I want to introduce you to what I believe is one of the greatest investment opportunities the financial crisis has thrown in our path. What you might call a “real wealth” accumulation program.

But first a bit of background…

The yield on the 10-year Treasury note yields 1.9% as I type. Official consumer price inflation has been running at an average rate of 1.8% over the last 12 months. At the current inflation rate, bond investors are apparently happy with a real return on their coupon income of roughly 0.1%.

Facebook founder Mark Zuckerberg has found a way to do much better. He has obtained perhaps the lowest mortgage rate ever recorded in human history. According to a document filed in the Santa Clara County clerk’s office, Zuckerberg pays just 1.05%, adjustable monthly.

Zuckerberg gets his money for better than free: at a rate of 0.65% below the annual consumer price inflation rate. An interesting detail the lender may one day regret: although the rate is adjustable, it may not exceed 9.95%.
On one website where the Zuckerberg article appeared a lender had taken out an advertisement. It offered fixed 30-year jumbo loans for 4.19%. And fixed jumbo loans for 15 years at just 3.45%.

This must be an opportunity of some sort. Perhaps a once-in-a-lifetime opportunity.

How to take advantage of it?

Thank You, Larry Summers

What prompts this recommendation believe it or not, is an article by Larry Summers, director of the National Economic Council.

Writing in the Financial Times, he noted today’s low interest rates. They are an opportunity for government, he said. The federal government can borrow at such low rates it now has the ability to make very profitable “investments.” Ten-year money costs the feds about 1.9%. He didn’t say so. But the implication is clear: That is a hurdle so low that even government employees can jump over it.

Summers cited “investments” in education, for example. But there is no evidence that education spending by government produces a positive return of any sort. In fact, since the 1960s educational spending has soared with no increase in test scores. This suggests that the money was completely wasted. And although it is true that people with more education tend to suffer less unemployment, there is no reason to think the job pool expands just because more people get pieces of paper claiming that they are educated.

Similarly, “investments” in the usual government activities – regulation, military procurement and deployment, health and so forth – are likely to have negative rates of return. So resources committed to government programs, unsurprisingly, are not likely to pay out…no matter how low interest rates go.

I imagine Summers is thinking that higher rates of government spending will produce higher GDP readings. This may be so. The official GDP tally makes no distinction between those things worth doing and those things that aren’t worth doing. The US recorded strong GDP growth rates during the housing bubble, for example, even though the ‘growth’ was in a sector that was already outsized and headed for disastrous retrenchment.

As a mainstream economist, Summers is not concerned about whether the economy actually makes people better off. He cares only about how it responds to his policy initiatives.

At a minimum, you might think that government spending would at least raise employment levels. It is logical. You spend. You hire. Unemployment goes down.

It is certainly true…or you can make it true…in a centrally planned economy. You can hire everyone…and insist that everyone has a job. Presto! Full employment. But in the US at least, even government spending does not result in higher employment levels. Just the opposite.

Big Government… Big Trouble

I’m grateful to my colleague Porter Stansberry for bringing this to my attention. Here is a chart comparing
government spending as a percentage of GDP and unemployment levels. Whether government spending actually causes unemployment, I don’t know. But this from Porter shows that it sure doesn’t help alleviate it:

Notice anything? (Source: St Louis Fed)

As you can see in this chart, higher government spending as a percentage of US GDP and higher unemployment rates are tightly correlated. The more government spending, the less opportunity. And vice versa. These figures are similar when studied comparatively across many different countries.

Only in the area of infrastructure are public investments likely to be at all profitable. And even there, each one needs to be analyzed independently. Government officials are fatally attracted to boondoggles. Taking the “shovel ready” projects of the TARP program, we would probably find that there was no net return on investment…and that many were simply bridges to nowhere.

But readers responded to Summers’ comments. One made the point that Washington’s borrowing costs are so low that they’d have to be idiots not to find a good use for the money. Summers suggested a radical plan: The US should borrow…and use the money to buy up the S&P500.

As of Jan. 7, 2013, the dividend yield on the S&P 500 was 2.6%. The 10-year Treasury-note rate is just 1.9%. The feds would have a positive income yield of about 0.7%...and the capital gains upside of rising stock prices. For once, they really would make a profit.

As a practical matter, this wouldn’t work. As soon as word got out that the feds were buying, prices would skyrocket. Dividend yields would decline. And if the government actually did follow through and buy control of America’s leading corporations, it would inevitably depress profits…leading to a further cutback in dividends and, ultimately, to the destruction of much of America’s industrial and commercial sector capacity. Governments, the commenter pointed out, are bad capital allocators and very bad stockholders.

What was interesting to me in this exchange was the central idea: that borrowing costs are so low that even a federal employee ought to be able to find a way to make money.

But if that is so, shouldn’t we?
The family publishing business has offices all over the world. In most places, we rent our buildings. But when prices turn down in a major way we look for better space. Needless to say, this is especially interesting when we can finance the purchase at giveaway interest rates.

Buying better buildings is not exactly an investment goal. Because we can operate just as well from modern, rented office space as from an elegant old building. Maybe better. But we acquired a taste for architectural gems in Baltimore.

The inner city Baltimore real estate market probably peaked in value in the late 1920s. It has been going down ever since. It appeared to hit what I thought would be an all-time low in the mid-1990s, when you could buy a very nice building in the Mount Vernon area for about one-tenth the replacement cost.

So, rather than move the company to the suburbs, we bought several of these historically important buildings. And we’re still there. Below you see the exterior of one of these buildings, 105 West Monument St, designed by Louis Lang and built by Augustus H. Albert in 1859.

I say this is not an investment goal, because we have no intention of selling. And when we are eventually forced to sell, there is no particular reason to think these places will be worth more than they are now. This is more of a real wealth accumulation program.

Good architecture is like good art. It has a value in itself. If it is also functional (such as providing office space)…profitable…and can be bought at distressed prices…or with money borrowed at little or no real cost…so much the better.
A friend bought a 100,000-acre ranch in Argentina for $250,000, during one of the country’s periodic crises. He was recently offered $18 million for it. Oceanfront houses in Malibu, California once sold for $2,000…back near the beginning of the last century. After World War II, you could have bought almost any apartment in Paris, France, for pennies.

But the last half a century was extraordinary. Never has the world’s population grown so fast. Never has its wealth increased more. And never before has the amount of credit expanded at such a pace either. It was only natural that real estate prices should increase too.

But what about the future? A report this week tells us that offer prices for houses in the US have gone up for the fifth month in a row. Will that continue? I don’t know.

Growth has moved to emerging markets. Populations in the developed world are either leveling off or actually shrinking. And credit? Except for the government, credit levels are falling. Real estate’s glory days – at least in the developed economies – may be in the past. Prices could be soft for decades.

But so what?

Unlike a stock or a dollar bill, a house or an office building has utility…and maybe even ornamental value. If you can get enough value out of it – from rents, from use, from the pleasure of owning it – what do you care if the price goes nowhere?

As long as the yield is positive, and you don’t need liquidity, here’s a recommendation. Buy great properties, mortgage them at the lowest rates you can get. Hold them. Be happy.