Caution advised

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Topics: Recession

Economist David A. Levy is a long-time student of business profits to analyze and predict macroeconomic trends. In Mount Kisco, Levy these days is applying his family's "profits perspective" to what he calls a "contained depression" that could continue for another decade.

His advice to businesses and individuals at the start of 2010: exercise great caution.

Levy is managing partner and chairman of The Jerome Levy Forecasting Center L.L.C., a research, consulting and investment business that takes its name from and traces its profits analysis to Levy's grandfather. The grandson in 2008 co-authored a pamphlet, "Where Profits Come From," that explains the firm's real-world analysis of flow and sources of aggregate profits to understand and predict the economy's operation and business-cycle dynamics.

To those trained in conventional macroeconomics, with its focus on gross domestic product, "The profit equation is pretty much unknown," Levy said. His grandfather, a physicist who became a wholesaler in knit goods in lower Manhattan, began his economic analysis in 1908 and had developed his "profits equation" by 1914. Applying his profits perspective to his own finances, Jerome Levy liquidated his stocks "and was basically retired when the Depression came" later that year, his grandson said. "He devoted his life with very little effect to convince people" of the merits of his profits method of analysis.

Levy's grandfather and his father, S. Jay Levy, began publishing their "Industry Forecast" in 1949. David Levy joined the firm in the late 1970s and with his father launched their consulting firm, Levy Economic Forecasts. The private business in 1991 became part of the nonprofit Jerome Levy Economics Institute of Bard College, an economic policy research organization started in 1986 by Levy's uncle, Wall Street financier Leon Levy.

In 2001, the family's forecasting center separated from the academic institute and returned to the for-profit consulting sector. "As a business model, this makes much more sense, to pay more attention to our own investments and our high-wealth clients," Levy said. Those clients include private equity funds and hedge funds managing more than $1 billion, he said.

“Right now I think this is a time for great caution,” Levy said recently at his firm’s small Mount Kisco office. “The problems we’re dealing with are multi-year problems. We’re not going to have another Great Depression, but I think the next 10 years are going to be difficult.”

“We use the term ‘contained depression,’” said Levy, who coined the phrase to describe the shorter recession of the early 1990s when the dot.com bubble burst. Government in this period is “lender of last resort” and an effective “flywheel” to keep the financial system and economy operating, he said.

“The private economy is sick,” Levy said. As for net private investment, “Nothing like this has happened since the 1930s. The government is actually playing a vital role in (averting) what would have been another Great Depression.

“These federal deficits are almost inevitable in the next several years,” he said. “If we didn’t have these deficits, the economy would have collapsed. Most people don’t recognize this.”

At the start of 2010, “I think the economy is expanding,” he said. “I think the first quarter and possibly the second quarter will look pretty good. I don’t think we’ll get much job growth.”

“As we move into the second half” of the year, he said, “unless we get some significant government help, we could be facing another recession.”

Levy said he expects the unemployment rate to average 8 percent over the next decade. “It’s going to remain a tough market and it’s going to be difficult to get the types of raises we’re used to seeing,” he said.

“There are going to be ups and downs,” he said, with another hiring slump and more company restructuring possible later this year. “If someone’s been discouraged looking for a job, I would encourage them to get out and look in the next several months.
“We’re going through a period that will have finite length,” the forecaster said. “This is not a one-way road to nowhere but a road that will take about a decade.

“A lot of debt has to go bad and get written off,” Levy said. A government program might be needed to directly absorb some of the mortgage loans of persons at risk of losing their homes. “I think the government may have to do that, otherwise this thing may spiral,” he said.

Levy said reduced household and business debt and pent-up investment could lead to an “explosion of new wealth creation … We will eventually get to a point where as private investment starts to come back, it will come back in a much healthier way than we have seen in the past.”

Levy said he is telling long-term clients that manufacturing will make “a big comeback” in the U.S. with a new focus on smart technology and green industry. “The main reason it has left, cheap labor, is going to be less and less important” with increasingly sophisticated technology and robotic production that will require a more highly skilled work force, he said.

In the meantime, “I think the next few years is a time when being cautious is certainly better than being too aggressive,” Levy said.

Tips from the Top

Predicting another decade of economic turmoil and high unemployment, David Levy, chairman of The Jerome Levy Forecasting Center, offered these survival tips:

For individuals: “The first objective is preserving capital. Before you worry about making money, don’t lose money. There continue to be tremendous risks.”

For businesses: “Don’t make the mistake of expecting everything to just come roaring back and being very aggressive.”

Have access to credit if possible.

Trends in consumer spending will go more toward value than luxury.