COMMENTARY

Ponzi scheme a painful reminder, but so was Enron

The last couple of months have brought back to our attention two lessons that should have been learned long ago: "Don't invest in what you don't understand" and "If it seems too good to be true, it probably is."

Most recently, the Ponzi scheme engineered by Bernie Madoff shows that even sophisticated businesspeople can lose sight of these principles when they are enjoying healthy investment returns. Madoff was arrested Dec. 12 for running what might be the largest fraud in Wall Street history - investor losses as high as $80 billion.

One of the many notable aspects of this case is that Madoff did not prey on the weak. His primary investors were high-net-worth individuals, hedge funds and institutional investors, all of whom the securities laws presume to be able to take care of themselves. Presumptions aside, these investors were enticed to invest in Madoff's funds.

This was because of the funds' high returns, reported to be 12 percent to 15 percent annually for decades running. Unfortunately, few, if any, of the investors questioned the legitimacy of Madoff's purported strategy for making these returns. Madoff called it the "Split-strike Conversion" strategy. Maybe a corollary to the "Don't invest in what you don't understand" principle should be: "If the name of the investment strategy means absolutely nothing, that's probably what you'll end up with if you invest."

Similarly, the meltdown of Fannie Mae, Freddie Mac and major commercial and investment banks reinforces the lesson from the Madoff scandal. Even the so-called "masters of the universe" can lose sight of investing fundamentals if they are seeing favorable returns. In the post-mortems taking place over the now-cold bodies of Bear Sterns, Lehman Brothers, Fannie and Freddie, we have learned that many of the decision makers at these organizations had no real understanding of the quality (or lack of quality) of the mortgage-based securities they held.

Instead, they put blind faith in the ratings given to the securities by various rating agencies. The comfort that "expert" rating agencies had vested the securities combined with the high returns from what are now being called "toxic assets," killed executives at these formerly venerable institutions into complacency. Fortunes, reputations and jobs have been lost as a result.

The response to these events includes calls for...
our cash flow. Our debt flow is going great, though.”

**Recession might ’09 interesting for N.C.**

Earlier this month, the Bureau of Economic Analysis announced that the recession in the U.S. was the most severe since the 1980s. The government's announcement came at a time when the nation was in the midst of a financial crisis, putting pressure on the government to take action.

The recession is that until the November data came out, it looked like North Carolina was doing relatively well. In a couple of months this year, payroll employment actually rose slightly, and our cumulative decline was less than the national figure.

But November was a really bad month. State payrolls fell 1.1 percent in that month alone, which is huge, and much larger than the national percent decline. The number of unemployed people in the state shot up 11 percent in one month and the unemployment rate jumped to 7.9 percent. We haven't seen a monthly unemployment rate that high in 25 years.

It appears that the recession is hitting North Carolina a bit later than the national economy. The already hard-hit manufacturing sector helps explain this as the most vulnerable manufacturing jobs are no longer around to be lost. The data bear this out: Manufacturing employment has fallen less in 2008 than during the 2001 recession.

The recession's delay is even more pronounced in the Triad region, where employment increased for most of this year. According to seasonally adjusted figures compiled by my colleague, Don Coutts, Triad employment didn't peak until August and fell only 0.2 percent through October (we're still waiting for the November data). Since the beginning of the national recession, employment in the Triad is actually up 0.8 percent. During the 2001 recession, Triad employment fell 3.2 percent.

Will the delayed onset of the recession in North Carolina and the Triad mean a shorter downturn here? Or will our recovery from the recession be delayed as well? Stay tuned for 2009: It could be a wild ride.

**Andrew Brod** is director of UNCG’s Center for Business and Economic Research and a member of The Business Journal’s Editorial Board of Contributors. Reach him at (336)334-4867 or AndrewBrod@uncg.edu. An archive of Brod’s columns is available at http://cbne.uncg.edu.

**Guest Column**

**Andrew Haile** is an assistant professor at Elon University School of Law. He can be reached at ahale@elon.edu.