Greenspan and Paulson

Greg's Note: After exiting the public arena, Alan Greenspan has now journeyed into the private sector. Fred Sheehan muses about the connections between Greenspan's handling of the housing bubble, and the personal fortune of the man who just hired him. Is something rotten, or are these two simply grabbing as many headlines as possible. Enjoy, and send your comments to the managing editor here: greg@whiskeyandgunpowder.com

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By Frederick J. Sheehan

The Absent-Minded Doctor

The Wall Street Journal: All three of your clients — Pimco, Deutsche Bank, and now Paulson — were bearish early on housing and mortgages. Is there a connection?

Greenspan: I hadn't [noticed] until you just raised the issue.

— *The Wall Street Journal,* Jan. 15

JOHN PAULSON, UNLIKE HIS NAMESAKE HANK, never entertained a fantasy that home mortgage problems were contained. But then, neither did he live in a neverland in which whatever he said was true. Paid by his clients to make money, not simply to imagine it, his two hedge funds that bet against the housing market rose 590% and 350% in 2007. Paulson earned a personal paycheck of $3 to $4 billion.

Should Paulson & Co. repeat this performance in 2008, former Federal Reserve Chairman Alan Greenspan may join his new boss in the *Forbes* 400. The research department at *Forbes* might check to see if this would be the first public servant to leverage his persona among the modern Fords and Rockefellers.

Paulson hired Greenspan on Jan. 15. *The Wall Street Journal* observed: "Housing and mortgage markets have been of intense personal interest to Mr. Greenspan since the 1960s, and he devoted hours of personal and Fed staff time to the subject. That could come in handy for Paulson."

Paulson has not announced the rookie's duties, but Greenspan plans to introduce his data system, in which he "[analyzes] both new and existing home sales by means of financing." One hopes — or the clients of Paulson & Co. should hope — the seasoned economist has discovered a magic potion that was absent four months ago.

On that occasion, when interviewed on Comedy Central by Jon Stewart, Greenspan admitted that models don't work: "I've been dealing with these big mathematical models of forecasting the economy…I've been in the forecasting business for 50 years…I'm no better than I ever was, and nobody else is. Forecasting 50 years ago was as good or as bad as it is today. And the reason is that human nature hasn't changed. We can't improve ourselves."

Should Greenspan's models regress to his 50-year average, clients may look at their 2008 returns with the same dejection expressed by Stewart: "You just bummed the [bleep] out of me."

Paulson may suggest the man who modeled variable-rate mortgages for the masses leave his briefcase at home. Greenspan's Jan.15 interview with *The Wall Street Journal* carried the title "Subprime Sales May Be Near Bottom." The hedge-fund manager gave a recent presentation with the title "The Worst Is Yet to Come." He predicts, "It will take years for home prices to recover."

Paulson seems more interested in the ex-Maestro's broader view: "Few people, if any, in the world have the breadth of experience with, and depth of understanding of, global financial markets as Dr. Greenspan. Anticipating the direction of the economy and assessing the potential for severity of a U.S. recession are fundamental in formulating current investment strategy."

Yet the nation's most successful mortgage salesman has disowned his ability to offer such direction. In March 2007, Greenspan told an audience he "doesn't believe that [forecasts]…can be accurately made in the near term. 'We really can't forecast' the economy over the next two years, he said."

The "Three Billion Dollar Man" should trust his own instincts. In mid-2005, when the housing market was near its peak, Paulson knew the bubble was about to pop. He told one of his colleagues: "We've got to take as much advantage of this as we can." Alan Greenspan, then chairman of the Federal Reserve, acclaimed by a lengthy list of economists as the greatest central banker who ever lived, told *60 Minutes* in 2007 that he did not understand the consequences that low adjustable-rate mortgages posed: "I really didn't get it until very late in 2005 and 2006."

Nor has he shown much foresight since. On Oct. 26, 2006, Greenspan announced: "Most of the negatives in housing are probably behind us." He predicted the housing slump is "likely past."

Greenspan may not be quite the rube he appears: Exactly one week later, this opinion was expertly choreographed into a new National Association of Realtors $40 million advertising campaign. The full-page newspaper ads announced: "It's a great time to buy or sell a house." Greenspan contributed to the sales pitch by assuring the fourth quarter of 2006 would "certainly be better than the third quarter." This prediction was choreographed to the rumble of home-building stocks rolling off a cliff.

While some have suggested Greenspan was hired for his connections, he doesn't seem to get around all that much. At the Brookings Institution in September 2007, he queried, in reference to the subprime explosion: "I ask you if anybody in early June could contemplate what we are now confronted with?" Anyone reading the morning newspapers already knew Paulson's anti-mortgage funds were producing spectacular returns.

Paulson has defended his new hire: "It's easy to look back and do Monday morning quarterbacking. The decisions he made at the time were right." They were right for John Paulson, who explained his own insight: "Most people told us house prices never go down on a national level…Mortgage experts were too caught up [in the housing boom]."

As chairman, Greenspan told Congress (thus, the nation, which hung on his every market prediction) just what Paulson disparaged: "The ongoing strength in the housing market has raised concerns about the possible emergence of a bubble in home prices…the 'national' housing market is better understood as a collection of small, local housing markets. Even if a bubble were to develop in a local market, it would not necessarily have implications for the nation as a whole."

This was exactly the line pushed by every real estate broker confronted with a hesitant prospective homebuyer. If Paulson had paid any attention to Greenspan's opinion, he would not have pursued the course that has made him so rich.

Since Paulson is rooted in the real, rather than the fantastic, Greenspan's opinions probably won't influence portfolio construction. Maybe he hired the global financial wizard for causing such a moneymaking opportunity; he undoubtedly hired him for "access." This was the opinion of every newspaper report when Pimco and Deutsche Bank signed him up.

Newspapers aren't infallible, but the proof is in the discreditable statements made by the firms. Pimco claimed, "This engagement provides Pimco with unique access and insight from the former Fed chairman, whose perspective on financial markets, global economic trends and investor behavior is truly special." (Granted, they are special.) Deutsche Bank CEO Josef Ackermann admires Greenspan's ability to "explain very complicated subjects and situations in simple terms." To cover all possibilities, maybe Greenspan was speaking German all these years.

A final possibility is the modern temptation of fame. Here, the hedge fund manager must be careful. According to *The Wall Street Journal,* "Mr. Paulson has tried to keep a low profile, saying he's reluctant to celebrate while housing causes others pain." He may plan to live vicariously through his protégé, but his new aide-de-camp has lost the instincts that served him so well.

Greenspan controlled the media that elevated him to godlike status. He has forgotten that if the famous don't manage their own publicity properly, the press will magnify every blemish on the way down that they concealed on the way up. A&E's "most fascinating person in 1999" now competes with Britney Spears as a media punching bag. His off-the-cuff criticism of Ben Bernanke — for which Greenspan was rightly rebuked — elicited the most disingenuous of self-justifications: "I was beginning to feel quite comfortable that I was fully back to the anonymity I was seeking."

There have been few government bureaucrats who have craved the footlights as Greenspan did — and does. He needn't fear lack of attention as long as he keeps talking. The economist's poor judgment matches Britney's. Claims from the podium include "I have no regrets" and "A lot of people are going to lose their homes. It's a family tragedy. It's not an economic — or macroeconomic — tragedy." As with Britney, his primary role as Federal Reserve chairman was public entertainer. He shows no signs of disappointing us in this function.

Regards,
Fred Sheehan

Greg's Endnote: With the government all but ensuring that the value of the dollar plunges, wouldn't you like to have a guarantee that something will be able to hold its value? Luckily, that same government has offered you the chance to get in on an investment that is guaranteed never to lose money. Click here to find out how…

Greg's Final Endnote: *Greenspan's Bubbles,* the new book by Fred Sheehan and William Fleckenstein, published by McGraw-Hill, will be available next month. But if you would like to pre-order it now, click here.