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Race Track Industry Program

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A Perspective for Racing — The Economy

Speaker:
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MR.DOUG REED: Good morning. Welcome to the 35th Annual Symposium. We're glad to have you all here. Yesterday seemed to go off pretty good, I didn't see any hitches in the wagon or anything, the wheels didn't come off. I have to give a lot of credit to the faculty, staff and students. And if you did see anything go wrong, please let me know because I must be to blame, I must have dropped the stick there.

Just a couple housekeeping notes before we get started. I want to remind you that during the session, during the Q&A part, please step up to the microphones, not only are we recording it, but people in the room can't hear the questions if you don't step up to the microphone. Also, I want to take this moment to thank the sponsors. Again, without the sponsors this program would be much tougher to run and put on. We appreciate all that. The reception last night was really crowded, and we appreciate Mountaineer Casino, Racetrack and Resort's sponsorship of our reception last evening. Lunch yesterday and the TPA awards were sponsored by AmTote. Our breakfast this morning was sponsored by IGT. Our beverage break following this is sponsored by Caliente/MIR and Plusmic Corporation. The keynote address today is sponsored by Prairie Meadows Racetrack and Casino. So first of all, let's thank all of our sponsors.

(Applause)

MR. REED: To start things off I want to introduce the dean, the Vice President and Dean of the College of Agriculture and Life Sciences, Eugene Sander. Gene has been with the University of Arizona for I think 21-plus years; he will probably give you the more accurate number. He is the only dean that I've known in my academic experience and in my tenure in academia and I hope that he stays at least as long as I'm here because of his constant and great support of the Race

Track Industry Program. So I hope that he is the only dean that I have to deal with. Please welcome Dean Sanders.

(Applause)

DR. EUGENE SANDER: Well, thank you. I hope, too, that I'm the only dean that you have to deal with. Seriously, on behalf of the University of Arizona, I want to welcome all of you to this racing symposium. I've been coming out both to Ventana and here with a year off sabbatical leave as the provost last year, for a long, long time. I can tell you what an enthusiastic and important crowd we have and as a matter of fact, this is one of the most significant and important symposiums that the University of Arizona sponsors throughout the entire academic year.

I too would like to thank all of the sponsors and all of the good things that make this happen. I know Doug does an excellent job of recognizing the people who truly make a difference in terms of making this symposium work and that is essentially our students. This is a student-driven Symposium. All of the work, most of the work that has to occur is handled by our students. They gain the kind of experience that you are going to want to have as you're looking for a really smart young person to work in your organization. So our students are an important part of this. However, nothing happens without leadership, and so I personally would like to thank Doug Reed for all the good work that he does in managing and making the Symposium, and for that matter, the entire RTI Program, work. So help me thank Doug Reed for a job exceptionally well done. Thank you, Doug. And for that matter, the head of our animal science department, Ron Allen, is also a strong supporter of the RTI Program, so Ron, thank you so much for the work that you do in support of this program.

Well, I know that you didn't come to hear me this morning. So let me introduce our keynote speaker. In Arizona, when we think about forecasts relative to the economy, the name Marshall Vest is synonymous with accuracy and an ability to look forward and tell us, sometimes good, sometimes bad, about where we are essentially, in this state. Marshall puts on a luncheon that will be held later on, I believe, this week, right here. He will talk with a whole bunch of business leaders and academics as well, about where we are in Arizona. Marshall is an excellent economist and has focused his entire career on looking forward and trying to making accurate predictions about economies and particularly the economy in Arizona. Help me welcome Marshall Vest, who is currently the director of economic and business research center at the University of Arizona. Marshall?

(Applause)

MR. MARSHALL VEST: Well, thank you for that very nice introduction. And after that introduction I am so excited I can hardly wait to hear what I'm going to say, especially with what's going on in the economy now a days.

You know, economics is often referred to as the dismal science, for good reason, I think. Most of the time economics is something that people choose to ignore, but when the economy enters a recession, we all become students of the business cycle. We do that, of course, because we want to understand what's going on, we want to know when this recession is going to be over and the economy gets back to being good again so that we can go back to ignoring economics once again. So it's no wonder that economics is referred to as the dismal science. With what's going on in the economy nowadays, you are in for a treat today. Does anybody have any questions?

(Laughter)

Me too. Lots of things going on out there that are pretty remarkable. So what I would like to do is to try to offer my feeble understanding of what I see going on and give you some idea of what lies ahead. You can think of it as a view from 30,000 feet. I'm going to use Power-Point here, simply because it keeps me organized. Can you hear me okay back in the cheaper seats?

I'm going to spend some time today on the question of how we got into such a mess. Then I will review some of the recent evidence which quite frankly, is both dreadful and frightening at the same time. And then I will offer a forecast of what lies ahead. This is kind of a guess, as you might imagine. But I think at this point, just give you the punch line right up front, I think that we're looking at a severe recession that lasts at least through the middle of next year, more likely through the end of the year, and it could even creep into 2010. Finally, I'm going to offer you just a few thoughts on how this recession is likely to change the business landscape. Some of the things that are happening are truly transformational. And at the end I will be happy to entertain your questions.

So how did we get into such a mess? Well, in short, we've had way too many financial innovations and far, far too little regulation, in a nutshell. You could describe the first seven years of this decade as a period of easy money. History tells us that asset bubbles don't form unless it is accompanied by an expansion of credit. So this time around it was the introduction of sub-prime mortgages and the securitization of these mortgages. Securitization allowed the risk to be spread amongst investors around the world and in the process, it was believed at one time, at least if you looked at the ratings being put on this by the rating agencies such as Moody's and Standard and Poor's, it was as if the securitization process risk just disappeared. And of course we all know that that didn't happen. So we had this tremendous expansion of credit which really happened outside the regulated portion of the banking system, so there was very little regulation. Commercial banks are highly regulated institutions but hedge funds and investment banks, very little regulation, hedge funds none at all. So they were able to create credit, a tremendous amount of credit. So where we are now, of course, that house of cards is collapsing, credit is contracting. We find that over-extended financial institutions are now being forced to de-leverage and as we know, that is a very painful process which is best described here in recent weeks as being gripped by panic; it is just outright panic by not only the banks but investors and market participants as well.

Financial institutions have suffered crippling losses of capital. The nation's investment banks have now have all but disappeared. Portions of the financial markets have all but stopped functioning.

Just recently the word bailout was declared as the word of the year for 2008. The word bailout turn on the television and that is all you hear. Did you ever notice that during the good times we used metaphors that are related to clear blue skies and we are soaring above the clouds and so forth but when we get into periods of recession, the metaphors are typically related to water? Just some examples, we are drowning in a sea of red ink, it's a perfect storm, it's a tsunami, we are in uncharted waters, we're navigating through choppy seas, we're on a sinking ship, batten down the hatches and of course, the idea of bailing water out of the rowboat. Well Warren Buffet, the investment guru and oracle of Omaha recently gave us a new one, he said, you don't know who has been swimming naked until the tide goes out. And the tide has gone out and it is not a pretty sight. They are all aging baby boomers.

So if we look at this, what we say is that initially liquidity was not the problem. But liquidity is the answer. Initially, the freeze in financial markets was precipitated by the bursting of the housing bubble and the subsequent insolvency of investment banks who, number one, hold large quantities of mortgage-backed securities, but they were also major facilitators in the securitization process. What investment banks would do is tap credit markets to raise enough money to go out and buy pools of mortgages. They then pool these together, slice them up into different pieces of risk and for securities out of them and then sold those securities off to investors around the world. In essence these were essentially operating as hedge funds with very, very high levels of leverage and taking on huge risks. So the failure of Lehman Brothers in mid-September really was the beginning of the hard freeze on portions of financial markets.

Now, you can be reassured by the idea that this is a classical, financial crisis in a long series of well-documented crisis. My favorite book on this is a book by Kindleberger and it is called Manias, Panics and Crashes. Anybody read this? If you take one thing away from this talk today, go out and buy this book and read it. You would be amazed by what's going on, it's all here in this book, it is now in its fifth addition, the first addition came out in 1958. If you want to understand what's really going on, he does it right there.

So we have crisis well documented way back into the 1600s, but some of the more recent crises include the savings and loan scandal, of course, during the mid to late '80s. We have Japan during the decade of the '90s. Mexico got into trouble in '94 and '95. We had the Asian financial crisis in '97 and '98. And right at the tail end of that, Russia defaulted on its bonds. Long-term capital management, which was a huge hedge fund, got into trouble that was in 1998. We had the high-tech bubble in the year 2000, which was accompanied by the terrorist attacks, 9/11, which closed financial markets for a week.

So the dynamics of financial markets and how to deal with them are very well understood by Fed chairman Bernanke. He was quoted in a speech a year or so ago, I'm going to quote now, The Federal Reserve's first responsibility is to do its part to ensure the integrity of the financial infrastructure, in particular the payment system and the system for settling trades of securities and other financial instruments. If necessary, the feds should provide ample liquidity until the immediate crisis has passed.

And that is exactly what the Fed has been doing. So liquidity wasn't the problem, but it is the solution. Now, the handbook also tells us that authorities should rescue the first institution and let the second one fail. Bear Stearns was the first and JP Morgan Chase took over Bear Stearns with aid from the Fed. Lehman Brothers was the second to step up and of course they were allowed to go under. So far the Fed and the federal government are following the handbook fairly closely, at least in principle.

So Lehman triggered the panic across financial markets. So we see asset prices tumbling, the U.S. stock market has lost over 40 percent of its value so far, that is the largest drop since the 1970s. The Dow is down about 2.7 percent yesterday, I didn't see what it was doing this morning. The past week hasn't been too bad but we have seen these tremendous swings of as much as five, six, seven percent either up or down in a day. The volatility is unprecedented. Oil prices have fallen from over $140 per barrel to below $50. Yesterday it was at $42 and my guess is that it is going to drop into the high $30s by the end of the year. Home prices are down, you can choose which measure you want to believe here, according to the national association of realtors, housing prices are down about nine percent, this is nationwide. Other measures from the Federal Housing Finance Agency, which is the brand new regulatory agency which sits over the top of OFHEO, which is the Office of Federal Housing Enterprise Oversight, who were the regulators for better or worse of Fannie Mae and Freddie Mac, anyway, they have a house price index, it is a repeat sale index, it is down 7.9 percent since peaking in April of 2007. The Standard and Poor Case Schiller index peaked back in July of 2006 and it is showing a decrease of 21.8 percent nationwide. Now if you were to look at Arizona statistics because these of course vary significantly from around the country, you've got Arizona, according to OFHEO, down 13.5 percent. The Standard and Poor Case Schiller index for Phoenix down 38.5 percent from the peak so far. So it really does make a difference what part of the country, some parts of the country are hit harder than others, and I'll show you a map of this in a moment.

Now, as we know, the root cause of declining asset prices is the crash in home prices. So far, policymakers have really been unable to fashion a plan that directly addresses that issue. Bernanke recently called addressing the rising foreclosures a high priority and he outlines several methods including incentives for refinancing of mortgages, bulk purchases of at-risk mortgages and going in and modifying the payments. They also talked about subsidizing the interest rates that mortgages are tied to. Now, none of these, unfortunately, addresses the problem of declining employment and insufficient incomes to pay down the mortgage.

Dropping the mortgage payment by $100 a month really doesn't help if you don't have a job and if you're upside-down in the house, that is you owe more on the house than what it is worth.

So here is a map that shows foreclosures, this was data that came out last Friday from the Mortgage Banker's Association. It shows that in the third quarter, 1.1 percent of all loans were starting the foreclosure process; there are several steps to this so we're just talking about the initial start where they are notified that they will be foreclosed. Now, the Mortgage Banker's Association estimates that there are about 2.2 million mortgages that will start the foreclosure process during this year. Regionally, we see the share of mortgages that are beginning the process were most heavily in California, Nevada, Arizona, Florida, Georgia, of course, around the Great Lakes areas as well. More than two percent of the mortgages in Nevada, Arizona, those are typically pointed out as being the hardest hit. So in the third quarter, nearly seven percent of all mortgages were delinquent. So this is a wave, a tsunami that is still out there and there is part of it that will hit going forward.

So the Fed has been doing just as one would expect, that is, again, providing liquidity. In this process, which evolves from day to day, I mean, everyday there is something new, the Fed is taking unprecedented measures to provide this liquidity. As lender of last resort, the Fed has set up new lending facilities for primary dealers, that's essentially your investment banks, they've never done that before, they don't regulate investment banks. Lending facilities for asset-backed commercial paper markets, they are backing money market mutual funds, and of course they have credit swaps with many foreign central banks. Working through the U.S. Treasury, the federal government has essentially nationalized the mortgage lending industry and has assumed control of the nation's largest insurer, that being AIG. Now, the Fed more recently has been buying preferred stock in dozens of the nation's largest banks and it has begun buying mortgage-backed securities. Two weeks ago it announced that it would begin buying high-quality securities backed by the government-sponsored enterprises, the GSEs, that's Fannie Mae, Freddie Mac, the Federal Home Loan Bank as well as securities backed by student loans and so forth. They are trying to buy the assets that are of high grade, which is important, and I will come back to that in a minute.

As short-term interest rates approach zero, the Fed, its typical policy tool has run out of bullets, you can't lower interest rates lower than zero and they will probably lower the federal funds rate to a quarter percent or eventually, I think, to zero in just the next few months. Then their policy actions shift, rather than pumping money into the system that way, they are actually going to go out and start purchasing long-term treasury securities so as to drive down interest rates with longer maturities. And in so doing drive down mortgage rates as well. Earlier this week the yields on 10-year securities were only 2.6 percent. The yields on short-term securities were effectively zero. The auction earlier this week for very short-term notes, the interest rates were zero, so investors are saying, take my money, just hold it for me, I just simply want the money back. I don't care if I make any money back on this at all, I just want to make sure that I get my money back. Of course that is the panic, trust is so important and trust is gone at this point, it is all fear.

All of these actions, once again, are taken in an effort to pump liquidity into the financial system and they are doing it in whatever portions of the financial system happen to be clogged at that particular time.

Since the economy floats on a sea of credit and since credit is shrinking, it's no surprise that that U.S. economy also is now in a freefall. Real GDP declined at a modest five tenths percents in the third quarter, its likely going to plunge by a four or five percent annual rate here in the fourth quarter. You can expect real GDP to continue to decline until the second half of next year. The reports that you read in the Wall Street Journal and other business magazines in recent weeks have all included the tag line, the worst since, and there are lots of these that you can choose from, just to give you some idea. Consumers we know are in full retreat as year end approaches. They are truly stunned by recent developments as consumer confidence measures have fallen to the lowest ever recorded, and that is with 40 years of record-keeping. Household net worth has fallen by roughly 13 percent from its peak, actually you might think that that number is a little bit low because the largest asset of households are their houses and the Fed is using the OFHEO numbers rather than the Standard and Poor's numbers, so you could make an argument that perhaps that 13 percent should be bigger and would be bigger if they were using a different price index of housing.

So what we find is households are highly leveraged, they are very illiquid and their balance sheets are in the worse shape since World War II.

Now, I don't know if you've looked at your quarterly retirement statement recently, but my 401k has turned into a 201 and I'm afraid that it is heading to a 101. So I think that we can understand why consumers are truly stunned.

Real consumption dropped 3.7 percent in the third quarter that is the worst decline in 28 years. Auto sales in October were the lowest since 1983. And if we look at this, I think we have to conclude that consumer finances are unlikely to get better any time soon. We have falling employment, we have declining real wages, we have the negative wealth effect from lower housing values and stocks, we have tightening credit conditions, we have high debt burdens, low savings. It's hard to see how consumers are going to lead us into this recovery. The inflation adjusted consumption is expected to log its worst back to back years during 2008 and 2009, the worst that we've seen in the post-World War period. So there are lots of examples here of the worst since.

Homebuilding, of course, is at the lowest level since 1945. Starts nationwide have dropped below one million at an annual rate and housing starts about down about two-thirds now, from the peak. There are pretty sobering statistics.

On December first, the National Bureau of Economic Research officially declared that December of 2007 marked the peak of the last expansion and the beginning of this recession. So the last expansion lasted just a little over six years, that's pretty good. It's interesting that they waited a whole year to tell us that we were in a recession. And usually when they do that, the recession is almost over, oftentimes it is. Unfortunately, that is not the case this time around because earlier in the year the economy really didn't lose much ground, it wasn't until August that the economy started to decelerate. And then as we moved into September and into October it was as if someone had turned the lights out. So this means that the recession is already a year old, it is already longer than either of the last two recessions, '90-'91 and 2001, that's really our reference point, after all. The younger folks weren't here then and those of us with gray hair can't remember that far back. The downside is the worst part of this recession still lies ahead of us. So we now expect a recession equal in severity to the one in the mid-1970s and there were actually two recessions in the early 1980s. So equal in severity but because of the shape of things, it's going to be longer.

Now, this map will show you — here the red states, all of these states, there are 32 of them that are now in recession. The remaining states, which are primarily in the Great Plains area are all growing very, very slowly and are at risk of falling in to recession.

Now, one of the questions that I'm often asked is are we headed for a depression? The answer is no and the reason is there are four positive factors that are acting to limit the severity of this recession. First we have oil prices, they are today less than half of the $140 per barrel peak that we saw just a few months ago. That means that households have nearly $300 billion additional dollars that they can spend for things other than gasoline, they don't have to leave that money at the gas pump. That's $300 billion, that's twice as big as the fiscal stimulus package that we got from Congress last spring.

The second reason is we have swift and coordinated actions by governments from around the world and that is going to stabilize financial markets, probably sooner rather than later. The Great Depression occurred, in large part, because of government inaction, simply didn't know what to do.

Third item, these actions have infused tremendous amounts of liquidity into the financial system and it will help recapitalize the banks and get credit flowing again. The evidence here in just the last few days is that investor's appetite for risk is beginning to return. Panic is beginning to recede.

Number four, we can expect further fiscal stimulus very soon. I don't know how much yet, in terms of size, how many dollars, but expected to be included are grants to states for such things as infrastructure and Medicaid and our safety net programs, including an extension of unemployment insurance. And of course, you can expect rebates to individuals similar but no doubt smaller than the ones we saw last spring.

So if you combine all these actions, these are huge amounts of stimulus. Of course, it changes daily but the most recent figure is about $8.6 trillion has been committed, of which $2 trillion has been deployed. So there is $8.6 out there in the wings ready to be deployed, and that is so far; again, this changes almost everyday. All of this is being poured into the financial markets and we can rest assured that more can be forthcoming if needed.

Now, this chart compares the peak-to-trough declines in real GDP during all 11 of the recessions that we've had since World War II. The year that the recessions started is used to label these particular events. So according to Global Insight, which is a global economic forecasting firm with whom we partner when we prepare our forecast, Global Insights sees the peak-to-trough to decline in real GDP this time around, ranging from between 1.6 percent and 3.3 percent. You notice that in the mid-'70s the decline was a little over three percent. The '81-'82 recession was a little less than three percent. And then you can compare what we're looking for this time with the 1990 and the 2001 recessions which were very mild recessions, we didn't lose much at all.

Now, this graph shows how long these recessions have lasted as measured in months. The mid-1970s and the '81-'82 recessions both lasted 16 months, that's a little less than a year and a half. Well, this one, no doubt, is going into the record books as the longest because it is going to span, according to Global Insights, somewhere between 18 and 24 months. That stretches us into the second half of 2009. That will be the longest then in the post-World War II history. So we should be looking for the bottom now at the earliest, somewhere around mid-year to the end of next year.

Now, the outlook for consumers is especially important I know for your industry. It is clear that the consumer spending binge is over. That's because the sources of available cash to support spending have disappeared. Just look back at the first few years this decade, consumers tapped equity in their houses, they sold off stocks, more recently they have been using their credit cards to continue their spending ways. But as we know now, these sources have dried up and we find that consumers, once again, are in full retreat. In short, consumers have been running a deficit just like the federal government has been running a deficit for the past decade. They've been spending more than they earned, going deeper and deeper into debt by selling off their assets.

This graph captures that idea as well as any graph that I've seen. This is a net financial investment. It's a flow of funds measure and it is calculated as household acquisition of financial assets less the increase in liabilities. Okay, so what is a financial asset? Well, that would include deposits at financial institutions, the holding of securities and equities. It does not include the value of your real property such as ones home, these are financial assets. Liabilities include your mortgage, various forms of consumer credit and loans and other forms of borrowing. So if liabilities grow faster than assets then the net financial investment is negative, and that is what we've seen since 1999. Now, this graph only goes back to 1970, but we actually have data going all the way back to 1929. And if you look back that far you will see there were only six years in which households ran deficits. They did so during the Depression, during World War II and for a couple of years immediately following World War II. So this recent sting of dis-saving is unprecedented in terms of magnitude and duration. It is estimated that over the past 10 years U.S. consumers have run up about $3 trillion in excess borrowing and spending that is not justified by income.

So now that the easy money has dried up, households are going to be forced to return to normal and that means that spending will not be a driver as we begin the recovery phase of this business cycle. It means that we can't count on the consumers going forth.

So I think there is a good chance that policies and behaviors are going to change in response to the current upheaval. First of all, the structure of the financial system is changing very rapidly and as a result the regulatory structure will also need to change. What we've learned from history is that whatever regulations are adopted, it doesn't take long for the financial innovators to figure out a way around it. And so the policy of minimal regulation that has been in place for the past decade — it was put in place because of the belief that financial institutions would self-regulate in the interest of their shareholders and their own institutional preservation. Well, it is clear that that has failed. Former Fed chief Greenspan has admitted that to Congress just a few weeks ago. He said, that is what I thought, I really thought that financial institutions would self-regulate, I was wrong. So I think what you can expect going forward is much tighter regulatory oversight and let's just hope that they don't overdo it. We have been on a crusade for the last two and a half decades to get government off of our back and to reduce the dead weight loss from regulation and it should be clearer to everyone now that there is a nice balance. You don't want to over do it but you don't want to under-do it either.

Well, what about the issue of moral hazard? Will the "too big to fail" doctrine entice even riskier behavior in the future? If you know that it's okay to take those risks because if you fail, Uncle Sam is going to be there to bail you out, to essentially socialize those losses.

We should expect a change in spending and saving patterns on the part of consumers, the graph that I just showed you. Household net worth now is down 13 percent, that means less spending, more saving. American standard of living has taken a hit in the process. You know, we've seen already a shift in preference toward smaller, more fuel efficient cars, it will be interesting to see if that lasts now that gasoline prices are no longer four bucks, it was $1.50 the other day. Homeowners may even rediscover the wisdom of paying down the mortgage or paying off the mortgage. There for a while it was widely accepted that you never want to pay down your mortgage, you need that as a deduction on your income taxes, don't ever pay it off.

So consumers are going to be boosting their savings rather than spending every dollar. That is going to be a big change for this society. The nation's policies to boost home ownership, after all, that is the great American dream, really lie at the heart of the current financial crisis. I mean, we've had affordable housing programs, we've had grants for down payments, we've had low interest, interest owner and negative amortization mortgages, we've had second mortgages taken out to cover the down payment, and all of this, it was okay to do so because we wanted to promote home ownership. And many loans, as we all know, were given to people who had no possibility of servicing that debt. The standard joke is that mortgages is for anyone who could fog a mirror.

Additionally, we have mortgage interest and real estate taxes are deductible, the gains on the sale of a house are free of capital gains within certain limits. I think a big policy question is whether we are going to continue down this path to continue to promote home ownership.

Americans are now being blamed by other countries around the world for the economic problems that they are now experiencing. This is not just the U.S. recession, this is a coordinated worldwide recession now. So the question is will U.S. financial markets retain the safe haven status that they've enjoyed for years? So far so good, the money still seems to be pouring in, but going forward will foreign investors continue to provide the capital and do the saving for us?

Another topic of interest in coming months is how the federal government will extricate itself from financial markets; it is now the nation's de facto mortgage lender. It controls the largest insurer, it has assumed large equity stakes in banking institutions. And at present, the government unfortunately doesn't seem to have an exit strategy and it is beginning to worry policymakers. In fact, there was an article in this morning's Wall Street Journal talking about the possibility of the Federal Reserve issuing debt. Now, the Federal Reserve has never done that before, the Treasury issues the debt. But the Federal Reserve would actually issue bonds in trying to shore up their balance sheet. The assets of the Federal Reserve have grown from a little less than $1 trillion to about $2.3 trillion in just a matter of a few weeks. The way that that works is as the Federal Reserve makes a loan, of course, that goes onto their balance sheet as an asset. If they buy a security, of course, pumping money out into the system, but they have the security then becoming an asset. The problem is with the quality of those assets. It is so important that all this liquidity gets drained out of the system once the economy begins to expand once again. If they don't manage to drain that liquidity, we're looking for a period of inflation and much higher interest rates and it will happen very quickly. So Fed policy here, it's all about timing, and there is concern that the quality of some of the assets that they put on their balance sheet are non-marketable. They are not going to be able to turn around and sell those assets and thereby drain those reserves back out of the system. So we may be sowing the seeds for the next bubble. I mean, do you like roller coasters? When this economy comes back it could come back very strongly and it has policymakers worried.

Let me conclude here with these ideas and then we'll go to questions. The bad news is the world's economy is in a severe recession that is going to stretch into the second half, perhaps through the end of the year. Business failures, foreclosures and personal bankruptcies will get worse, consumer spending patterns will change significantly and will not be a source for renewed growth. The public sector is going to struggle to balance budgets by cutting services and laying off workers. But the good news is the stimulus that is being applied in unprecedented amounts will change things, it's not too early to start looking for a break in that negative feedback loop that we have going between economic activity and financial markets. I would expect panic in financial markets to soon subside and investors' appetites for risk to return. You take a look at some of the prices on assets nowadays, whether its real estate or whether it is in the stock market, these things are getting to be very cheap and at some point it will become compelling and the money will flow back in and we will be off to the races, so to speak.

So in the meantime, the biggest challenge for business owners and everyone in this room, I would say, is to remain solvent, that means you need to be able to pay your bills, you need to be able to survive. And if you happen to have kept some of your powder dry, you might be thinking about putting some of your reserves to use going forward, because there are some good deals out there now.

So thank you very much. What I'm going to do at this point, I'm happy to entertain questions. I don't promise to answer them, only entertain them. So please use the microphones so that I can hear your questions.

How much time do we have? We have 10 minutes. Anyone care to venture a question? Our first question.

A VOICE: We are all in the gambling business, how do you see the gambling business effected as we go forward in this economy?

MR. VEST: Well, it is certainly a fair question. I don't know that much about gaming, quite frankly. I'm concerned that the period of easy money is over and the sources of cash will be restricted, so I think that has to be bad news. I've heard reports out of Las Vegas that the gaming business there is off. I have a colleague that studies these things quite closely at the University of Nevada, Las Vegas, and of course their economy is down there as well. I welcome any insight that anyone has into that question. The microphones are open.

A VOICE: Just a question here, as the pendulum swung for anti-regulation, do you look for it to swing back and see increased regulation?

MR. VEST: Yes. I think you're going to have more regulation. You know, it's interesting that sometimes the left hand and the right hand don't really know what's going on. So on the one hand you have the Federal Reserve pumping all of this money into the system, doing their best to encourage banks to lend the money. At the same time you have the regulators going into the individual banks, going through their books, and they are being absolutely brutal. They are coming in looking for a problem. They are making banks write down loans that are performing loans, they're current, the outlook is good but the regulators out in the field don't seem to be on the same page with what's going on. So there is no doubt parts of the economy are over-regulated, but in the case of financial markets, with all of the changes that we've seen, we have to have re-regulation. Whatever regulation is put in place, it won't be long before the financial innovators figure out a way around it and that is why the regulations need to continue to change and adapt as we go forward.

A VOICE: I keep hearing that people say that you should buy gold, but gold is dropping just as much as any other assets. What's your opinion on that?

MR. VEST: I've never liked gold. You have the cost of holding it and it doesn't have a return and, you know, it's supposed to be a good inflation hedge. Right now inflation is not what we're worried about, it is deflation. I suppose that you could make the argument that now is the time to buy. Maybe if you have a very well-diversified portfolio you might want to have a little bit of gold there but I would keep it very small. The point is, when everybody else is selling, that is the time to buy, not just gold, I'm talking about all assets. We have Warren Buffett out there who is buying and we have, of course, the federal government and the Fed acting not only as lender of last resort but buyer of last resort. There are no other buyers; maybe we should take a clue from Warren Buffett. Just look at what he has done and the successes he has had over a lifetime. Now is a good time to buy, it is just that you don't know where the bottom is. You don't want to buy today if it is going to fall by 10 percent tomorrow. But if you have enough dry powder and you don't have to borrow money on margin to buy and you can hold for three, four, five years, now is a great time to buy, I would think, any asset you select.

A VOICE: Thoroughbred racing has some issues in which people are not participating for reasons not related to the economy. Could that be a blessing in disguise? This is an opportunity for racing to fix some issues and then by the time people have money to put back into the game it will be more attractive to them that left for reasons not related to the economy but might not get back into it right now because of the economy.

MR. VEST: Well, I think that you have stated not only the question but the answer. I will consider that a rhetorical question, I think you've answered it quite well.

A VOICE: I figured you might say it better than I could.

MR. VEST: No. You said it very well.

Okay, with that, thank you so much for having me. It has been a pleasure.

(Applause)