stay with us here just for the quick review. If nothing else, it will help you hold up your end of the discussion with some people who may still be in the dark about what is really happening.

You Are Not Asleep with the Sheep

Back in 2006, when the U.S. economy was still looking pretty good, our first book, *America's Bubble Economy*, accurately predicted the future popping of the real estate bubble, the fall of the stock market bubble, the decline of the private debt and consumer spending bubbles, and the widespread pain all this was about to inflict on our vulnerable, multibubble economy. Of these bubbles, we said the real estate bubble would be the first to go, kicking off the fall of stocks and the decline of private debt and consumer spending—exactly what occurred in the financial crisis of 2008. We also predicted the eventual bursting of the dollar bubble and the massive government debt bubble, which are both still to come.

Other bearish analysts have also predicted some of our current economic troubles, but very few did so as early as 2006. Even those who did see parts of this mess coming are still failing to connect all of the dots. They don't fully understand what's happened so far, and they can't tell us what will happen next. *America's Bubble Economy* was the only book to *both* warn about the current economic problems here and around the world, and also to go way out on a limb by predicting in substantial detail what would occur, why it would occur, and when. Not too many authors have been willing to go that far out on a limb, mostly because they can't. They don't yet see the whole story, and they don't dare take a chance on making inaccurate predictions that may come back to haunt them later. We went out on a limb and it turned out to be rock solid.

Of course, back in 2006, our prescient predictions were largely ignored.

Then our next two books, *Aftershock* (2009) and *Aftershock*, Second Edition (2011), further fine-tuned our forecasts, explaining in more detail how massive stimulus spending by the federal government and massive money printing by the Federal Reserve would temporarily boost the falling multibubble economy, particularly the stock market, but would only kick the can down the road and later make our bubble economy crash even harder.

This time, with the memory of the 2008 financial crisis still painfully fresh, more people began to take notice. In 2009, *Aftershock* was named one of *SmartMoney*'s Best Books. And in 2011, within weeks of publication in August, *Aftershock*, Second Edition, became a *New York Times* business bestseller, a *Wall Street Journal* business bestseller, and the number one Amazon personal finance book and number one Amazon economics book. Since then, the book has been translated into Japanese, Chinese, Polish, and Korean, and recently became a Korean bestseller. The book was made even more accessible in the form of an audio book, beautifully read by Christopher Kipiniak, which was nominated for an Audie Award. By the end of 2011, *Aftershock*, Second Edition, was named by *The Economist* magazine as Amazon's third bestselling personal finance book, not just in the United States but in the world.

What a difference a crash makes! Some people are clearly starting to wake up.

But despite all the kudos and recognition our books have gotten, our basic macroeconomic message is still falling mostly on deaf ears—or, more accurately, on *denying minds*. Most people simply do not want to wake up and fully face the truth of what is really happening. Even the bear-oriented analysts are missing the bigger picture. This is not merely a bearish "down cycle" that will eventually be followed by a bullish "up cycle." *This economy is evolving*. We are not going back to how it was before. We are going forward to something new.

For a fuller explanation of our macroeconomic views, we encourage you to take a look at *Aftershock*, Second Edition. For your convenience, we are also summarizing the key ideas of that book in this first chapter, before we tell you how you can potentially protect and grow assets in this dangerous and evolving economy.

But before we get to that, we would like to take a moment to congratulate you—the person who is reading these words right now—not just for opening this book, but more importantly for *opening your mind*, if not to our entire macroeconomic point of view, at least to the *possibility* that something is not quite right with this so-called "recovery." Perhaps we are headed not back to the prosperity of the past but forward, toward something entirely new, highly dangerous, and potentially profitable. You are part of an elite, early group of people with their eyes open and their lights on. You may not know everything about what is occurring or exactly what to do about it, but you, dear reader, are not asleep with the sheep!

"Tell me the fairytale about the economy."

Bubblequake! First a Rising Bubble Economy, Now a Falling Bubble Economy

The first thing you need to know about our current and future economic problems is that they didn't start yesterday. It all started decades ago with a combination of declining productivity growth beginning in the 1970s, coupled with a growing propensity to run big government deficits beginning in the 1980s.

Please understand that, in and of itself, running big deficits is not necessarily a bad thing. In fact, there are times when borrowing big money is really quite smart. For example, you might borrow a large sum of money to start a profitable business or to go to medical school, which among other benefits can increase your real wealth in the future. But this big government borrowing was not the equivalent of starting a profitable business or going to medical school, and it did not lead to increasing the nation's *real* wealth in the future. Instead, we just borrowed money to buy things we wanted without having to raise taxes—the equivalent of being able to go shopping with a credit card without having to get a better-paying job.

Now, to be fair, the $1 trillion federal debt in 1982 really wasn't that much compared to today's nearly $16 trillion federal debt, but the relatively small annual federal budget deficits in the 1980s were significant because they were the early beginnings of the big federal borrowing and big deficit spending that would come later.

Of course, at the time, no one was too worried about the beginnings of big federal borrowing and deficit spending in the 1980s. In fact, the U.S. economy grew nicely over the next couple of decades, with a 260 percent increase in U.S. gross domestic product (GDP) from 1980 to 2000. And asset values, such as stocks, bonds, and real estate grew even faster.

However, there was a hidden driver behind much of this rapidly rising abundance: *bubbles!*

What Is a Bubble?

This should be a relatively easy question to answer, but, believe it or not, there is no academically accepted definition of a financial or economic bubble. For our purposes, we define a bubble as an asset value that temporarily rises and eventually falls, primarily due to changing investor psychology rather than due to underlying, fundamental economic drivers that are sustainable over time.

Before it is a bubble, an asset value may first begin to rise because of real fundamental economic drivers, such as when population growth pushes up the demand for housing and therefore the price. But at some point, the impact of the underlying fundamental driver has a diminishing effect and hopeful investor psychology takes over, pushing the asset value temporarily higher, creating a bubble.

In the course of history, asset bubbles have varied greatly in their causes, duration, height, and crash impact, but one thing has remained absolutely constant about all bubbles of every type and size: *they all eventually pop.* By definition, if it is a bubble, what goes up must come down. That is the economic reality that no bubble can escape. *Gravity happens.* It's only a matter of time.

Because bubbles go up primarily due to investor psychology rather than due to fundamental economic drivers, all it takes for a bubble to fall is a significant enough change in investor psychology. What makes investor psychology change significantly? Investor psychology changes when enough people figure out that they have bought into a bubble, leading to a sell-off and a bubble pop. If it weren't really a bubble, the deep sell-off wouldn't last. Nonbubble asset values can certainly drop, but the underlying fundamental economic drivers would still be in place and eventually investors would soon return to buy back the asset, stopping its fall. Only bubbles pop; nonbubbles may fall but eventually recover.

Is it possible to stop a bubble from falling or to reinflate it once it falls? The short answer is no. You cannot indefinitely prevent a popping bubble from popping, nor can you push it back up and keep it up once it fully pops.

However, the longer, more nuanced answer is yes and no. While we can't permanently prevent a bubble from popping, we can *delay* it from falling and even push it back up a bit with a lot of resources and artificial stimulus. As we will see later in this chapter, that is only temporary and often leads to a much bigger bubble crash down the road.

Why doesn't artificial stimulus work to *permanently* reinflate a bubble? Because, generally speaking, you cannot fool the same people twice, and even when you can fool the same people twice, you cannot fool them for as long. For example, if you were among the investors who lost money when the Internet bubble popped, how willing have you been since then to buy stock in technology companies that show no profits? Investors do generally learn and move on.

However, with massive amounts of artificial stimulus (like massive money printing by the Federal Reserve), it is possible for a falling bubble to defy gravity and temporarily rise again. But because of the enormous costs, massive stimulus cannot continue forever. Eventually, the stimulus has to stop and gravity wins. So, for various reasons, including artificial stimulus, a popping bubble may not go down in a straight line. Instead, it may pause in its descent or even lift up for a while, but in the end *down* is its destiny.

How to Spot a Bubble

How can we know if an asset value is rising primarily due to positive investor psychology (speculation leading to a bubble), rather than due to underlying, fundamental economic drivers that are sustainable over time (real growth)?

While it is not always easy, it is possible to analyze and identify a not-yet-popped bubble if you are willing to stay rational and objective, and not get caught up in wishful thinking. It is human nature to want to believe in a rising bubble, especially when it is a bubble that you profit from or depend on. The only way to see a bubble that has not yet fully popped is to make a firm commitment to clear-eyed logic. *You cannot stay asleep with the sheep.*

As we pointed out in our earlier books, there are two important truths about bubbles.

Bubbles Are a Lot Easier to See *After* They Pop

and

The Hardest Bubble to See Is the One You're In

Throughout the ages, asset bubbles have always been largely invisible right up until the end. For example, no one could see the Dutch tulip bubble before it popped in 1637. Virtually no one saw through the appealing South Seas stock bubble until it burst in 1720. Investors were not the least bit worried about the great Florida land boom in the 1920s until the property values crashed back to earth, just as few people concerned themselves about the intoxicating stock market boom of the 1920s until it evaporated into the crash of 1929 and the Great Depression. And more recently, precious few investors and analysts recognized the irrational exuberance of the Internet stock bubble in time to get out before it popped in 2000.

Looking back, these examples of past bubble booms and busts seem so obvious now, don't they? Of course, it makes no logical sense to overpay for tulips, buy swamp land in Florida, or invest in dot.com companies with no profits, but at the time, all these seemed perfectly plausible, even desirable to investors. Regardless of the time, place, or type of asset in question, all bubbles share this common feature: positive investor psychology pushes the bubble up, and negative investor psychology pushes the bubble down.

Here is the typical bubble-up, then bubble-down pattern:

- An asset value begins to rise due to some underlying, real economic drivers that begin to boost demand and therefore the price.
- As the asset value begins to rise, investor psychology begins to rise as well, leading to some investor speculation about the future value of the asset.

- Investors become even more interested in owning the rising asset, pushing up the price.
- More and more investors take notice and want to buy in before the asset price rises even further.
- As the bubble approaches its peak, some investors become anxious about future growth and sustainability, which leads some investors to increase their profit taking (selling the asset).
- Other investors take notice and become anxious or at least do not feel as positive about owning the asset, also deciding to sell.
- The asset price no longer rises and begins to decline.
- Positive investor psychology is increasingly replaced with neutral or negative investor psychology, sparking a larger sell-off.
- A critical level of negative investor psychology is reached, a mass exit begins, and the bubble pops.
- Most people cannot exit quickly enough and most of their assets go to Money Heaven.

After the fact, it all seems so terribly obvious, doesn't it? However, this pattern is anything but easy to recognize *before* a bubble pops. Not-yet-popped bubbles are amazingly difficult to see. Why? Because we don't want to see them! We want the big run-up in prices to be real and sustainable, not a bubble. It takes a firm commitment to logic to see a bubble before it pops.

Now let's take a clear-eyed look at our current bubbles, the ones that have been working together to help push up the U.S. economy over many years, and more recently have started to deflate and lean heavily on each other, helping to push down the falling U.S. economy as they pop.

America's Bubble Economy

The U.S. economy has been such a strong and prosperous powerhouse for so long, it's difficult to imagine anything else. Our goal is not to convince you of anything you wouldn't conclude for yourself, if you had the right facts. Most people don't get the right facts because most financial analysis today is based on preconceived ideas about a hoped-for positive outcome. People want analysis that says the economy will improve in the future, not get worse. So they look for ways to create that analysis, drawing on outdated and incorrect ideas, such as repeating "market cycles," to support their case. Such is human nature. We all naturally prefer a future that is better than the past, and luckily for many Americans, that is what we have enjoyed for many years.

Up until a few decades ago, we grew our rising economic prosperity the old-fashioned way: by increasing real productivity. We laid railroad track from coast to coast that led to an explosion of trade. We invented cars and airplanes that changed how we lived and did business, and that impacted economies around the world. It wasn't all perfect, but rising productivity growth worked like Miracle-Gro on the rising U.S. economy.

Then something changed. Instead of rising productivity growth, real productivity growth began to slow down in the 1970s. In addition to declining productivity growth (and perhaps in some ways because of it), we also began to borrow massive amounts of money. Please do not waste precious time assigning political blame. Over the years, presidents and congressional leaders from both parties participated in this orgy of borrowing and deficit spending. Love or hate what we spent the money on, the fact is we have been borrowing and spending a whole lot of OPM (other people's money) since the early 1980s.

And please don't just blame the politicians. All this public borrowing and spending by governments was accompanied by plenty of private borrowing and spending by businesses and consumers. Plus, there were plenty of investments in what would eventually become asset bubbles, all combining to give us what we call America's Bubble Economy (spurring us to publish a book by that name in 2006).

To quickly review, we identified six colinked, economy-boosting bubbles that together helped boost the rising multibubble economy in the 1980s and 1990s. Since 2006 (with the popping of the real estate bubble), these bubbles have been deflating and falling, each putting increasing downward pressure on the others. These are . . .

The Real Estate Bubble

Now that it is partially popped, the real estate bubble is easy to see. As shown in Figure 1.1, from 2000 to 2006, home prices grew almost 100 percent.

If nothing else, looking at Figure 1.2 on inflation-adjusted housing prices since 1890, created by Yale economist Robert Shiller,

Figure 1.1 Income Growth versus Housing Price Growth 2001–2006

Contrary to what some experts say, the earlier rapid growth of housing prices was not driven by rising wage and salary income. In fact, from 2001 to 2006, housing price growth far exceeded income growth.

Source: Bureau of Labor Statistics and the S&P/Case-Shiller Home Price Index.

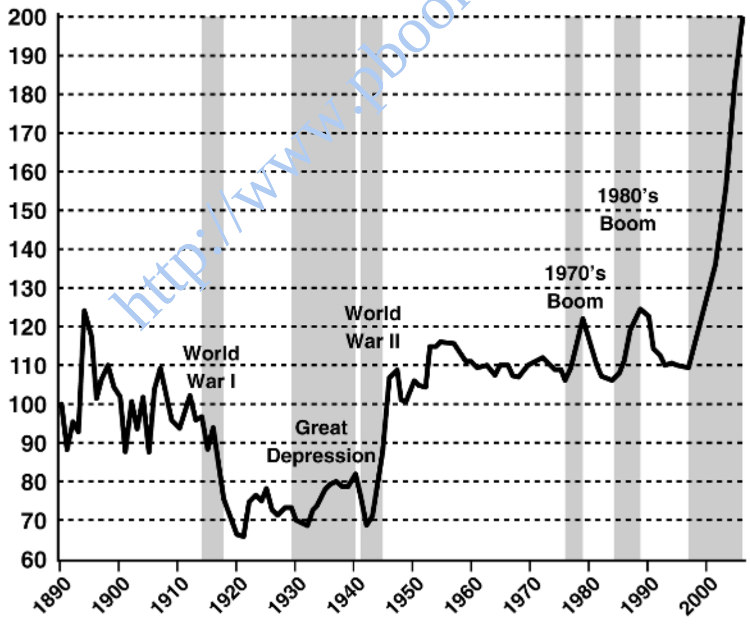

Figure 1.2 Price of Homes Adjusted for Inflation Since 1890

Contrary to popular belief, housing prices do not ordinarily rise rapidly. In fact, until recently, inflation-adjusted home prices haven't increased that significantly, but then they just exploded after 2001 (1890 index equals 100).

Source: Irrational Exuberance, Second Edition, 2006, by Robert J. Shiller.

should make anyone suspicious that there was a very big real estate bubble in the making. Note that home prices barely rose on an inflation-adjusted basis until the 1980s and then just exploded in 2001.

According to the Case-Shiller Home Price Index, while the inflation-adjusted wages and salaries of the people buying the homes went up only 2 percent for the same period (according to the Bureau of Labor Statistics), home prices shot up. The rise in home prices so profoundly outpaced the rise of incomes that even our most conservative analysis back in 2005 led us to correctly predict that the vulnerable real estate bubble would be the first to fall. (We have a lot more to say about what's ahead for the housing market in Chapter 6, and it's not what the economic cheerleaders want you to think.)

The Stock Market Bubble

The stock market bubble is one of the easiest, most obvious bubbles to spot, yet so very difficult for most people to see. Stocks can be analyzed in so many different ways. We find the state of the stock market is easier to grasp by looking at Figure 1.3. If this doesn't

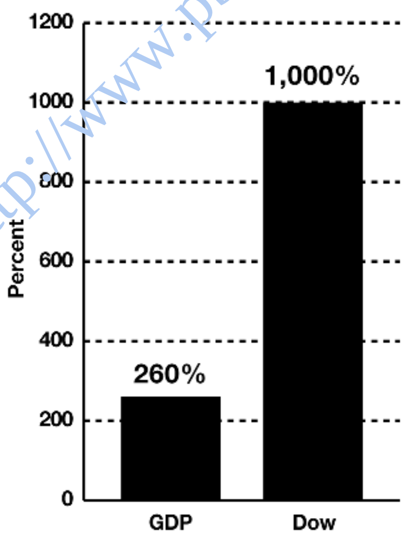

Figure 1.3 GDP up 260 Percent, Dow up More than 1,000 Percent, 1980–2000

The stock market rose almost four times as much as the economy grew from 1980 to 2000. That's a good indicator of a bubble.

Source: Dow Jones and Federal Reserve.

convince you that there was a stock bubble, we don't know what will. From 1980 to 2000, GDP rose a very decent 260 percent. However, the U.S. stock market, as measured by the Dow Jones Industrial Average, leaped up an astounding 1,100 percent!

We call that a stock market bubble! It looks even more out of line when you consider that the population of the United States grew only 25 percent from 1980 to 2000. Given that population growth is one driver of GDP growth, and given that GDP growth is the fundamental driver of corporate earnings growth and therefore stock prices, we would more or less expect to see the Dow rise about as much as GDP, which was about 260 percent. A 1,100 percent rise in the Dow is a giant flag, spelling out the word *B-U-B-B-L-E*.

Shown in a different way in Figure 1.4, the value of financial assets as a percentage of GDP held relatively steady at around 450 percent from 1960 to 1980. But starting in 1981, financial assets as a percentage of GDP rose to *more than 1,000 percent* by 2007, according to the Federal Reserve. We call that prima facie evidence of both a stock market bubble and a real estate bubble.

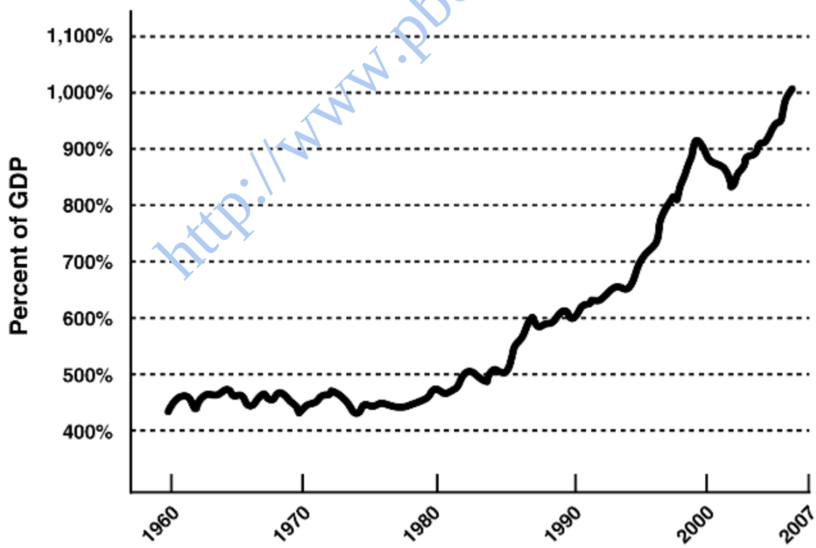

Figure 1.4 Rise of the Financial Assets Bubble: Financial Assets as a Percentage of GDP

The exploding value of financial assets as a percentage of GDP is strong evidence of a financial asset bubble.

Sources: Thomson Datastream and the Federal Reserve.

The Private Debt Bubble

We can simplify the complex private debt bubble by seeing it as essentially a derivative bubble, driven by two other bubbles: (1) the rapidly rising home price bubble; and (2) the rapidly rising stock market bubble, which combined to make for a rapidly growing economy. In both cases, lenders of all forms (not just banks) began to feel very comfortable with the false belief that the risk of a falling economy had been essentially eliminated, and the risk of any type of lending in that environment was minimal. This fantasy was supported for a time by the fact that very few loans went into default. Certainly, at the time we wrote our first book (one year before its publication in 2006) commercial and consumer loan default rates were at historic lows.

The problem was not so much the amount of private debt that made it a bubble, but taking on so much risky debt under the false assumption that nothing would go wrong with the economy. For us, it was easy to see even in 2006 that if the value of housing or stocks were to fall dramatically (as bubbles always eventually do), a tremendous number of loan defaults would occur. We felt the private debt bubble was an obvious derivative bubble that was bound to pop when the real estate and stock market bubbles popped.

The Consumer Discretionary Spending Bubble

Consumer spending accounts for about 70 percent of the U.S. economy. A large portion of consumer spending is discretionary spending, meaning it's optional (how big a portion depends on exactly how you define *discretionary*). Easy bubble-generated money and easy consumer credit made lots of easy discretionary spending possible at every income level. When the real estate stock market, and private debt bubbles began to pop and people started losing their jobs or were increasingly concerned they might, consumers began to reduce their spending, especially unnecessary, discretionary spending.

This is typical in any recession, but this time the effect has been much more profound for two key reasons. First, the private debt bubble allowed consumers to spend like crazy because of huge growth in housing prices and a growing stock market and economy, which gave them more access to credit than ever before, via credit cards and home equity loans. As the bubbles popped, that credit started drying up, and so did the huge consumer spending that was driven by it.

Second, much of our spending on necessities has a high discretionary component, which is relatively easy for us to cut back. We need food, but we don't need Whole Foods. We need to eat, but we don't need to eat at Bennigan's or Steak & Ale (both now bankrupt). We need refrigerators and countertops, but we don't need stainless steel refrigerators and granite countertops. The list of necessities that can have a high discretionary component, complete with elevated prices, goes on and on. And, of course, there is a lot of other discretionary spending, beyond necessities, such as entertainment and vacation travel.

The combined fall of these first four bubbles—housing, stock market, private debt, and consumer spending bubbles—make up what we call the Bubblequake of late 2008 and 2009. Unfortunately, our troubles don't end there. Two more giant bubbles are about to burst in the coming Aftershock.

The Dollar Bubble ("Airbag" Number 1)

Perhaps the hardest reality of all to face, the once mighty greenback has become an unsustainable currency bubble. Due to a rising bubble economy, investors from all over the world were getting huge returns on their dollar-denominated assets. This made the dollar more valuable but also more vulnerable. Why? Because we didn't really have a true booming economy based on real underlying, fundamental economic drivers. We had a rising multibubble economy. Therefore, the value of a currency in a multibubble economy is linked not to real, underlying, fundamental drivers of economic growth (like true productivity gains), but to the rising and falling bubbles. For many years our dollars rose in value because of rising demand for dollars to make investments in our bubbles. More recently, demand for U.S. dollars has remained pretty strong, especially in light of the current European debt crisis. But that strength will wane as the falling bubbles lead to falling demand for dollars, despite all kinds of government efforts to stop it.

In our effort to stop the fall of our multibubble economy, the government has created two giant "airbags" to cushion the falling bubbles. The first airbag is the dollar bubble, created by massive money printing by the Federal Reserve. The Fed has been printing massive amounts of new money through their program of

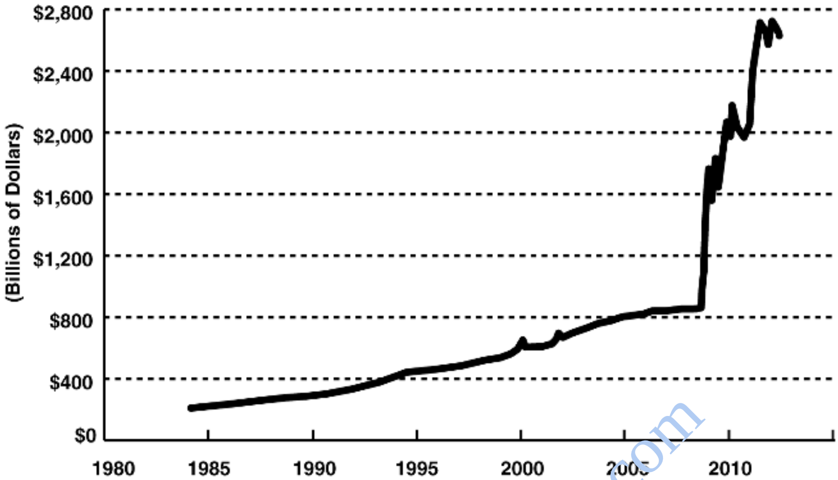

Figure 1.5 Growth of the U.S. Monetary Base

Money printing basically kept pace with economic growth until financial crisis, when it exploded in 2009.

Source: Federal Reserve.

quantitative easing (QE). Two rounds of massive money printing (QE1 and QE2) have increased the U.S. money supply from $800 billion in March 2009 to nearly $3 trillion in 2012 (see Figure 1.5). This massive amount of money printing (the dollar bubble) will eventually cause significant rising inflation.

Future Inflation Will Cause Rising Interest Rates In and of itself, rising inflation would not be so bad if the only consequence were rising prices and wages. But rising inflation also eventually causes *rising interest rates* (see *Aftershock*, Second Edition, for more details), and rising interest rates will have a very negative impact on the rest of the bubbles and the economy.

Rising interest rates will certainly be a big downer for the bond market (bond values drop as interest rates rise), as well as the real estate market (housing is not improving much now, even with mortgage rates at record lows).

Higher interest rates also mean consumers will buy less on credit, if they even qualify for credit cards and loans, further depressing consumer spending, on which 70 percent of the U.S. economy depends.

And, of course, rising interest rates will also mean that businesses will borrow less money, buy less inventory, hire fewer workers, and generally expand less. That will negatively impact employment, which will negatively impact consumer spending, reduce company earnings, and lower stock values.

Even without the already falling bubbles, rising interest rates would not be good for a nonbubble economy recovering from a recession. For a falling bubble economy, rising interest rates will be the beginning of the final multibubble pop. While that is still off in the future, when it finally occurs, it will not take long for U.S. stocks, bonds, real estate, and other dollar-denominated assets to drop. Many investors, including many foreign investors who now own an enormous amount of U.S. assets (see Figure 1.6) will not want to hold on to these declining investments. Foreign investors don't have to all run away at once to cause a big downward drop in dollar-denominated assets. Even a significant decline would do the trick. And, of course, domestic investors will not want to stick around either.

With inflation and interest rates rising, and even more money printing likely in the future as the Fed tries to support the falling bubbles with more quantitative easing, it is only a matter of time before the big dollar bubble pops.

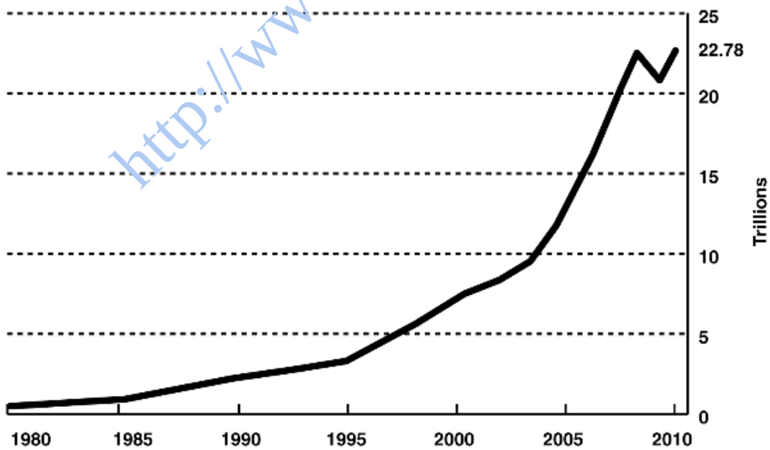

Figure 1.6 Growth of the Foreign-Held U.S. Assets

Part of what fueled our bubble economy in the 1980s and 1990s was massive inflows of capital from foreign investors, which grew from less than a trillion dollars in 1980 to $22.78 trillion in 2010. We remain highly vulnerable to their continued support.

Source: Bureau of Economic Analysis.

The Government Debt Bubble ("Airbag" Number 2)

In addition to massive money printing (the dollar bubble), the government has pumped up another enormous airbag to temporarily cushion the falling bubble economy. Weighing in at more than $8.5 trillion when our 2006 book was published and now (2012) nearing $16 trillion, the whopping U.S. government debt bubble, as shown in Figure 1.7, is currently the biggest, baddest bubble of all. Much of this debt has been funded by foreign investors, primarily from Asia and Europe. But as our multibubble economy continues to fall and the dollar starts to sink, who in the world will be willing—or even able—to lend us more?

From Boom to Bust: The Virtuous Upward Spiral Becomes a Vicious Downward Spiral

On the way up, the six conjoined bubbles described above helped co-create America's booming multibubble economy. In a seemingly virtuous upward spiral, the inflating bubbles helped the United

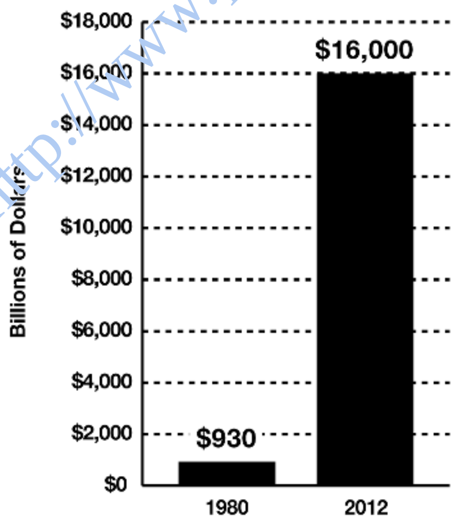

Figure 1.7 Growth of the U.S. Government's Debt

The U.S. government's debt is massive and growing rapidly. With no plan and little ability to pay it off, the debt is quickly becoming the world's largest toxic asset.

Source: Federal Reserve.

States maintain its status as the biggest economy the world has ever known, even in the past few decades, when declines in real productivity growth could have slowed our expanding economic growth. Instead, these bubbles helped us ignore slowing productivity growth, boost our prosperity, disregard some fundamental problems, and keep the party going.

Not only did the U.S. economy continue to grow and remain strong, but the rest of the world benefited as well. Money we paid for rapidly increasing imports boosted the economies of developing countries like China and India. First World economies benefited from America's Bubble Economy, as well. Because of our rising bubbles, developed economies, such as Japan and Europe, were able to sell us lots of their cars and other high-end exports, which helped their home economies prosper. The growing world economy created a rising demand for energy, pushing up oil prices, which made some Russian billionaires, among others, very happy. Growing demand for minerals, like iron, oil, and copper, pumped money into every resource-producing country. For example, China's and India's expanding appetite for steel boosted iron ore exports from Australia, lifting their economy. All combined, America's rising bubble economy helped boom the world's rising bubble economy.

Now, as our intermingled global party bubbles are beginning to deflate and fall, the virtuous upward spiral has become a vicious downward spiral. Linked together and pushing hard against each other, each time a bubble begins to sag and pop, it puts tremendous downward pressure on the rest.

First the Bubblequake, Next the Aftershock

As we said earlier, the first four of the six bubbles—real estate stock, private debt, and discretionary spending—have begun to pop, creating the beginning of what we call the Bubblequake. In response, the federal government and the Federal Reserve have been pumping up the remaining two bubbles—the dollar and government debt bubbles—with massive money printing and massive deficit spending since early 2009 in a dramatic attempt to stop the falling bubbles and to boost the overall economy. This massive stimulus spending and especially the massive money printing have been helping *in the short term* to temporarily boost the stock market and keep the overall bubble economy from sagging further.

But this massive stimulus cannot continue forever, and in the longer term, the bubbles will continue to fall. Not only will the massive stimulus eventually have to end, it will actually make our bubbles crash even harder when they finally do pop. Continued use of massive stimulus is like using a powerful short-term drug that will later become a toxic poison. The stimulus itself will later make the future crash all the worse.

It is important to understand that the Bubblequake problems we are now facing are due to much more than merely a popped real estate bubble. If all we had was a burst real estate bubble, it would not have created so much financial pain here and around the globe. In addition to the real estate bubble, the private debt bubble and the stock market bubble also began to fall. These Bubblequake problems are not going to be permanently resolved anytime soon, not even with the temporary boost from massive stimulus spending and massive money printing. Rather than a real economic recovery, the combination of sagging bubbles and the future poisonous consequences of the massive stimulus will put increasing downward pressure on our entire bubble-based economy.

Once our last two bubbles—the dollar and government debt bubbles—finally burst, we will enter the next phase, what we have dubbed the Aftershock, in which all our asset bubbles will burst and the U.S. economy will fall dramatically.

It's Not Just America's Bubble Economy—The World Has a Bubble Economy, Too

When America's bubble economy fully pops, so will the world's bubble economy. Why? Because all these bubbles are *linked together*. On their way up, each supported and fueled the others; and on the way down, each falling bubble will put increasingly downward pressure on the rest.

For example, the real estate boom in the United States created a consumer spending orgy here that helped fuel China's rapid economic growth and boomed China's own real estate bubble. To keep up with growing demand for their exports, China in turn has been buying more natural resources from other regions, such as South America. But when our real estate bubble began to pop and U.S. consumer spending dropped a bit, China's growth also began to cool down over the past few years, although it is still growing, just at a slower rate. In the coming Aftershock, when U.S. consumers will buy much less than they do today, China's bubble economy will take a deep hit, which will then spill over to South America, Australia, and other places that currently supply China's commodities demand.

Meanwhile, back in the United States, stocks, bonds, real estate, consumer spending, and government spending will be down, inflation and interest rates will be up, and the bubble economy will be over. In the coming Aftershock, the global multibubble crash will kick off a deep, long-term downturn here and around the globe.

Please understand that we are not intrinsically pessimistic or doom-and-gloomy by nature. We are not driven by any particular political agenda, left, right, or sideways. We are not fanatical gold bugs (although we think gold will do quite well). And we are not paranoid survivalists who think you should run out and build a fallout shelter filled with two years' worth of food. We are just calling it as we see it, based on facts and rational analysis, and we would like to help you see it, too, while there's still time to protect your assets and prepare.

All Dogs Go to Heaven, and So Will a Whole Lot of Money!

People often ask where the massive amount of investment capital in stocks, bonds, and real estate will go in the future. The answer is Money Heaven. Most investment money will go to Money Heaven in the future because most people won't pull their money out of falling stocks, real estate, and bonds soon enough. Anyone who doesn't move money out early won't be able to move it out at all. That's because other people will have moved their money out of those investments earlier, most importantly, and there will be little demand for those investments afterwards. Hence, the values of most people's investments will decline dramatically.

At that point most people will realize they should have moved their money out, but it will be too late. Their portfolios will have been automatically rebalanced for them, heavily weighted toward Money Heaven. For the money managers and financial advisers who will preside over this reweighting of investors' portfolios into Money Heaven, it's going to feel a lot less like Money Heaven and a lot more like Money Hell.

Why Don't We Have the Aftershock Right Now? Temporary "Airbags" Are Supporting the Other Partially Popped Bubbles

Question: We have four falling bubbles but they are not yet fully popped. What is keeping these bubbles partially inflated?

Answer: The pumping up of the final two bubbles!

The easiest way to understand the economy right now is to look at it as a set of deflating bubbles (stock, real estate, private credit, and consumer spending) whose fall is being cushioned by the rapid inflation of the two final airbag bubbles: the dollar bubble and the government debt bubble. By rapidly pumping up these two bubbles, the government is temporarily postponing the fall of America's multibubble economy. Because they are cushioning and supporting the other bursting bubbles, we like to think of these last two yet-to-pop bubbles as America's airbags—they are preventing a dangerous crash for a while, but eventually they, too, will fall. When these final airbags overinflate and burst, the rest of our bubble economy will burst, bringing on the global Aftershock. But, these airbags aren't going to pop immediately and that's why we don't have the Aftershock right now.

Airbag #1: Massive Government Borrowing

Massive government borrowing (the government debt bubble) is boosting the economy. In fact, most of the growth in the economy since the financial crisis has been directly related to the massive 500 percent increase in federal government borrowing since 2007. And let's not forget that the U.S. deficit wasn't exactly tiny in 2007, when it was already weighing in at $170 billion. Now our deficit is nearing *$1.2 trillion*/year. That is a big fat government debt bubble becoming a truly colossal government debt bubble.

Naturally, with the country awash in so much deficit spending, the not-yet-popped government debt bubble is acting like a still-inflated, protective airbag, keeping the other bubbles from fully falling. Surely, had we not borrowed and spent all that extra money, the U.S. economy would be in far worse shape today. The problem is, airbags eventually pop, too. By pumping up this protective airbag so gigantically, it will only make the future crash all the bigger.

Airbag #2: Massive Money Printing

Massive money printing (the dollar bubble) by the Federal Reserve, mostly in the form of quantitative easing or QE, has also been acting as an airbag, keeping the U.S. and world economies protected from the popping bubbles. Massive money printing has worked like Viagra to reinvigorate the stock market bubble whenever it shows signs of deflating. This temporary lift to the stock market also indirectly boosts the rest of the consumer-based economy. Stock investors spend more when their portfolios are up, and studies show that even people who own no stocks spend more when the stock market is doing well. So massive money printing has been doing its temporary airbag job, first with QE1 and QE2 (2009–2011), and next with more money printing ahead.

But the Airbags Only Postpone the Inevitable

The trouble with pumping up America's airbags (the dollar bubble and government debt bubble) is that it is just a short-term fix. And worse than being just a short-term fix, it is a short-term fix that comes at an incredibly high long-term price. We're not just kicking the can down the road—we're just piling up sticks of dynamite in the can that will cause an even more massive explosion when we can kick the can down the road no further.

Rising Future Inflation Is Key

When the airbags fail, all the bubbles will pop. What will cause the airbags to fail? *Rising future inflation.* In a terribly ironic twist, the very things we are doing to support the economy (by printing money and borrowing money) will lead to what eventually pops these airbags and causes the rest of the bubbles to fall even harder. (For more details, please see *Aftershock*, Second Edition.)

Right now, we can keep on borrowing (pumping up airbag #1, the government debt bubble) as long as we can keep on printing money (pumping up airbag #2, the dollar bubble). Massive money printing keeps interest rates low so we can keep borrowing. We will keep printing money to fund our borrowing for as long as we can print money *without creating inflation.* As long as inflation remains low, as it is today, America's airbags can continue to keep America's Bubble Economy from fully popping. Rising future inflation (and the rising interest rates it will cause) can be avoided for a while longer, but rising inflation cannot be avoided forever. We simply cannot increase the money supply threefold, with even more money printing to come, and not eventually get some very significant inflation.

Rising inflation will force interest rates higher, whether the Fed likes it or not. The Fed can't control interest rates once we have significant inflation. Printing money can solve many of our ills short term, but one ill it can never solve is inflation. That inflation will push up interest rates, and rising interest rates will devastate the stock, bond, and real estate markets, and all the bubbles will fall.

Inflation is key. When rising inflation and rising interest rates force the airbags to fail (i.e., when we can do no more money printing and borrowing), all the bubbles will fall. Until then, the airbags will hold off the coming Aftershock right up until they no longer work.

Why Don't Most Conventional Investors See This Coming?

The reasons for the current widespread bubble blindness by conventional investors are many. They include:

- A deep faith in "the myth of the natural growth rate" that is supposed to guarantee us continued economic growth no matter what. (The myth of the natural growth rate is described in detail in Chapter 3.)
- Denial: Human psychology makes it difficult to think rationally in the face of things we don't want to be true. (Investor psychology is also addressed in Chapter 3.)
- What we call "The Hamptons Effect": Conventional investors and analysts desperately need the current status quo (from which they greatly benefit) to continue; otherwise, they will lose everything: their jobs, wealth, homes (in the Hamptons, for example, for wealthy New York investors), social status, and so on. These people will fight to the end to keep what they have, even if that means complete bubble blindness. If you are counting on blind people to guide you, we suggest you keep your expectations low.

What's a Savvy Aftershock Investor to Do?

The deadly combination of declining productivity and the multi-bubble economy is giving us massive debt, massive money printing, future rising inflation and interest rates, falling assets bubbles, and an increasingly dangerous investment environment. Conventional wisdom on investing, such as the buy-and-hold value investing practiced by Warren Buffett, for example, will not hold up well under these worsening conditions. Instead of conventional wisdom, we need a new kind of Aftershock wisdom (see Chapter 3) for a new way of investing (see Chapters 4 to 11) that will guide you to and through the coming Aftershock. Ignore this new Aftershock wisdom at your peril.

The key to Aftershock wisdom for successful investing is to ignore the economic cheerleaders and stay focused on what really matters: *inflation*. Rising future inflation and future rising interest rates pose the biggest threat to the future health of your portfolio. Not too many people are worried about inflation and interest rates right now because both are remarkably low and pose no immediate threat. But rising inflation and rising interest rates will strike the final blow to the vulnerable dollar and government debt bubbles, and will send your hard-earned assets to Money Heaven faster than you can log onto your online brokerage account and hit "Sell!"

The rest of this book is entirely focused on helping you protect your wealth, whether it is $200 or $200 million. But there is only so much we can tell you in a book. This is an evolving economy and investment environment, and therefore the actions you take must also evolve over time. Beyond our books, you can keep up with us through our newsletters, or invest with us, and you will see each step we take as the Aftershock approaches. With or without our help, please understand that you must keep up with changing economic conditions in order to correctly manage and protect your assets in this increasingly dangerous investment environment.