"Whoever could make two ears of corn grow where only one grew before, would deserve better of mankind than the whole race of politicians put together."
Jonathan Swift, *Gulliver's Travels*

Wealth Creation Strategies

Tax and Financial Strategies

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Using Principles in Deciding How to Cast Your Vote

Once again, California voters are being given the opportunity to increase government spending and other costs under the guise of bond issues, increases in direct taxation and mandates on private firms. Because the majority of voters don't seem to grasp five fundamental concepts, your taxes, as well as the cost of the goods and services affected, will probably increase by more than they otherwise would.

1
All spending eventually results in tax increases

A corollary of this is that bonds must be paid off. While everyone knows the piper must be paid, few show it in the voting booth. Some people may figure it's not their money, so why not spend it. For example, low-income renters pay little in income tax and no direct property tax, yet reap the benefits of products and services provided by the proceeds of bonds. Before voting to spend more of other peoples' money, they might consider the fact that 80% of today's low-income earners will, at some point in their careers, achieve a high income and buy a home. Others may figure a small additional burden won't hurt and fail to do the math on all the "little" taxes that add up.

An example is California State Proposition 61, which asks voters whether bonds should be issued to expand, renovate and equip children's hospitals, as well as whether additional funds should be provided to the University of California acute care facilities. Noble though this cause may be, there are countless such propositions that could be put forth on the ballot, all of which cost money. For those who oppose government-provided health care in favor of private, voluntary (often charity-based) solutions, the answer is simple. For those who do not, the choice could be based on a willingness to spend a few dollars extra per year to support something obviously worthy. However, those who ponder more deeply may ask at what point the pinpricks into their pocketbook stop and whether there is another way of achieving the goal. A clue to the likelihood that most voters haven't asked this question is that local bond issues have increased property taxes by over 20% in Los Angeles County in just the last seven years in addition to the 2% annual compounded increase allowed under Proposition 13.

2
Without an overall cap in spending, the appetite for other people's money is limitless

Ballot initiatives are often used to increase the supply of proper government functions such as law enforcement, by building more police stations or hiring additional law enforcers. The question that cries out is, why aren't existing tax dollars, which in California are twice per capita what they were just twenty years ago, allocated to support these essential government functions? Because the wants and needs of humans are limitless, there is never enough money to go around. If there was a maximum level of government spending (as a percentage of gross output), the question would be, how shall we allocate existing government funds?

This idea is ignored on countless ballot issues relating to law enforcement, which should be the first (and in the opinion of some, only) service paid for by state and local government. Proposition 67 asks for a 3% surcharge on telephone usage in California to pay for emergency personnel training and equipment, community clinics, emergency phone systems and hospital services. God knows we need an improved 911 system, but the question of where the money that should have been used for such improvements went to goes unanswered. When we vote to impose or increase special taxes to provide services that government should already be providing, we encourage politicians to allocate general tax revenues to "pet projects." Such questions shouldn't even be on the ballot, but if they are, they should ask only whether non-essential government services be funded. There shouldn't be any question about "essential" services.

3
Taxation changes behaviors

If consumption is taxed, consumption decreases; if production is taxed, production decreases. Increased taxes in one area cause a shift in production, consumption and related employment to something - or somewhere - else.

This concept is overlooked in

Proposition 63, which would increase taxes on Californians with incomes exceeding $1 million, the proceeds of which would be used to expand and develop innovative programs for the mentally ill. Forget about the fact that government money is usually badly spent, even for noble causes such as this. Forget about asking for a definition of 'innovative,' which I would imagine is not mine (treating alcoholism as the primary cause of 80% of what looks like mental illness). It doesn't address the issue of simple avoidance by moving to another nearby, lower-tax state. State income taxes in Nevada and Washington are non-existent; Arizona's maximum tax of 4.7% is far below California's 9.3% (not including phase-outs of deductions and credits). As evidenced by the net outflow from California among my clients (see the article in this issue on the subject), there are plenty of great places to live in the United States. In addition, many with such incomes have experienced a one-time surge, such as those selling a valuable piece of rental real estate, the tax on which can be completely avoided via a tax-deferred exchange.

4
There are always hidden costs to taxes and mandates

To the extent a tax is paid, there is less money spent or invested on other goods - an effective tax on those who would have been the recipients of such funds. Because the increased maximum tax rate of 10% affects only the very high-income, it will probably serve to reduce investment and savings, not consumption. Yet, since capital and investment loans create jobs and funds for more capital investment, fewer jobs will be available and interest rates will be higher than they would otherwise.

The hidden costs in mandates will come home to roost in 2006 if Proposition 72 is passed, reaffirming the requirement that large companies provide health coverage for all employees. The cost of medical care will be pushed even higher due to increased demand by those who pay little or nothing for additional services. Some medium-sized employers will either cap their growth to insure they don't fall under the mandates, or simply move to another state. There will be an increased incentive for large employers to do the same. Some people will simply not start companies in California. Nevada beckons.

5
If government focused on protection, it would do a better job of protecting

Governments are supposed to provide protection from domestic and foreign thugs. As proven in the great socialist experiments of the 20th Century, private markets are far more efficient providers of all other goods and services. If government is asked to supply something new outside its area of expertise, ask why. It may have something to do with the fact that the private sector, with its limited resources, is already allocating funds to projects believed to offer the "highest and best use" for those limited dollars. Why should resources (money) be taken from other people to provide goods and services that the private market is unwilling to supply?

Proposition 71 would provide state funding for stem cell research. While those supporting such research believe it is a noble cause that could cure many diseases, an obvious question for those who believe large companies invest in ventures they perceive to be profitable is, why don't pharmaceutical firms plow funds into such research? If the long-term benefits of stem cell research exceed the costs, you can bet some capitalists will figure it out, if they haven't already.

You won't read these principled arguments in your official voter information pamphlet. I hope they will serve as a guide in this and future elections, as they have for me since I began voting.

A Vote for Gridlock

My vote this silly-season will, as usual, be for a President who would dramatically cut the size and scope of government and put your favorite tax professional out of business: Michael Badnarik, a software engineer running on the Libertarian Party ticket. I am proud to say that, with two exceptions (Tom McClintock some years ago and Arnold Schwarzenegger in '03), I have never voted for anyone who has ever won an election and, therefore, told you how to run your life. I particularly don't believe in choosing between a conservative who favors big government and a pseudo-liberal who favors big government. I vote accordingly, although this year, my principles are being tested. I lean towards a vote for gridlock. Here are my thoughts, confused though they may be.

A big government conservative

George W. Bush is a big government conservative who couches his broken English with occasional anti-government rhetoric. While his administration has dramatically decreased taxes for many, he has presided over the greatest percentage increase in government spending since the Great Society's Lyndon Johnson. Amazingly, spending increased 29% during his (first?) term, more than triple the rate of increase during Bill Clinton's second term. Total federal spending has increased from 18.4% to 19.9% of gross domestic product since 2000. Bush pushed through the biggest increase in the already bankrupt Medicare program since its inception. He nationalized airport security and has managed to increase federal spending on miseducation by 80%. While giving lip service to the idea of free trade, he not only caved in to Big Steel and imposed huge tariffs, but also signed on to $170 billion farm-welfare subsidy package (an incredible

$1 million per subsidized farmer). He has never met a spending bill he didn't like, failing to veto even one during his tenure.

While Bush talks about the "ownership society," he has failed to extend the idea not only to airports, but also to his overseas adventures. Ownership tends to reduce tensions, especially when enforced by equal application of law. The violence in Iraq would dramatically decrease if the Iraqi oilfields were privatized, with equal shares going to every Iraqi citizen. People just don't like to see their assets blown up. My concern is that democracies can be turned into de facto dictatorships. The "democratically" elected president of Venezuela, Hugo Chavez, controls its oil and, thereby, wields control over Venezuelans not dissimilar to that exercised over Iraqis by Saddam. The risk remains that the Chavez's of other countries can potentially become as dangerous as Saddam unless resources, particularly valuable ones, are privatized. Bush is right - assets should be privately held. If he expects to win the war and not just the skirmish, he needs to expand upon the idea and force the denationalization of government resources elsewhere. I'd hate to have to do this all over again with a "democratic" Iraq.

A big government liberal

John Kerry on the other hand supports big government in theory as well as deed. He is flatly opposed to the "ownership society" in the form of Health Savings Accounts and Social Security. His spending plan for health care would dramatically increase the role, power and revenue of the federal government. His voting record in the Senate is more statist than that of even Ted Kennedy, consistently rating near the bottom of the pack with a "tax and spend" grade of "F" by the National Taxpayers' Union, below Kennedy, Barbara Boxer and Dianne Feinstein. Ambulance-chasing Vice-presidential candidate John Edwards also earned an "F." The candidates' "tax-the-rich" demagoguery ignores the fact that "the rich" by their definition, the 2.7% of filers earning over $200,000 per year, already pay almost 50% of the nation's income tax and their "soak the rich" tax proposal will increase government revenue by only $50 billion out of a $2 trillion budget with a deficit projected at $400 billion. It shouldn't surprise if "the rich" are re-defined under a Kerry administration. Also consider that behavior changes as taxes increase - people work less hard at productive enterprise and harder at unproductive ones, including finding ways to shelter their earnings.

Iraq

With apologies to my friends who opposed the Iraq invasion, pronouncements by Kerry and Edwards on our overseas ventures are even more troubling to this admitted interventionist. They suggest that Bush lied about Weapons of Mass Destruction (WMD) in order to get us to attack Iraq. Yet, the facts belie the claim. The Clinton administration bombed Iraq in 1998 based on the belief they had WMD. Democratic Senator Joseph Lieberman, who appears to be a lone dissenter among Democratic leadership, said in 2001 we must deal with Saddam "before he strikes at us with" WMD. Edwards, who served on the Senate Intelligence Committee, called for Saddam's removal in September 2002 stating, "We know that he has chemical and biological weapons…he inches closer to his long-time goal of nuclear capability - a capability that could be less than a year away." As recently as September 2003 he stated that Bush was right to proceed without the Germans, French and Russians. Yet today he says the Iraq War was unnecessary and that we should not have done it "alone." According to a March 2002 piece in the New Yorker Magazine, a bastion of Democrats, the chief of German intelligence estimated that Iraq would have an atomic bomb in three years. CIA Director George Tenet told Bush shortly before the invasion that WMD in Iraq was a "slam-dunk." Everyone believed he had WMD, including possibly Saddam himself, *who everyone seems to forget refused to back down and show U.N. inspectors he had fully disarmed as we stood at his doorstep.* Even France's Jacques Chirac referred to Iraq's "probable" possession of WMD just a month before we stepped over the Iraqi border. I have a real problem with what I perceive to be lies and hypocrisy when it comes to national defense and my sense is, as much as all politicians deceive (Bush included, particularly about his professed belief in free markets), this is the greater offense. The "wrong war at the wrong place at the wrong time" is one that almost everyone initially supported.

Kerry and Edwards also claim that Iraq should not have been a target in the war on terrorism. Yet, Saddam paid the families of suicide bombers for murdering innocent civilians and harbored terrorist training camps that were set up in Northern Iraq with bin Laden's help. He provided a safe haven to Al Qaeda associates, including bin Laden's friend al-Zarqawi after he fled Afghanistan. The Clinton administration chose NOT to launch missile strikes on bin Laden's camps in Afghanistan because of concerns he would "boogie to Baghdad," where it would have been even more impossible to root him out, given protection by Saddam's powerful security apparatus. Saddam's favorite dictator was the greatest terrorist ever, Josef Stalin, about whom he maintained a voluminous library. And for those who understand alcoholism and power trips, the most disconcerting aspect to dictators with access to nuclear or other weapons of mass destruction is that Saddam is every bit as alcoholic as was Stalin. (By the way, I was a confirmed isolationist until I began to understand that alcoholic despots are capable of anything, which includes the use or sale of nukes.)

Those who suggest we went to Iraq for the oil should consider that we didn't keep Kuwait's oil after the 1991 war and haven't invaded Venezuela, which supplies us with far more oil than Iraq and whose people would probably welcome us with open arms. Those who suggest that Dick Cheney cares only about Halliburton's profits ignore the fact that the profit it earns in Iraq is one-fifth the usual margin for oil industry services at far greater risk to the safety of its employees, many of whom have been killed doing their jobs. And if Halliburton is doing so well, for God's sake buy shares of its stock.

It is also troubling that those allies who have not supported us in Iraq are those who curried favor with the former Iraqi Baathist regime. Politically well-connected Russians and French maintained enormous contracts with Saddam (the "oil-for-food" program), profits from which went "poof" with our invasion. No wonder they didn't support us. While Kerry now gratuitously states that Iraq was the wrong war at the wrong time, he would have sent troops to Haiti to shield Jean-bertrand Aristide, its megalomaniac dictator, from a revolt by his own people (and Chavez appears to think Kerry would do the same for him). It might seem inexplicable that he garners support among the Nicaraguan's Sandinistas along with other notorious socialistic anti-Americans abroad were it not for the fact that they prefer his proposed policies over those of Bush. The perception by would-be or actual dictators appears to be the world is safer for them under a Kerry administration.

Not a single-issue voter

Even still, we all have our key issues. I am a six-issue voter. First, we need to make the world safe from nuclear weapons. The only way to do so is to spread democracy and private ownership around the globe, which will serve to decrease the ability of evil people to seize government power. No political party supports this idea. Second, decriminalize drugs to remove the ability of bad people to harness untold private wealth. The major party candidates are hopeless on this issue.

However, there are four issues on which one party wins a measure of support: re-introducing accountability into health care, adding a dose of competition into education (via vouchers), privatizing Social Security and tort reform. While some believe the Republicans are working to reduce personal freedom in others areas, freedom of choice and reform in these areas is just more important to me. And as Ronald Reagan said, for Republicans, every day is the Fourth of July; for Democrats, every day is April 15. More Republicans than Democrats seem to believe that your money is yours.

On the other hand, when Clinton lost control over Congress in 1994, he quickly adopted (or gave in to, depending on your point of view) a number of pro-freedom ideas, including one that shrank the welfare roles by 50%. Government grew relatively slowly and its share of Gross Domestic Product shrank from 1994 to 2000. Perhaps, gridlock may be best for the health of freedom from government, which is what we may get **if** Kerry wins and **if** Congress stays in Republican hands. But no matter; my vote is still for the guy who'd put me out of business, especially in a state where the Electoral College vote has already been decided.

Sell?

California real estate prices have undergone one of the most extraordinary ascents ever, the more amazing in a state that threw out a sitting governor amidst financial turmoil. While giving a feel for the massive gains is difficult, I'll try, using my office-house as an example. Most of you know this house, which sits on the Granada Hills border with Mission Hills, half a block from the 405 freeway in the North end of the San Fernando Valley. The over three dozen clients whom I've never met (along with others who may stumble upon this letter on the Internet) should picture a basic 1,680-square foot three-bedroom, two-bath home with a family room and two-car garage in an average area of typical suburban America. In many areas of the country, its value would be $160,000.

I purchased the house in 1985 for $106,000. Its value skyrocketed (or so it seemed at the time) to $190,000 in 1989, when I predicted in an article in this newsletter that its value would drop 35%. Almost no one with whom I spoke or counseled believed prices could do worse than stabilize. Yet by January 1994, immediately preceding the Northridge earthquake, the market price had dropped to $145,000. While values stabilized for almost a year due to decreased availability of habitable homes, the collapse resumed, bottoming at about $130,000 in 1996.

Its value slowly crept back up, reaching just beyond the old highs by year 2000, at which point the market went on a tear, racking up over 20% annual gains to mid-2004. Here's what happens at this rate of increase, starting with an estimated $200,000 value in 2000:

2001: $200,000 x 1.2 = $240,000
2002: $240,000 x 1.2 = $288,000
2003: $288,000 x 1.2 = $345,600
2004: $345,600 x 1.2 = $414,720

The actual value reached $430,000 by Summer, 2004. While many admit that the rate of increase is unsustainable, as in 1989 they believe that price increases will merely slow or at least hold. Let's make their case.

Factors that could keep a floor under prices

There are several factors that could serve to force prices somewhat higher or keep them relatively elevated for a few years. One is the overhang of demand. In a period during which California's population increased by ten million, the supply of housing increased by only one million. The restraint on supply is largely artificial, including a NIMBY ("not in my back yard") attitude, pseudo-environmentalism ("save the Ahmanson Ranch") and a loss in relative local government tax revenues on new homes selling for less than $600,000, which serves to reduce the number of permitted homes. Be that as it may, there are no public policy initiatives on the horizon that will dramatically increase supply. Rules requiring builders to provide "affordable housing" have backfired, typical of coercive government programs: according to the Reason Foundation, *less* housing has been created due to these "inclusionary zoning" rules.

Another reason for optimism among current homeowners is the "Arnold" effect. Governor Schwarzenegger's forceful personality alone could provide the impetus for an increasingly rational state government even in the face of an appallingly socialistic and statist legislature. Decreased burdens on business such as a likely drop in the cost of workers' compensation insurance, driven by Arnold's threat to take reform to the ballot, could result in stable or even increasing demand for California residency despite the high cost of living.

A third reason why prices might not drop is the fact that the after-tax cost of owning is still not much higher than the cost of rent in many areas and price ranges. Because a tripling of price results in a mere doubling of the monthly payment when interest rates decline from 9% to 6%, the massive price increases have not been as hard on buyers as it might seem. While rents have not doubled in the same period during which home prices have tripled, they have increased by 50% or more in many locales. The fact that home prices began their extraordinary rise from depressed levels has served to dampen the impact of the increases.

Factors that could cause prices to implode: me and you

On the other hand, the disparity in prices between California and almost everywhere else has never been greater. Median house prices in California are $460,000 while nationwide they are $180,000. As recently as the early 1970s this difference was non-existent, even though the weather was the same then as it is now. There's a built-in profit to moving.

Before I create undue concern over the whereabouts of your favorite Enrolled Agent tax professional, I do not intend to sell. My work, family and life are based in California. I have no compelling reason to move. The cost of selling is huge: commissions, escrow, title insurance and other fees such as documentary tax stamps can eat up 8% of value, moving an office could easily run 10%, and the capital gains tax on large gains in California is close to 30% (not the advertised 15%). Since my cost basis is close to zero after depreciation, that 30% would apply to almost the entire sales price. I would not only be betting on an almost 50% price collapse, but also that I would have the ability to time the bottom and the stomach to repurchase when the psychological aversion to do so would be at its peak (it's always scary after values collapse). On the other hand, if I had a *reason* to move, such as retirement, I would sell subject to a tax-deferred exchange in a heartbeat. I wouldn't hesitate to exchange into property in Utah, Tennessee, Colorado or wherever else I find good value.

Aside from hard statistics, there are anecdotes. One is you: the number of clients moving into vs. out of California. There was a dramatic change in trend beginning in 2003. Here are the statistics as best as I can determine for the latest five years:

Year	Clients moving into CA	Clients moving out of CA
2000	2	5
2001	5	5
2002	5	4
2003	1	11
2004	2	9 (as of October)

States to which you moved in 2003 include (using Post Office abbreviations) GA, CT, UT, CO, TX, NC, FL (two) and NV (three). As an interesting aside and, perhaps, a clue to where the greatest long-term growth in real estate values could be, six of you moved to states with no income tax and all except one to states with lower overall tax costs than those in California. Eight of you continue to work. The numbers for 2004 are shaping up similarly: two to AZ and one each to FL, OR, NE, GA, CO, TX and WI. In addition, despite our fervent objections (but, of course, with our best wishes), our valued employee Kelly moved to Nevada. While only a small fraction of you move from one state to another each year, the extraordinary tilt out of California seems statistically significant.

The last time such a change in trend occurred was in the late 1980s. I began noticing an outflow of clients in 1988, a year before the last peak in real estate valuations. Department of Motor Vehicle statistics didn't identify a similar outflow until 1991. You seem to be ahead of the curve.

Other facts suggest a peak is here - or near

Hard statistics suggest massive overvaluation. One is housing affordability. Less than 20% of California households have the financial resources to purchase a median-priced home, while nationally (excluding California) close to 60% can afford to do so. While this lack of affordability is alleviated by the adjustable-rate mortgages (ARMs) secured by over one-third of buyers (up from just 14% a year ago), every upward move in interest rates increases minimum payments, resulting in a reduced ability to meet monthly obligations. In recent months over three-quarters of homebuyers taking out a jumbo mortgage (one in excess of $340,000) opted for an ARM. While the Wall Street Journal reports that a borrower with an annually adjustable mortgage of $450,000 begins paying around $2,250 monthly, the payment will increase to almost $3,500 if one-year Treasury yields rise to the levels of March 2000. Foreclosures will inevitably follow.

Federal Reserve policy has fuelled speculation by keeping interest rates low far longer than was reasonable (or, as my friend Bob Prechter would argue, social mood has resulted in a Federal Reserve policy of low rates). Asian central bankers have assisted by suppressing the values of their currencies through enormous purchases of U.S. bonds, helping fuel the demand for long-term debt that has kept mortgage rates low. Asians could grow weary of these weak currency policies. Mortgage rates of 8% would reduce the affordability ratio in California to near zero. If there are no buyers, prices have nowhere to go but down.

Yet, an increase in interest rates is not required for a housing collapse. As rates plunged in Japan beginning in 1990 when almost everyone believed the Japanese would soon own the rest of the world, so did housing prices. By 2003, they had dropped almost 75% in Tokyo. Stability in Australian interest rates has not prevented drops in Aussie house prices, which began plummeting in early 2004.

Another measure of affordability is the median-home-price to median-family-income ratio. An area in which the median home price (MHP) is $180,000 and the median family income (MFI) is $60,000 has a MHP to MFI ratio of three, the U.S. average. Cities such as Baltimore, Minneapolis, Portland (Oregon), Atlanta, Houston, Dallas, Phoenix, Pittsburgh and even entire states have ratios below this average. However, many major metropolitan areas have higher ratios. The range for Seattle, Denver, Las Vegas, Chicago and Atlantic City is three to four. The ratios in both Boston and Washington, DC are higher, but still less than five.

Bakersfield, with a ratio of 3.4, is at the low end in California. Many towns in the Central Valley, where we would expect low price-to-income ratios, have ratios over four. Stockton's is an astounding 5.7 and even Modesto's is 5, the same as Sacramento. The Inland Empire (Riverside and San Bernardino counties) has ratios over 5. Ventura's MHP to MFI ratio is 6.2, San Francisco's 6.8 and Orange County, Los Angeles and San Diego all have ratios over 7.

Many suggest that prices cannot drop because of a shortage of land. However, in almost any direction inland from coastal areas and sometimes even just north (as from Santa Barbara) or south (as from San Clemente), there is enough land to house tens of millions. The Not In My Back Yarders (NIMBYs) who stopped the Ahmanson Ranch development helped insure that the values of nearby existing properties remain elevated for a time. However, NIMBY may not survive the realization by those who do not yet have a home that such pseudo-environmentalism is not in their best interests. Yet, prices even in a land of NIMBY can drop if the experience of Hong Kong is any guide. A country in which there is perhaps a greater shortage of land than anywhere else on the planet suffered a collapse of almost 70% in the five years ending in 2003. As mentioned, Japanese real estate prices fell through the floor, even though Japan has three and a half times the population in a land area slightly less than that of California.

Pop?

Lending standards have become extraordinarily lax. According to one escrow officer, 75% of home price purchases of under $500,000 involve zero down financing and almost 100% are taking out interest-only adjustable-rate mortgages. New underwriting standards have increased allowable debt-to-income ratios. The number one and four nonfiction-best-sellers on Amazon.com recently were books on roads to real estate wealth. Such froth just doesn't occur at market bottoms, when we can expect to see fear and loathing to ever again invest.

Fortunately, the California market does not appear quite as speculative as did Australia's before its peak in late 2003, when investors accounted for 45% of new mortgage lending, or Japan's in 1989, when the Royal Palace was reportedly worth more than all the real estate in California. On the other hand, the availability of homes for sale has increased dramatically, spelling what could be the beginning of the end and suggestive of a crucial change in sentiment. Inventory in the San Fernando Valley, which peaked at almost 15,000 in 1993 and bottomed at barely over 1,300 in March 2004, has since more than tripled to over 4,600. The sales-to-listing ratio, a crucial measure of the supply-demand equation, dropped to below 50% for a couple of months (for every 100 houses newly listed, less than 50 were selling). In September 1989 when I saw this ratio drop to 30%, I knew the jig was up.

On the other hand, no one dreamt that prices, especially in a state with as many economic challenges as California's, would more than double in barely four years and triple in eight. Yet at this point and from these levels, a 20% drop would seem inevitable if not conservative. Due to the parabolic rise and the fact that prices often over-react in both upside and downside frenzies, a 30% collapse shouldn't surprise. Serious accounting and/or hedging problems at the giant mortgage originators Fannie Mae and Freddie Mac could reduce the availability of funds, which might result in a tightening of lending standards. Their regulator (the Office of Federal Housing Enterprise Oversight) portrays Fannie Mae's accounting policies and internal controls as "dysfunctional and ineffective." These are harsh words against a company that is the second-largest U.S. financial firm and world's biggest mortgage lender.

It doesn't take many sellers to adversely affect prices. Only 2% of all outstanding shares changed hands on Black Monday, 1987, when the stock market dropped 20%. While major swings in the value of residential real estate take longer, shakeouts have and will continue to occur. Suggesting otherwise is denial; we simply have to deal with such declines and hope they don't bury us.