Investor Class Civil War: Stewart v. Cramer

Posted by Glenn on March 19, 2009 - 9:01am
Topic: Economics/Finance
Tags: capitalism, economic growth, energy infrastructure, energy investment, investors, stock market [list all tags]

When "class warfare" is typically discussed, it usually refers to the farmers, lower income or working class trying to negotiate for a larger share of the economic pie against landlords, government or business owners respectively. Sometimes there is a settlement and life goes on. Other times bitterness lingers for years or a generation.

Many might label the current feud that has erupted between The Daily Show host John Stewart and CNBC as part of this tradition of class warfare, but it has really exposed a rift between the investor class between Wall Street insiders and outsiders that have faithfully invested their money over the years to save for retirement, higher education, buy a home or whatever. This rift, has exposed a deep gulf of trust that could impact personal investment & savings patterns for generations if unresolved. And this has major implications for the future of capitalism and in particular publicly traded energy companies.

Or Link HERE to see the full interview on the Daily Show's website.

For a quick recap of how the CNBC v. Stewart feud got started, a couple of weeks ago Rick Santelli, a CNBC reporter had a rant from the trading floor of the NYSE about how "loser" homeowners should not be helped out by the government or let courts reset the terms of loans.

Stewart then wanted to have Rick Santelli on his show and when he "bailed out", Stewart ran an extended segment on all the wrong calls made by CNBC commentators and missed opportunities for CNBC reporters to ask tough questions to CEOs of troubled companies.

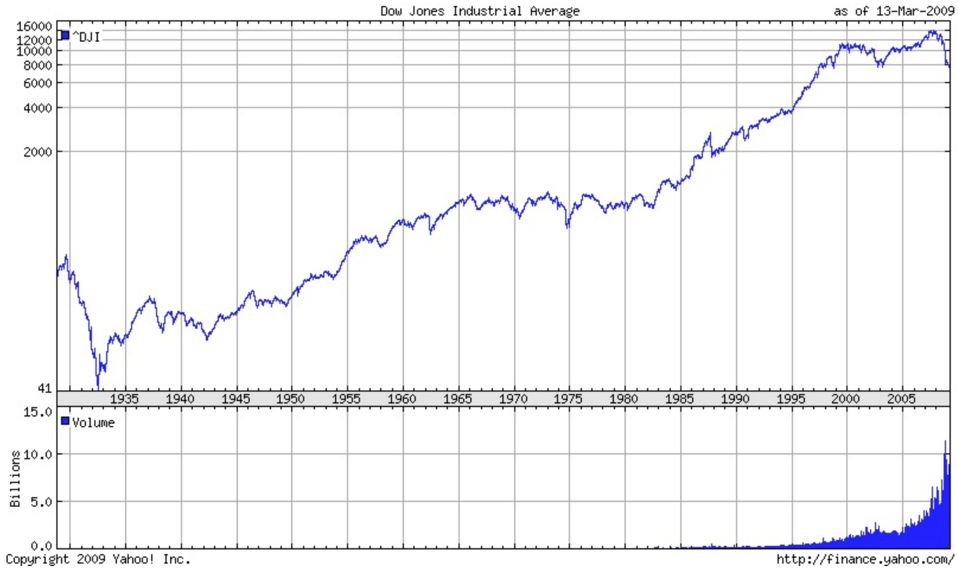
The Daily Show With Jon Stewart M - Th 11p / 10c
CNBC Gives Financial Advice

Daily Show Full Episodes | Political Humor
Important Things w/ Demetri Martin | Jim Cramer

Jim Cramer, host of CNBC's show "Mad Money", took particular offense to Stewart focusing on his calls to buy Bear Sterns stock right before it had a liquidity crisis (run on the bank) and needed to be rescued by the Federal Reserve and JP Morgan. Essentially, because of a highly leveraged balance sheet with risky assets (e.g. sub-prime loans) now exposed, there was a crisis of confidence of people & institutions that lent money to Bear Sterns. Thus, a lack of trust developed and without that trust, Bear Sterns could not continue to operate. Stewart was merely extending this concept of questioning trust in Jim Cramer, as someone who continued to pump up investor demand when he was not willing (nor his network) to challenge basic important assumptions and ask the tough questions of the companies he was recommending to his viewers.

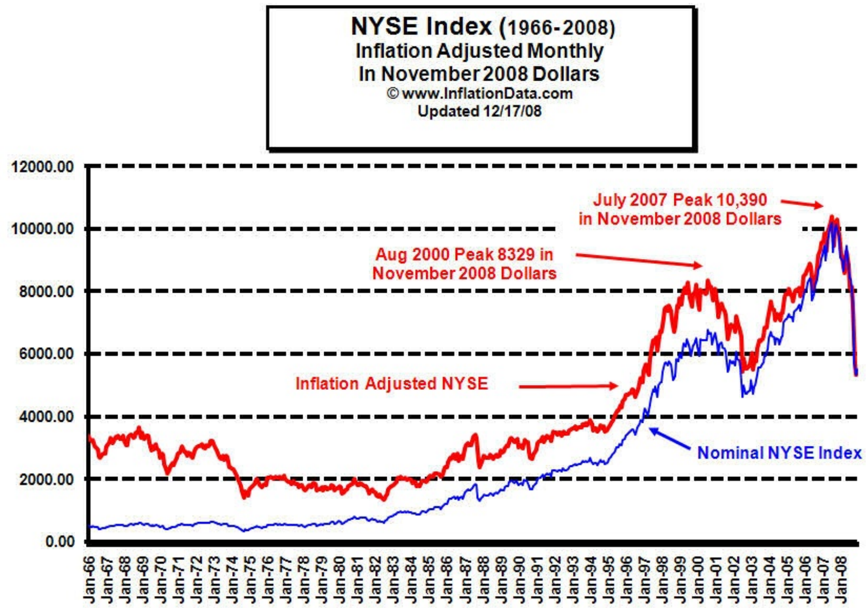
Stewart's attack on CNBC was not "class warfare" populism as you might see from say Caesar Chavez, Huey Long or more recently John Edwards idea of "Two Americas", rich and poor. It was a reaction of an angry investor himself who has probably lost a ton of money personally and is concerned about his parent's retirement funds. He's angry at Wall Street insiders that play ego games with his and "other people's money". He's angry because insiders walk away year after year with hefty bonuses while leaving outsiders that "invested" the money for the insiders to play with less than they had 10 years ago. And at another level he's angry that insiders have created such systemic financial risk that their institutions are holding the US government & taxpayers hostage to either bail them out or face the financial equivalent to a nuclear bomb detonation.

Angry investors can have long memories that can last for years or generations. It's only in the last 2-3 decades that average middle class folks have developed enough trust in the stock market to think of it as a long term savings vehicle akin to a high interest saving account at a bank. Many people felt that as long as they were well diversified through a mutual fund or 401k fund and practiced dollar cost averaging of regular monthly investments they would reap above average returns with minimal risk. That's not what prior generations believed about the stock market. They thought of the stock market after 1929 as something to be fearful of, akin to gambling with your hard earned money. They felt it was best to stick to what they understood - Savings went to the bank to protect it and earn some interest. There have been long periods in the stock market history where nominal gains over 10-15 years were minimal and could have easily been beaten by interest from a savings account.



And in part it was the lack of trust in the stock market and the feeling that small investors would be taken advantage of that kept prices of stocks from inflating much beyond the dividend yield would allow, keeping stock prices close to 15-20 times actual earnings (rather than inflated expectations of future earnings).

It would take the next generation that didn't remember the great crash of '29 or long periods of stagnant market performance to see the market as a way to boost the growth of savings for long term financial goals like retirement (Baby Boomers) or near term financial goals like buying a house (Gen Xers). They pushed the market to new heights through the sheer volume of new dollars flowing into the stock market, creating two bubbles that both spectacularly collapsed this decade as stocks have fell back to their historical range of 15-20 times earnings.



Taken together, these two bubble bursts could be interpreted as proof that growth is at best incremental and needs to be tied to fundamental. For those aware of peak oil / energy, it's another example that there are real physical limits to economic growth.

And now, just as corporate earnings are set to take a big hit, the middle class is again becoming wary of investment in the stock market as a way of saving for the future potentially depressing stocks for another generation or two. That is unless trust can be restored in the financial regulatory system to identify investor risks early.

Which brings us to the impact on the energy sector. The massive investments in energy infrastructure necessary to manage the decline rates of existing oil/gas fields, drill for new oil/gas resources and build up the next generation of renewable energy sources will rely in large part on middle class investors to trust that the stock market is a safe place to save money over the long term. Otherwise investment in new infrastructure will be limited to direct government spending and energy company revenue from current operations. Restoring confidence in a financial system that is based on economic fundamentals like natural capital will be important to financing the energy infrastructure of the future.

There is already evidence that the current low energy prices are reducing investment in future production and taking on more debt to finance their operations:

> The world's third-largest oil company, behind Exxon Mobil and Royal Dutch Shell, has reduced its production forecast for the next several years and is reviewing its degree of investment in major projects around the world.
>
> Because of lower oil revenues, all oil firms will need to assume increased debt in coming years to cover their dividends, capital spending and exploration costs, BP Chief

> Executive Tony Hayward has warned. Natural gas prices also have weakened.
>
> Hayward estimates oil prices must reach $50 a barrel to cover this year's dividend and $60 to cover the dividend and investment in projects.

On the other hand, higher energy prices would further weaken the ability of the middle class to afford necessities like food, fuel and heat, never mind save for the future or invest in an unpredictable stock market (even if energy companies have good earnings). Thus, it will also be important to create incentives to invest in all forms of energy conservation and more efficient living arrangements now to prepare for higher costs later.