Introduction

Res tantum valet quantum vendi potest.

~ Latin for "a thing is worth only what someone else will pay for it."

The year: 1634. The place: Amsterdam, Holland. Tulips were introduced to Western Europe from Turkey in the 16th century and were immediately popular for their varied and unpredictable colors. Unknown at the time, the tulips with more exotic patterns were a result of a virus called *mosaic*. These were scarcer, and thus more valuable, than common uninfected bulbs, which already were selling at a premium. Prices were bid early in the year, but the bulbs were not actually delivered until late summer after the growing season. As the bidding progressed, more people started to jump on the bulb wagon and prices started to rise. Over the next two years, the "artisan" class—the early Dutch equivalent of the working class—saw the tulip trade as a sure-fire way to make some quick and easy money.

In late 1636 and early 1637, demand and prices rocketed and lost all connection to reality. In his *Memoirs of Extraordinary Popular Delusions*, historian Charles Mackay recounts how the price of the common bulb, the Witte Croonen, rose by more than 25 times. As the market frenzied, one fancier agreed to pay a deposit of four cows for a quarter pound of bulbs, with an additional cash payment on delivery. Incredibly, houses and land were sometimes part of the deals and the price of a single exotic bulb rose to 5,200 guilders, about 21 years' salary for a carpenter.

Then—with no direct trigger—prices plunged.

In the first week of February, Witte Croonen fell to one-twentieth of its peak price and over the next few months, overall prices had plummeted some 95 percent. Seventeenth century Dutch speculators were right in believing that tulips would catch on, but they were terribly wrong in assuming they could forever make money by investing in them.

This phenomenon is called a "speculative bubble." A bubble exists if the reason the price is high is only because investors believe that the selling price will be higher tomorrow and fundamental factors do not seem to justify such a price. Speculators jump in to make a quick buck (guilder) with little consideration of risk. This rapidly spirals: a continuous sharp rise in the price of a particular asset, leading to further price increases driven by new speculators, who are seeking profits through even higher prices. According to economist Douglas French, "These higher prices are driven by the potential profits to be made through trading, rather than the earning capacity or economic value of the asset."[37] At the peak of the boom, optimists feel their instincts have been justified. The free fall begins as expectations suddenly change and buyers quickly become sellers in mass. Consequences are often disastrous, with the ensuing crash inflicting severe financial pain, massive worker dislocation, and great numbers of bankruptcies.

BRAIN SNACK: *Speculative bubbles have occurred throughout history and there have been some real doozies.[38] In 1720, the South Sea Company sold exclusive trading rights to all trade with Mexico and South America. Dubbed the "Enron of England," stocks that were traded for 1,000 British pounds in 1711 were reduced to nothing by 1720.[39] In Miami, land bought for $800,000 in 1926 could, within a year, be resold for $4 million before it crashed to pre-boom levels. Precipitating the Great Depression, in 1929 the stock market dropped 40 percent from early September to late October. It bottomed out in 1932, down nearly 90 percent from its high. In possibly the greatest speculative bubble in history, in the 1840s share prices in Britain's railways shot up, peaked in 1845, then collapsed. Investment advisor Sandy Nairn, author of* Engines That Move Markets*, says anyone who invested in railways in 1847 would have had to wait until the end of the century to get their money back.*

Can't happen these days? Wrong. When too much fiber-optic cable was laid to support the 1990s telecom boom, an infrastructure bubble was created. Wholesale prices fell at an annual rate of 60 percent and massacred Internet infrastructure companies. This period also saw a major jump in growth of Internet users, seen by companies as potential consumers. Internet startups were funded based on nothing but "vaporware." In March, 2000 the NASDAQ Composite—the index for technology shares traded on Wall Street—peaked at 5,046 points, double the value of where it was the year before. Two and one-half years later, the NASDAQ hit a low of 1,114 points, a whopping 78 percent loss of value. The implosion of the "dot.com" bubble rocked the financial system.

But these were only warm-ups for the main act. Up to 2006, the housing market in the U.S. was flourishing. Government policies made it easy to get a home loan, so more people wanted to buy a house. Increased demand raised prices, and this attracted "flippers" who were looking for fast turnaround and quick profits. The froth created more demand and higher prices, and while some people could not afford it, lending institutions didn't let that get in their way. Riskier adjustable rate and interest only loans were hyped with no down payment or proof of employment

37 Interestingly, economists Earl Thompson and Jonathan Treussard don't see this as a speculative bubble. Rather, they see tulip-bulb investors as rationally responding to changes in the rules of tulip investing after the Dutch Legislature converted tulip-bulb futures contracts (an obligation to purchase bulbs at a fixed price) into tulip-bulb options (an *opportunity* to do so).

38 Something that is extraordinary; named after the Duesenberg, a luxury car of the late 1920s and 1930s that was renowned for its quality.

39 Sir Isaac Newton is quoted as stating, "I can calculate the movement of the stars, but not the madness of men." Newton's niece Catherine Conduitt reported that he lost twenty thousand pounds in the company, a fortune at the time (equivalent to about $3.75 million today).

required (remember those annoying TV ads?). Whenever someone experienced difficulty making their mortgage payments, they simply borrowed against the value of their house since—huzzah!—it was now worth more! Wall Street firms rolled up huge numbers of these loans like tobacco leaves in a cigar.[40] Independent rating agencies assessed the riskiness of these mortgage backed "fatties" and pitched them as being "savings account safe." Sliced and diced into marketable chunks, they were sold and re-sold to profit-hungry investors—from individuals to big financial institutions—all over the world. Life was delicious for everybody.

Then, property values stopped going up.

Rising prices had masked the consequences of cheap money. Like a neutron bomb, falling prices triggered a devastating chain reaction. People found themselves overextended and began to default on their mortgages. This increased the number of houses on the market. The oversupply and lack of buyers (due to tightened credit) further depressed prices, causing some people to owe more than their property was worth. This produced more defaults. By the time the Wall Street suits started to panic, it was already too late: Titanic was headed for the bottom. In truth, these securities were so complex that no one knew their real value so the whole system froze in fear. Later, when models used by rating agencies to assess risk were found to be flawed, most of these issues ended up worth less than half their initial value.

The irrational exuberance of the real estate bubble brought the world's financial system to the brink of total collapse. Few managed to dodge the bullet and with the smoke still clearing, households lost $13 trillion of wealth. By early November, 2008 the Standard and Poor's 500, a broad U.S. stock index, was down 45 percent from its 2007 high. Housing prices dropped 20 percent from their 2006 peak and in California they fell 33 percent in one year alone. According to a Spectrem Group report, retirement plans lost nearly a quarter of their value during the crisis. This time when the bubble burst, the blood bath was universal.

How the BLEEP! could this happen? Nobel Laureate Robert Shiller (*Economics*, 2013) reckons that "animal spirits" animated investors during the property boom. But urban economist Edward Glaeser argues that bubble behavior is often consistent with investors' reasonable beliefs about the future. What is the lesson for those of us on Main Street? Perhaps the best advice comes from economist Kenneth Rogoff, co-author of *This Time Is Different: Eight Centuries of Financial Folly*: "It's not a matter of could it happen again; it's a matter of when."[41]

Reali-tude:
Beware the phrase, "It's different this time."

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40 This process is called *securitizing* the loans (think of a security as a stock).

41 The enormous level of student debt in higher education is seen by some as the next bubble to burst. Total student debt now exceeds $1 trillion, more than total credit card debt. Critics allege a viciously wasteful circle—the size of the loan pool expands to enable students to pay ever higher fees to schools, whose costs expand because money is coming their way.

The Good

A man has got to know his limitations.
~ Clint Eastwood, actor, director

If you were in school during the 2008 financial meltdown, there is a good chance that you were not directly affected by the turmoil. If you worked through the recovery, however, this wrenching crisis carries a silver lining. Homes are now more affordable if you have good credit. Contributions to your retirement plan bought stocks at cheaper prices than before the crisis. Most of you cut back on discretionary spending and added money to savings.[42] But the single most important benefit is psychological—you now realize that good times are not guaranteed. Life is no bed of roses.

In the midst of the crisis, Congress passed the *Consumer Credit Fairness Act* (2009), designed to protect consumers from abusive practices by credit services companies. As expected, the financial services industry lobbied heavily against passage of the bill. Why? Your fees pay for their bonuses. Some of the protections enacted that affect young persons include:

- *Payment period.* Bills must be sent out 21 days before payment is due. If the due date falls on a holiday or weekend they must accept your payment on the following business day without charging a late fee.
- *Pay highest balance first.* Payments above the minimum amount are applied against the highest-interest balance first rather than against the lowest-rate balance.
- *Banned retroactive rate hikes*. The interest rate you are already charged on any existing balance you carry on the account cannot be increased. New, higher rates apply only to future purchases.
- *No short-lived teasers.* Promotional interest rates must be maintained for at least 6 months and the rate on your card cannot be raised for the first year that you hold an account.
- *Notification time.* Companies must now give you at least 45 days notice before any interest rate, fee, penalty, or finance charges are raised.
- *No card shuffling.* Previously, credit card companies could hike the interest rate charged on your account simply because you made late payments on another card.
- *College students.* With few exceptions, young adults through age 21 must have a parent co-sign on their account and they must request permission for a credit limit increase on their student's card.
- *No bill-pay fees.* Companies can no longer charge cardholders fees to pay their bills on-line by electronic transfer.

42 The U.S. Bureau of Economics tracks a metric known as the personal savings rate; this is the percentage of one's income that's saved rather than spent. In 2005, this was actually negative—more was spent than was earned. In 2008, savings spiked upwards as people were alarmed by the financial crisis, but by the end of 2012 the savings rate was once again precipitously low. Old habits die hard.

Nothing drives change more than bad times and this recession—Generation NeXt's Great Depression—has profoundly transformed the way you live, think, and work. The recession forced NeXters to go head-to-head with older workers for jobs observes business psychologist Debra Condren, author of *Ambition Is Not A Dirty Word*. "What young persons discovered was distinctly old-fashioned. They need to pound the pavement, take less money, and work their way up the ladder, just like the generations before them," she writes. This is a good thing.

BRAIN SNACK: *In their book,* The Fourth Turning, *historians William Strauss and Neil Howe argue that the western world consistently moves in 80-year cycles. Within each cycle are four "turnings." The first turning (*High*) is a heightened sense of community and collective optimism following a period of great crisis, most recently in the U.S. in the mid-1940s through early 60s. The second (*Awakening*) is when society begins to gravitate to more individualistic pursuits and demands that personal interests come first (mid-1960s through early 1980s). The third (*Unraveling*) is a period when individualism, cynicism, and bad manners dominate and institutions are increasingly discredited (mid-1980s through the '90s). Finally, the fourth turning (*Crisis*) is a time of great turmoil, when society's basic institutions are torn down and rebuilt. If their theory is correct, we can look forward to a future first turning period of renewal, collective optimism, and willingness to work together.*

Reali-tude:
Credit services companies make money from your stupidity.

The bottom line:

- You will likely experience several speculative bubbles in your lifetime.
- Once everyone else is "doing it," resist the temptation to join.
- The 2008 financial system meltdown was a valuable life-lesson.
- The stakes are high for Generation NeXt.

The Bad

If we fail to act now to improve economic literacy in this country, our children will be at risk for crippling personal debt, costly decisions at work and at home, and lack competitive skills in a fast-paced global economy.
~ National Council on Economic Education (NCEE)

In an era of intense global competition, being literate about personal economics is very important. Financial writer Helen Myers warns that "An economically literate population is essential to the well-being of our nation. Educating young people in economics and personal finance is one of the smartest things we can do to prepare our next generation of adults." In a report titled *Goodbye to Complacency,* the