

Memorandum

To: Members and Friends of the GA 400 Think Tank
From: Mark Wyssbrod, Managing Member
Date: December 16, 2010
Re: Mental Status On Economic Activity

Bill Gross told CNBC on December 2, 2010 a repeated message, "the nation is mired in an economic slump that will be hard to fix considering a mindset that is not looking toward the future." Mr. Gross is not far off of the reality. Paul Volcker repeated his warning last week that the US is "in the most difficult economic circumstances of the post-World War II era and so is almost all the developed world." Mr. Volcker continues his position by stating instead of being a single super-power, both economically and military, the US is now faced with a broken financial market system, underperformance of our economy and a fractious political climate.

We, of course, are additionally bombarded with the negativity of other news sources. What we see and hear does influence our economic behavior. As our news sources are negative and full of fear as well as political leaders from both major parties mention depressions and major recessions, the consumer has responded with panic, risk avoidance and erratic spending patterns, similar to an individual on a crash diet. This is the opposite of the information we were given by the news networks, economics and politicians several years ago when extreme risk was taken nonchalantly, debt was free flowing for a fee and greed was ramped, but un-acknowledged.

I do not state these facts to intimidate you or upset you, but to inform you of the reality of our situation. Action is needed and required in order to transition with the new and continuously developing economic forces.

The economic forces include transitioning to a new foundation for our economy. From the 1980's to mid 2000's our economy was based on falling interest rates, favorable tax treatment and low commodity prices. Now our future presents interest rates poised to raise, higher and more complicated taxes, and significantly higher commodity prices. Can we mentally transition into the new economic environment? Can we accept the new rules?

Additionally, we seem to be confused by some of the temporary economic rules. For example, interest rates are supposed to be based on risk of the individual and the risk of the items being acquired. The higher the risk the higher the interest rate! However, the current rules indicate higher risks, but lower rates. You can see this with mortgages by residential real estate being one of the most risky asset classes currently and mortgage rates being at historic lows.

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Our mental status is affecting even the wealthy. There are indications that the wealthy and high income earners are not looking toward the future. In larger cities, such as New York, there is a growing trend to rent at \$10,000 - \$20,000+ per month instead of owning. The decision is due to not believing real estate has bottomed yet, not wanting to tie up cash and cash flow in an illiquid asset, and uncertainty in the future. If such decisions are being made by the wealthy and high income earners, what does this signal for the rest of us? I believe it is a sign that real estate will not be going anywhere, especially compared to inflation, for years. No matter what the signal is this is another challenge the real estate sector is faced with. The solution for this is to make money on the purchase of property, not on the hopes of a sale; location is becoming increasingly more important; and purchase a property for a realistic purpose (i.e. it's a home, not an investment).

Deflation, or the falling of prices, has been talked about a lot in the news. The Federal Reserve policies are anti-deflation or inflationary (increase in prices). However, for most individual and small businesses revenues have fallen, but prices from vendors have increased. There is a disconnect for small businesses from the national economic statistics. We continue to search for and wonder where the deflation for small businesses and individuals is. I believe the deflationary effects we hear about are from the continued decrease in the price of the housing values. However, grocery and energy prices have increased as wages has stalled. The average individual is not feeling the deflationary effects, but is faced with inflation at a time prices or income cannot keep pace. The result is lower margins, lower savings and higher financial stress. The solutions are to review operational procedures and stay in budgets. Additionally, the mental state of the consumer is the greatest deals in the world and once in a life time special discounts will remain for the long-term or a lower price will be in the future. This increases the likelihood the consumer will delay purchases. Solution, have a compelling reason for your customer to purchase today. This is not always about price, so we recommend understanding your customers' decision process to be able to influence on other variables.

As an aside; mentally everyone wants a discount or deal. However, we are finding the dangers of deflation when our economy runs on discounts. I am not encouraging you to overpay for goods or services, however, we should recognize that a potential fix to our economy will be the increase in price. Mentally we do not want to pay more, but it may just be the best thing for our economy.

For years small businesses did not have a sustainable business model. Many individuals can compare this to their unsustainable life-styles or funding their lifestyle with debt which I will mention in a moment. However, the business owners' were unaware of their position and deteriorating situation as debt began growing faster than revenues since they were still able to cash flow their business responsibilities and life-styles. The mindset of the nation at this time was the future is bright, why worry? Or, if it ain't broke don't fix it.

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“If it ain’t broke, don’t fix it” the old saying may seem agreeable at first, however, such a mindset is dangerous at best. For if business owner’s allow this mindset to corrupt their business environment they become nothing more than just managers of an un-improving process. Instead, the mindset should be of continuing improvement and innovation. Leadership needs to emerge and triumph over the perpetual stall management we currently have.

For years’ consumers and small businesses spent monies they had not earned. Debt financing, social pressures and human nature influenced behavior from “I need to earn it before I receive the reward” to “I deserve the reward and, perhaps, I will earn it in the future”. The attitude was “I will pay it back in the “better” future”. Well, the future is now and repayment of debt is being forced in one of the most difficult economic environments since World War II. Additionally, the mental status of consumers and small businesses has been one of shell shock. Small business was late in cost cutting initiatives and then when implemented destroyed more value than save. The consumer seems to be spending similar to a person on a crash diet; they are good for a month or so and then they spend, spend, spend! The economic enforcement of living below one’s means instead of above it has cause a huge wave of resentment, perhaps anger, and negativity to invade one’s mindset. Complaining and negative attitudes are contagious.

So what are the solutions? Small businesses need to re-examine their business model and business plan. Is the business sustainable in the long-term? Should the business change strategies or perhaps cease operations, sale or merge? Does the small business have a board of directors to hold the business owner accountable? Is the small business owner able to adjust their attitudes and the attitudes of their team?

My closing thoughts are to be cautious of your surroundings. Being a small business owner is challenging since you need to show a good attitude, be optimistic and be ground to reality. These forces seem to contradict one another often. Negativity can easily sneak into your mindset. You become sarcastic and complain more. Sarcasm may lead to an enjoyable laugh in the short-term, usually at someone’s expense, however, in the long-term sarcasm causes more damage mentally. Additionally, when you spend your time and energy on complaining you are not spending your time and energy on solutions. I was told as a child that it is ok to complain as long as you provide three solutions for every complaint. Mentally and financially you will do better if you focus on solutions.

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