How to Make Big Money: 11 Time-Tested Strategies

By Gary Shilling

An unprecedented number of Americans have received unprecedented incomes and accumulated unprecedented net worths in recent years. Sure, the gains are tempered by the reality that while the top tier is gaining, the income shares of the rest are falling. Many Americans have seen no purchasing power gains in decades, and they've only recently advanced because of the big fall in energy prices

While some wring their hands over income polarization, we're more interested in how the rich get rich. There are many strategies. A number are far from new, but have been pursued much more vigorously and with much more spectacular results in an era when extraordinary liquidity is readily available due to low volatility and low perceived risks. We've identified 11 different strategies that have stood the test of time. None of these strategies are sure-fire. All of them have pitfalls, sometimes because they are so successful that they invite their own demise.

1. Government Subsidies

Perhaps the most time-honored and surest way to make big money is the old fashioned way--skill, brains, luck, clairvoyance, hard work--and so much government support you can't miss. Benefiting directly from direct government spending is obvious. What's more subtle and therefore more interesting are the vast government subsidies.

Energy

Petroleum remains heavily subsidized by tax measures such as the depletion allowance, accelerated depreciation and expensing of intangibles, making fortunes for oil tycoons for decades. Windmill farms would not exist without heavy government subsidies. Ditto for solar energy.

Ethanol is subsidized with a $0.51 per gallon tax credit, an import duty of $0.54 per gallon and the elimination of ethanol's main oxygenate competitor, methyl tertiary butyl ether (MTBE). The Department of Energy plans to provide $385 million in subsidies to six companies to produce bio-fuel alternatives to ethanol that will cost $1 per gallon.

But despite the current zeal for ethanol, it cannot be shipped by pipeline due to its corrosiveness, and the needed trains, tracks, storage tanks and loading and unloading facilities will be expensive. Add in the current high price of ethanol's main feedstock, corn, at $4 per bushel and the natural gas needed to convert corn into ethanol, and this fuel could not compete with gasoline profitably without huge government support.

Agriculture and Real Estate

U.S. agriculture has been heavily subsidized since the 1930s, with the prices of grains, wheat, corn, cotton, tobacco and even honey supported in one way or another and providing about a third of farm income. Some in Congress are trying to concentrate subsidy payments on small farmers and cut the gravy to larger, highly profitable operations that receive the bulk of revenues and government payments.

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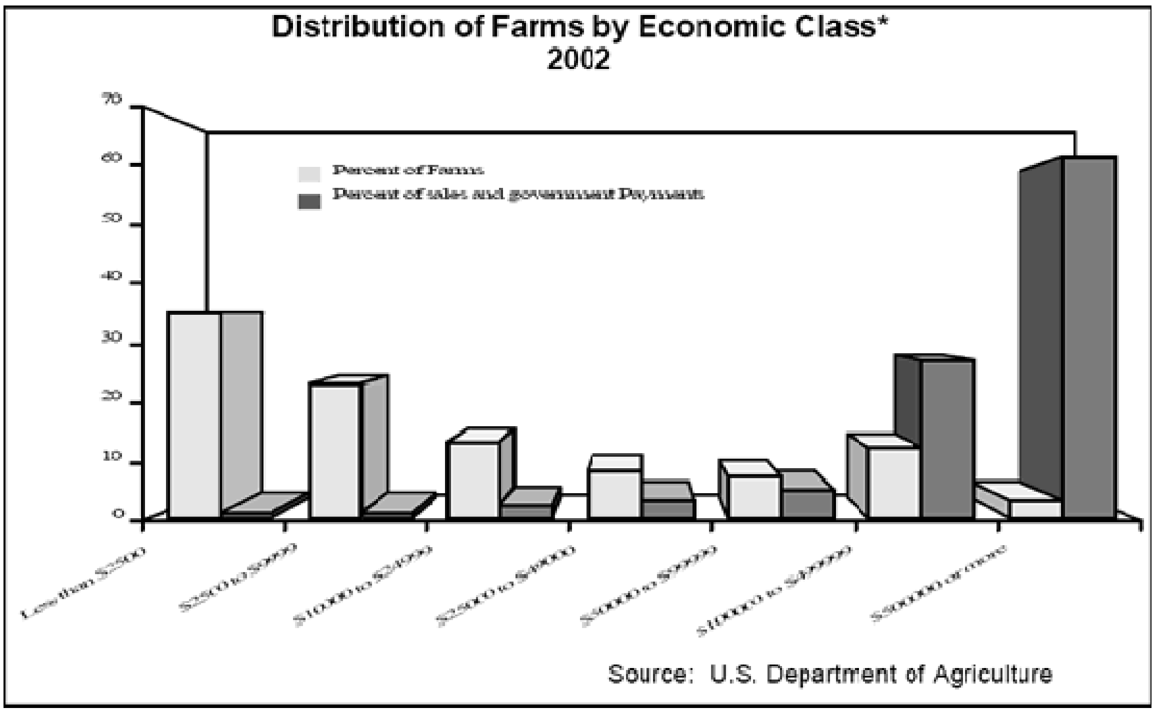

But despite the tiny and dwindling percentage of the nation's workers in agriculture, sizable farm subsidies will persist as long as there are two Senators from every state.

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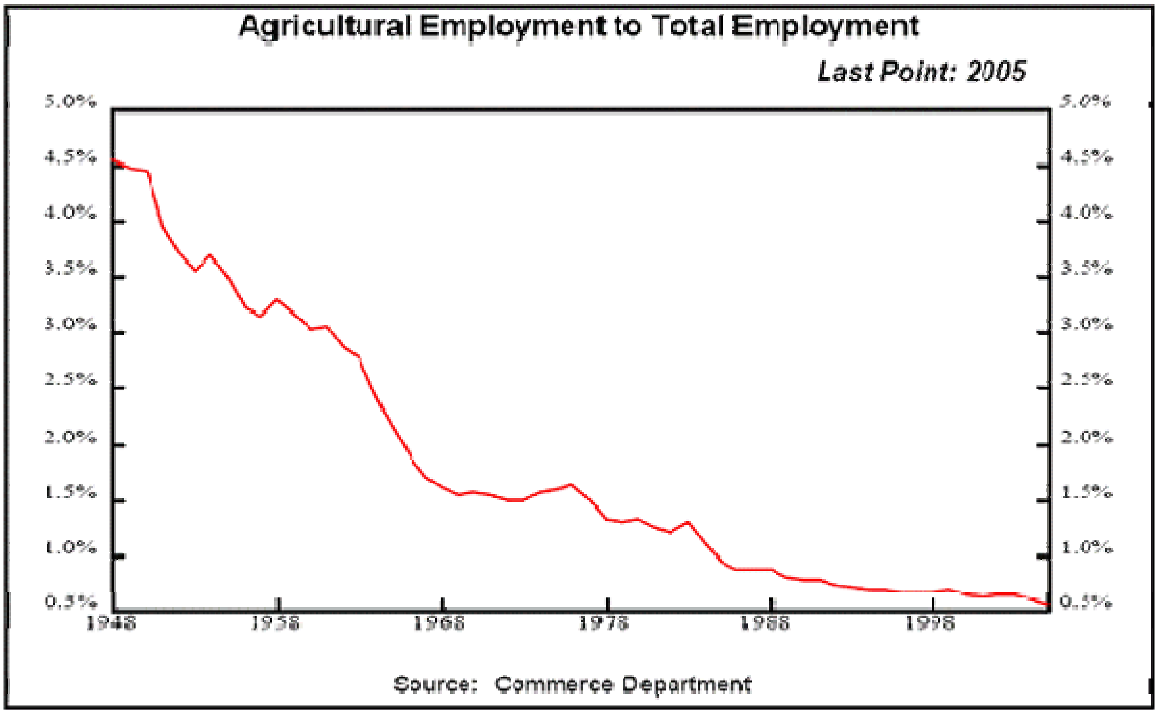

Real estate is another large beneficiary of government largess. Commercial real estate investors enjoy tax-free exchanges that allow them to defer taxes by promptly buying a second property after selling a similar appreciated property. Full-time real estate professionals can deduct depreciation, interest costs and property taxes from their income. Individuals can deduct mortgage interest, and realize up to $500,000 of appreciation for a married couple on their primary residence every two years. Residential real estate has been in a speculative bubble, but how much of the recent leap in homeowner values would have occurred without these government goodies?

Health Care

The government, of course, hugely subsidizes the mushrooming health care bill and currently pays 45% of the total through Medicare, Medicaid and other programs. That share is forecast to reach 50% in 10 years--to the immense profitability of many. And with the aging of the postwar babies, government support for health care will mushroom.

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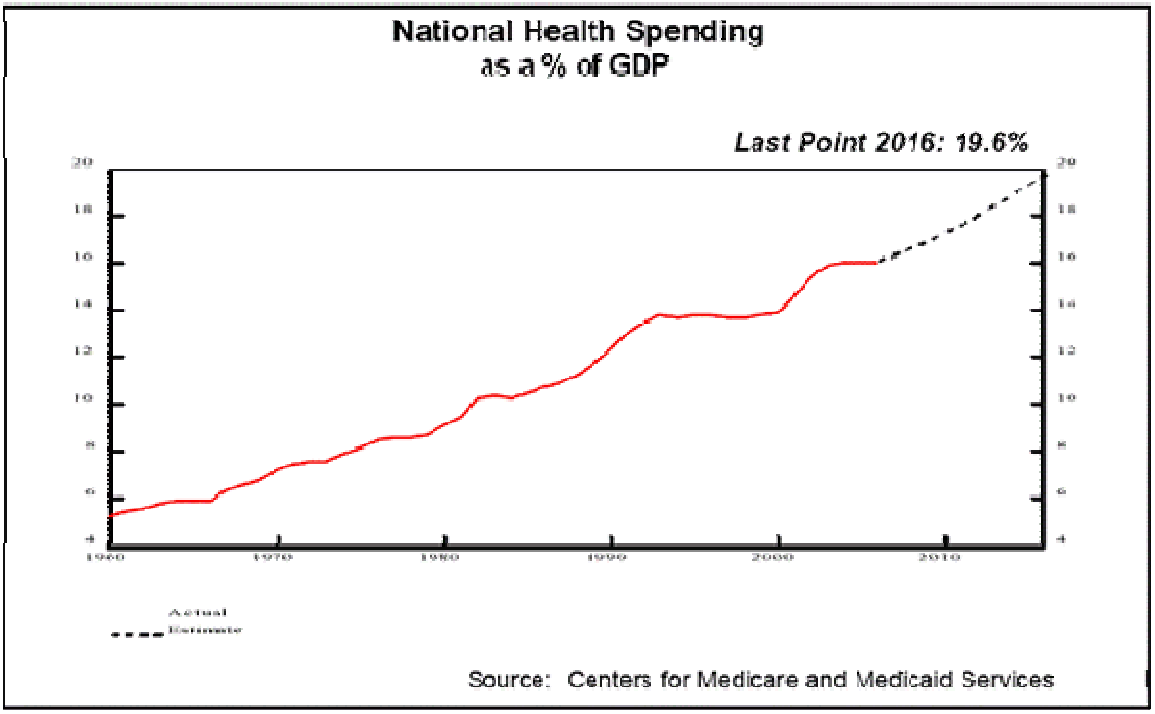

Feet in the Trough

Over decades, we've examined the breadth and depth of government involvement in the economy to determine the percentage of the population that depends on government in a major way. When we added up government employees and their dependents, suppliers of government purchases and their dependents, recipients of Social Security, welfare, Medicare, Medicaid, student loans, farm subsidies, etc., we found that the percentage of the American population climbed from 28.3% in 1950 to 55.0% in 1980. That figure receded to 49.4% in 2000 due to strength in the private sector while anti-government sentiment slashed the number of welfare recipients. But the percentage climbed back to 52.6% in 2004, and is headed for 60% in the decades ahead as the postwar babies tap Social Security, Medicare and Medicaid.

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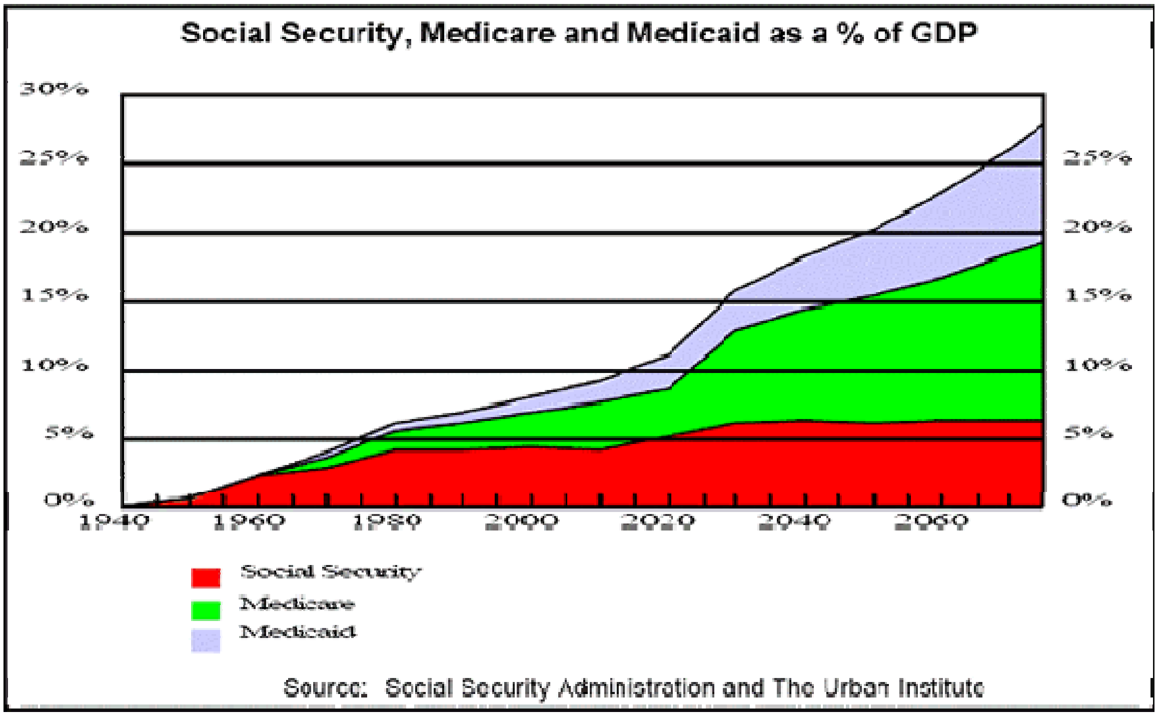

Since over half of Americans have their feet firmly planted in the government trough, it's highly unlikely that government subsidies will disappear or even be cut substantially.

2. Inheritance

You can always make big money by picking rich parents who die young, or wealthy and feeble uncles with no other heirs. For most, however, inheritance is not the route to riches. A study by AARP found the total for inheritances of all people alive today to be $12 trillion in 2005 dollars. Most of it, $9.2 trillion, will go to pre-boomers born before 1946, only $2.1 trillion to the postwar babies born between 1946 and 1964, and a mere $0.7 trillion to the post-boomers. The study goes on to show that the percentage of people receiving inheritances since 1989 has been quite consistent, so there's no reason to expect big jumps in their numbers any time soon.

Furthermore, the value of all previous inheritances as reported in the 2004 survey was $49,902 on average, with $70,317 for pre-boomers, $48,768 for boomers and $24,348 for post-boomers. Clearly, these are not numbers that will provide for comfortable retirements.

3. Little Equity, Lots of Debt

You can make lots of money by investing with little equity and huge borrowing--as long as you're right on the investment's price direction! Real estate is obviously in this arena. Earlier, 20% down payments on houses were the norm, but they've shrunk to zero or even negative numbers with "piggyback" loans, second mortgages on top of the usual 80%

first mortgages, which can take the total loan to more than 100% of a house's value.

But remember, those with little or nothing down are highly susceptible to delinquencies and defaults when falling prices, as at present, push their home equity into negative territory. Giant British bank HSBC Holdings found this out recently. It plunged into subprime second mortgage lending in the U.S., which in aggregate leaped from $145 billion in new loans in 2000 to $640 billion in 2006. HSBC also bought billions of dollars of these loans from other lenders. Its second mortgage holdings leaped from $6.3 billion in September 2005 to $10.2 billion in March 2006.

But delinquencies on those loans are leaping and HSBC recently set aside $1.76 billion to cover soured mortgages and other bad debt. Now the woes are spreading to Alt-A mortgages, those between subprime and prime, and headed upward, with the Alt-A default rate doubling in the last 14 months to 2.4% and the subprime rate at 10%.

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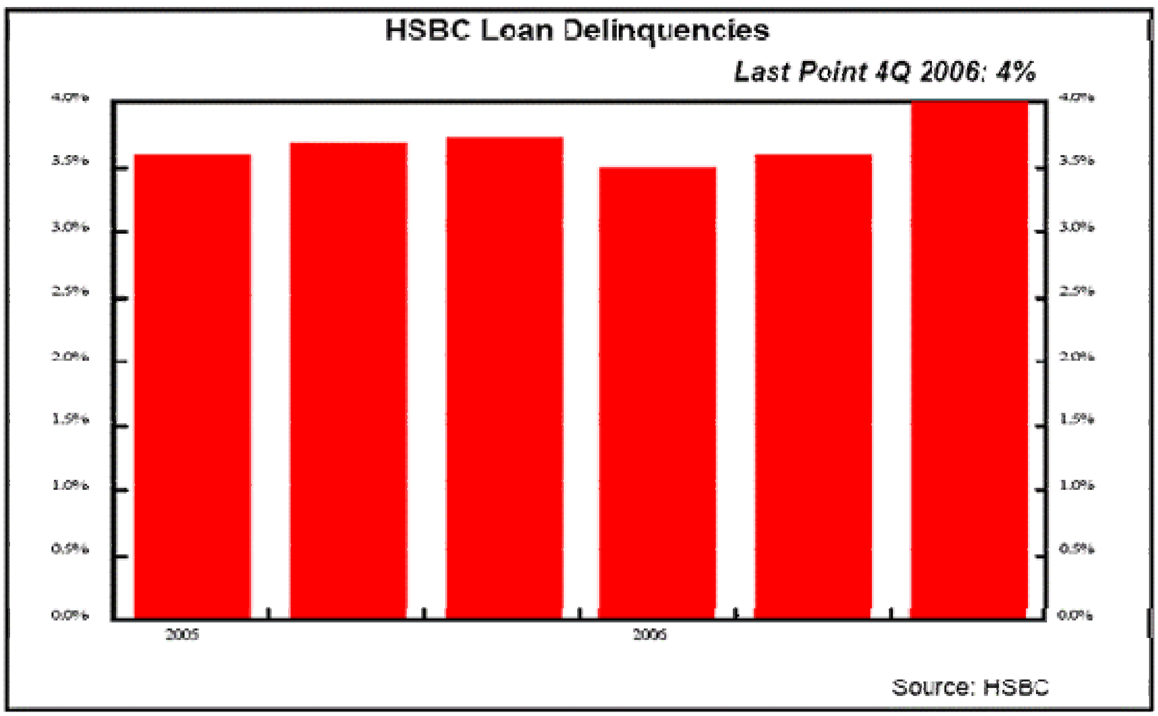

These unfolding disasters point out that big borrowing to finance real estate only works, as it has spectacularly in recent years, because of leaping prices. Otherwise, residential real estate would be a lousy investment.

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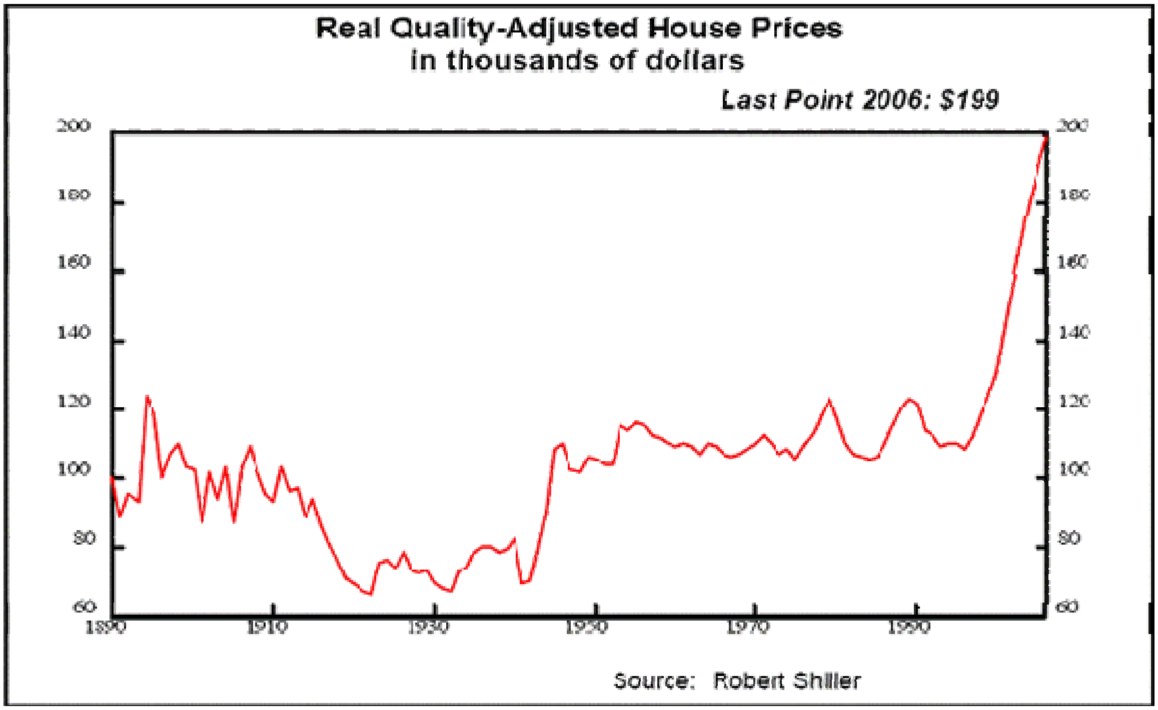

Hedge Funds and Private Equity

Hedge funds, of course, employ tremendous borrowing, an estimated $900 billion to $4.2 trillion. And investors are enamored by them despite the reality that their growing size, now $1.4 trillion in assets, has led to the full exploitation of many of their investment opportunities. Last year, on average, they returned 12.9% compared with 15.8% for the S&P 500.

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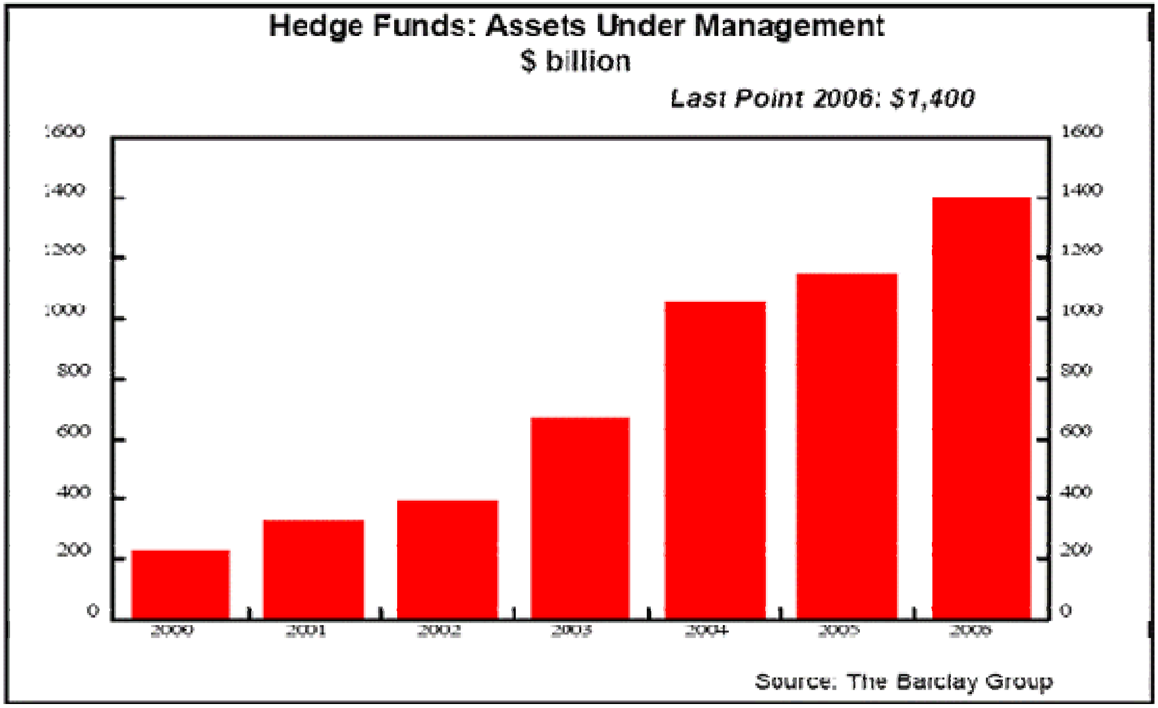


Private equity funds, the latest Wall Street darling, also use heavy borrowing. Typically, they load corporations with debt after taking them private and then attempt to cut costs and otherwise improve cash flow to justify the huge interest expense. Oceans of liquidity and little fear of risks have driven investors to private equity. That fueled $418 billion in deals last year, triple the 2005 level.

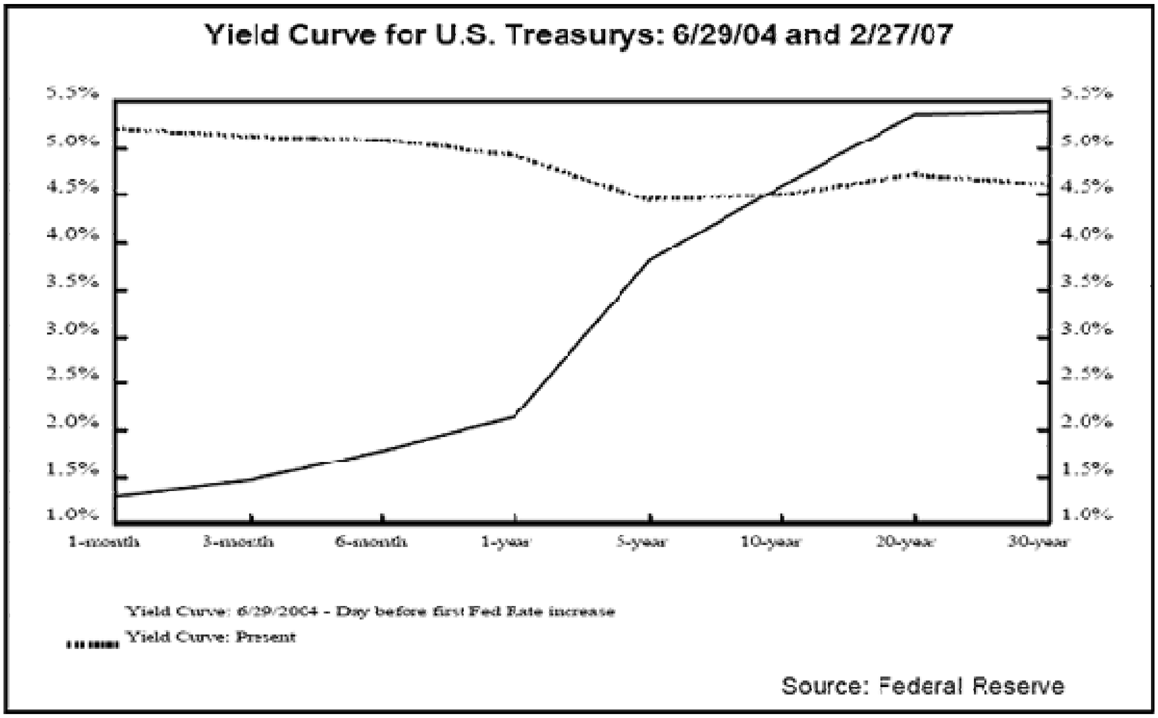
Futures

Futures contracts don't exactly involve borrowed money, but it amounts to the same thing. To buy or sell a futures contract on $113,000 of 30-year Treasury bonds requires a speculator to put up $1,350 with his commodities broker. If bond prices rise 1%, he makes $1,130, or 84%, on his money, excluding commissions. But, of course, futures work both ways. A 1% price decline would almost wipe out his capital.

Banks

Banks typically borrow 10 times their capital or more through deposits and other means, which gives them immense financial leverage. Much of this borrowing is used to finance long-term and relatively safe business and consumer loans. But some of those loans now have unusual risk, as demonstrated by HSBC's bad second mortgage loans. Also, with the inverted yield curve, this spread lending is not very profitable today.

CHART 8



So many lenders, especially the big banks, have been emphasizing proprietary trading, private equity investments and all manner of derivatives activity. Given the small size of the banks' equity relative to the assets controlled, the profits are tremendous if the bets work out--but so are the losses if they're wrong.

4. Leverage

Our third strategy, little equity with lots of debt, of course, amounts to huge financial leverage. But leverage as a way to make big money extends well beyond the use of debt. Think about movies vs. stage productions. A play can only reach an audience of several hundred and must be repeated night after night by the same actors to generate much revenue. Sure, road companies of successful musicals are the norm and provide some leverage for owners of the show. And popular musicians perform in huge football stadiums to reach much larger audiences.

But none of these enhancements rival the leverage of movies, which are presented to unlimited audiences worldwide and, if they have legs, for decades to come. The same leverage and opportunity for big money exists for entertainment transmitted via CDs, DVDs, radio, TV and the Internet.

Leverage is the lifeblood for professional and, to a certain extent, college athletics. Decades ago, professional athletes weren't especially highly paid except for a few superstars. But then came TV broadcasts of games. Today, negotiations over $10 million-plus contracts are simple decisions on how the TV revenues will be spent. Those TV revenues, of course, are provided by advertisers who hope their messages will be effectively and profitably leveraged many, many times to viewers. Ditto for radio, newspapers and magazines as well as the Internet ads that are increasingly replacing those in print media.

The leverage we're thinking about also applies to lawyers. Big law firms don't make their big money from billing partners' time, even at $500 per hour. It's the time of all those associates who may be paid $150,000 per year or $75 per hour, but are billed out at $350 per hour. That's why legal bills that involve three hours in partner time but also 20 associate hours aren't uncommon.

Then there are all those mass-produced items. Producing the first one of a new car model costs tens of millions of dollars, but mass production drops the unit cost drastically--and pumps profits--at least for Toyota and other foreign companies with low marginal costs and growing market shares. Building each vehicle still requires lots of steel and other materials. To the extent that a mass-produced product contains fewer raw materials and more intellectual content, the leverage is greater. Consider Microsoft. Once a new software program is developed, it costs next to nothing to transmit it via the Internet to a customer. As a result, the firm piled up so much cash that when it paid its first and monstrous dividend of $33 billion in late 2004, it caused total corporate dividends to leap.

5. Great Ideas, But Not Necessarily The First Implementers

Sometimes, entrepreneurs are better off preaching sermons while waiting to build the second or third version of the better mousetrap. Alexander Pope said, "Be not the first by whom the new are tried, nor yet the last to lay the old aside."

Ever hear of Seattle Computer Works? That firm developed a computer operating system in the 1970s that Bill Gates bought in 1980. IBM was late in realizing the potential of PCs after Apple led the way, and knew that its engineers were too tradition-bound to develop an operating system quickly. So Gates paid $50,000 for Seattle Computer Works and licensed MS-DOS to IBM for use in every one of its PCs.

Prodigy Service, an online computer business, was launched in 1984 with three big backers, IBM for technical assistance, Sears for selling its wares online and CBS to help with delivering online news and selling online ads. CBS backed out early but IBM and Sears spent $1.2 billion on the venture. Prodigy's focus was on electronic shopping, but online subscribers back then were more interested in chat rooms, e-mail and then the Internet. America OnLine had the winning approach so Prodigy's early lead dissipated and it was sold in 1996 to an investor group for only $250 million.

Until the early 1960s, AT&T had a nationwide monopoly on long distance telephone service. Then Tom Carter invented the Carterphone, a device that allowed you to rest the telephone receiver earpiece over a microphone and the mouthpiece over a speaker. Only 4,000 Carterphones were ever installed, but AT&T saw it as a threat. Carterphone and AT&T went to court, and in 1968 the Supreme Court ruled in favor of Carter Electronics. So the FCC ordered the nation's phone companies to connect their lines to non-Bell devices, as long as they were technically compatible with the phone network. Little Carter broke the huge AT&T monopoly, but did that give it a commanding lead in supplying telephone instruments and related gear? It voluntarily dissolved in 1969.

6. Small Slices of Very Big Pies

Fortunes can be made by taking small slices of very big pies, especially if those ultimately granting the slices are making money. Fees of, say, 0.1% if the transaction's price don't sound big, but they add up to big numbers. This is especially true if a merger or IPO or leveraged buyout involves tens of billions, as a number have recently. And note that large acquisitions often don't require much more work than smaller ones.

CHART 9

Acquirer Merger Fees

Date	Acquirer	Target	Acquirer Fee
11/2006	Freeport-MoMoRan	Phelps Dodge	$50 million
12/2004	Sprint	Nextel Comm.	$46 million
1/2004	J.P. Morgan Chase	Bank One	$40 million
11/2005	Koch Industries	Georgia-Pacific	$30 million
5/2006	Wachovia	Golden West Financial	$23 million

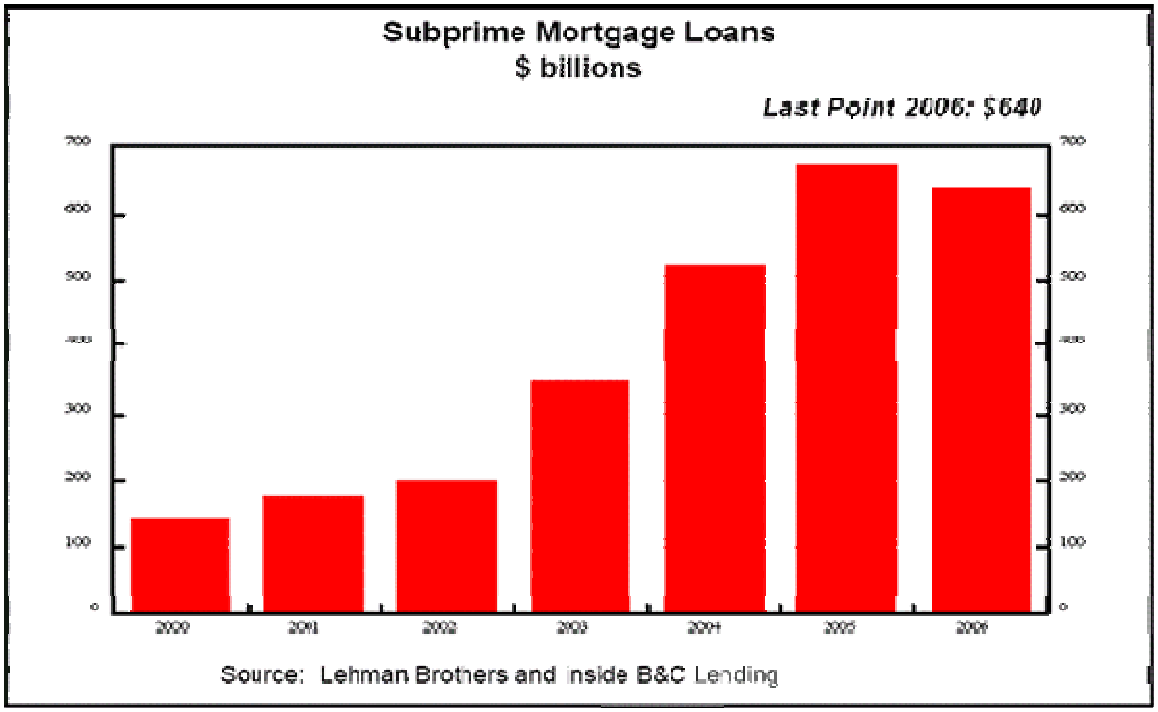
Source: Dealogic

Furthermore, buyout outfits normally charge the investors in their funds 1.5% annually. The percentage may sound small, but the funds are getting huge. Goldman Sachs is expected to raise $19 billion for its latest private equity fund, and Blackstone and Kohlberg Kravis Roberts are expected to close funds in the $20 billion zone. So 1.5% of $20 billion equals $300 million. And managers usually also charge 20% of the profits. One estimate is that with good investment success a $20 billion fund could pay the managers $7.7 billion over its 10-year life, or almost 40% of the capital committed to the fund.

Mortgage Lenders and Banks

Mortgage lenders who securitize pools of subprime loans also have been getting a small but lucrative piece of a very large pie. Last year, $640 billion in subprime mortgages were issued, up from $145 billion in 2000. The vast majority of those were Adjustable Rate Mortgages, which Fed-induced rising short-term interest rates threatened to cut back. So, to keep origination fees and the related mortgage servicing income flowing, lenders dramatically lowered their lending standards last year.

CHART 10

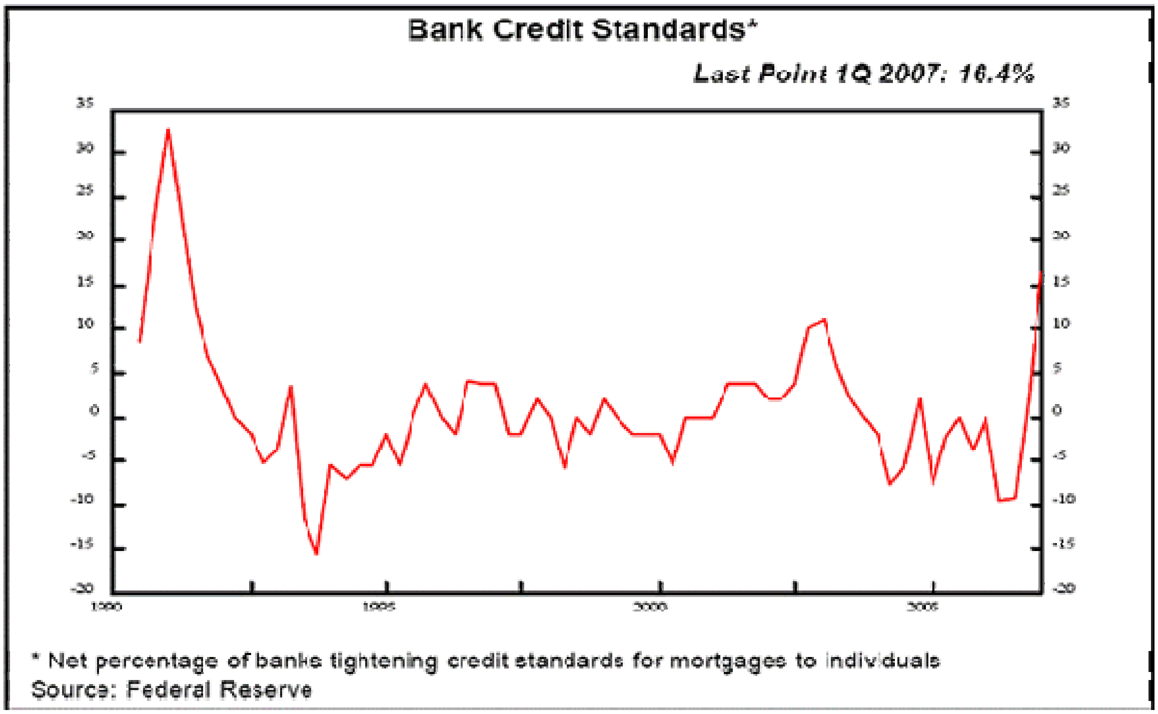


Banks, of course, traditionally profit from the spread between the interest rates they pay on deposits and the higher rates they charge on loans. These spreads of a few percentage points are greatly magnified as a return on bank capital by the relatively small ratio of capital-to-assets, now capped by regulators at 8%. In effect, banks combine our third strategy, invest with huge financial leverage, with our sixth, small pieces (interest rate spreads) of big pies.

Now, however, the inverted yield curve, with short-term rates above bond yields, has squeezed banks' spreads since most deposits and other borrowed money are short term while loans have longer durations. So, to augment earnings, these lenders have not only emphasized other investment areas, but also by lowering their reserves for bad loans. Low defaults in an era when more than ample liquidity has made refinancing easy for even the shakiest borrower has also favored lower reserves. From 2004 to 2006, the country's biggest banks got 37% of their earnings growth from loan-loss reserve reductions, and at large regional banks, it was 52%.

But now with deteriorating credit in residential real estate and other loans, banks are under pressure to increase reserves. HSBC recently announced a $1.7 billion increase, largely to cover weakening second mortgage loans to subprime borrowers, as noted earlier. Estimates are that a 10% increase in reserves, which may be small in the financial world we foresee, would cut bank earnings growth by four percentage points. Under pressure from regulators, banks are also tightening lending standards, which will curtail the growth of the pie from which they get their slice.

CHART 11



Banks and other mortgage lenders often sell those loans to investors, but are forced to keep some as their own investments. Many subprime lenders are being pressured to raise their reserves to keep up with rapid loan deterioration. NovaStar's reserve moved from 0.75% in the third quarter of 2006 to 1.05% in the fourth on its $2.1 billion in loans held as investments. This, among other factors, has not pleased investors. Furthermore, lenders are being forced to buy back from investors some of the loans that became delinquent quickly or suffered other problems, as noted earlier.

And higher reserves and the resulting lower earnings are almost certainly in the cards for subprime, Alt-A and prime mortgage lenders. That's especially true for issues of option ARMs that allow borrowers to make monthly payments that don't even cover the interest due. Under accounting rules, lenders such as Bank United count unpaid interest as current revenue with reserves for expected losses. The assumption is that the interest will be paid eventually but if it isn't, this rising share of earnings will be reversed.

Losses will leap as the periods during which monthly payments less than interest due run out and subprime borrowers who can't afford the larger reset payments default. Ditto for Alt-A mortgages. Already, loans that require full interest payments but no interest in the loan's early years are suffering delinquencies of 60 days or more those Alt-As originated in 2006.

CEO Pay

There's much hand-wringing over current high and leaping CEO pay levels, which averaged $2.4 million in 2005, up from $2.1 million in 2003 at 350 large companies. But here, too, corporate leaders' compensation is often tiny compared to profits and much smaller as a share of revenue. That's one reason why shareholders have shown little effective concern--as long as stock prices are rising.

Regulation of CEO compensation, now being considered by Democrats in Washington, is no match for the formidable pressures to increase pay. A 1993 law limiting corporate compensation to $1 million per executive unless it was based on performance meant everything over $1 million immediately became linked to performance. That spurred stock options, which pressured corporate managements to produce quarterly results to please stockholders and neglect the long run. That short-term orientation in part fueled the equity bubble of the late 1990s. It also encouraged option backdating, now an ever-widening scandal. Talk about unintended negative consequences!

Of course, as we saw at Enron, when shareholders lose lots of money, there is a cosmic need for scapegoats, and CEOs and their pay will do very nicely. Furthermore, with big declines in sales and corporate earnings, normal when stocks are retreating, their compensations become bigger slices of smaller pies and more questioned. But otherwise, this strategy is a great way to make big money.

Fast Food Franchises and Manufacturing

The small slice of a big pie route to riches isn't confined to finance and CEO pay. Fast food franchises make pennies per hamburger and nickels on a soft drink, but it adds up as they sell millions of dollars worth. The same is true of many other businesses where profits per dollar of revenue are small but volumes are huge. Polls consistently show that most Americans believe that profits represent a much, much higher portion of sales than they actually do.

7. Cartels and Monopolies

Cartels and oligarchies are great ways to make big money--as long as they last. Of course, a cartel only works when demand is so insensitive to price that higher prices will actually increase the seller's total revenue. The earliest known example of an international cartel is the salt cartel of 1301. In those days, salt was an extremely important commodity--perhaps as important to the society as oil is today.

Why Set Up Cartels?

The purpose of cartels, of course, is to exercise monopolistic control--to raise prices and revenues by limiting production, restricting exports, setting prices, dividing up markets among the cartel members, setting up standards of accounting and markups, etc. There are numerous reasons why cartels are set up, however.

Reducing the risk of losses due to volatile markets and new entrants is an important reason, and was a prime motivator of the grain cartels of ancient Greece and Rome. It also encouraged the formation of medieval craft guilds that set working hours and output quotas, prohibited members from soliciting each other's customers or finishing the work started by another, prevented non-members from practicing their trade, etc. Another important force for cartel formation has been to offset cutthroat competition in the products involved, often the result of new sources of supply. The alum cartel of 1470 and the copper cartel of 1498 fall in this category, as do the rubber and sugar cartels of the 1920s and many, many in between.

Another reason for cartel formation is to eliminate foreign competition, especially in new geographical areas, as was the case with English Merchant Adventurer companies that flourished in the 16th and 17th centuries. Armed with royal charters, they monopolized the whole of England's foreign trade. Patent agreements have often developed into cartels, as was the case with incandescent lamps and glass bottles early in the last century.

Government Needs

Providing urgently needed funds for the government has been a great stimulator of cartels over the years, as in the case of the salt cartel of 1301 or the alum cartel of 1470--and today's oil cartel. Governments also sponsor monopolies to foster technological innovation--patents that grant the inventor exclusive rights to sell his product for a set time. Benjamin Franklin, America's Renaissance Man who invented bifocals and the lightning rod, among other new devices, advocated a Patent Office when our nation was being established and had patent rights included in the Constitution.

In recent years, pharmaceutical companies spend millions to reformulate and repatent successful drugs whose patents are expiring. And remember the knock down, drag out over eBay's use of MercExchange's patent on the "buy it now" feature that allows customers to skip the auction process and buy the merchandise immediately at a set price? Patents are supposed to be granted for important innovations that aren't trivially obvious.

Why Cartels End

Just as excessive competition has usually initiated cartels, it has also led to their demise. Falling demand in the depression killed many of the cartels set up in the 1920s and early 1930s. The development of substitutes or alternative supplies often had the same effect. Smuggling, the desire for still high prices by cartel members and outright cheating have broken some cartels. The copper cartel of 1498 was broken when the Függers, the rich and famous German bankers who formed the agreement, sold considerable amounts without the knowledge of the other cartel members. It's a no-no for a cartel's leader to be the cheater!

Steel and Utilities

The American steel industry had a powerful cartel that lasted for over half a century after the founding of US Steel in 1901. But foreign competition killed the U.S. cartel and its pricing power late in the last century, despite repeated government attempts to provide protection. Almost all American producers except US Steel went bankrupt under the weight of noncompetitive labor costs.

Electric, gas, water and telephone utilities used to be treated as natural monopolies and, therefore, regulated. They made good, steady returns but weren't fabulously wealthy since regulators usually allowed a set return on investment, which encouraged them to spend on plant and equipment whether they needed it or not.

Serious deregulation started in 1984 when AT&T was forced by a federal antitrust suit to spin off the 22 local companies into seven "Baby Bells." Deregulation of natural gas pipelines and electric utilities followed and free competition was hailed as the consumer's friend. But some electric utilities are essentially being re-regulated. The seven Baby Bells have shrunk to three that include wireless, cell phone and other telecom modes. Still, competition in telecom remains fierce and consolidation reflects it more than it heralds a new golden age of oligarchy profits.

Airlines

Until 1978, airlines were controlled by the Civil Aeronautics Board, which controlled airline routes and fares. Upon deregulation in 1978, airlines invaded each other's territories with gay abandon. Old line carriers fought deregulation with frequent flyer programs designed to create customer loyalty. They also challenged deregulated fares with sophisticated computerized pricing models that separated price insensitive business flyers from cost-conscious leisure flyers. The over-the-weekend stays required to get the low-ball prices are only one example.

These competition-deflecting strategies by high-cost airlines had some success in the 1980s and 1990s, but by the end of the last decade, the legacy carriers were no longer able to buck the jet stream of competition. With the stock market collapse in 2000-2002, the huge gap between business and tourist airfares induced many businesspeople to fly steerage. Mushrooming Internet websites made it easy for passengers to overcome the airlines' deliberately confusing array of fares and nail down the lowest ticket costs. Meanwhile, leaping jet fuel costs could not be offset with higher fares.

Furthermore, the previously successful hub and spoke air route system proved too expensive to compete with the point-to-point systems of upstarts, specifically Southwest.

A very important deterrent to consolidation in the airline industry is the cost-cutting opportunities of bankruptcy. This makes it possible to cancel labor contracts, and even the threat of filing for bankruptcy can wring concessions from unions. Bankruptcy also allows airlines to drastically reduce or even eliminate debt to say nothing of essentially wiping out stockholders. Another big advantage of bankruptcy is the opportunity to dump defined benefit pension fund obligations on the federal government's Pension Benefit Guaranty Corp. With all these advantages, it's no wonder that airlines have entered bankruptcy 163 times since 1979, some of them multiple times.

So, on balance, the airline industry now seems to be defying economic forces, but for well-defined reasons. With deregulation of fares and routes 29 years ago, it should have long since consolidated, but hasn't. Planes are full--been on one that isn't lately? Air travel is at record levels. But costs are still at noncompetitive levels for many carriers. And none can raise fares enough to cover the recent leap in jet fuel costs. The moral of this story is that regulation fostered a heavenly cartel structure for airlines, but deregulation introduced unmitigated and seemingly endless hell.

8. Sell the Sizzle, Not the Steak

An age-old route to riches is to promote hopes and dreams, regardless of how far they may be from reality. Of course, government regulation has curtailed the wild health claims for snake oil and many other patent medicines, hair restorers, potency formulas and fountains of youth, but opportunities still abound.

Garlic growers have benefited from the belief that garlic protects against heart attacks. Health food entrepreneurs have accommodated those who don't like the taste or digestive effects with garlic pills, widely advertised on TV and elsewhere. But a brand new scientific study, complete with double blind tests and placebos, found absolutely no effect in reducing cholesterol. Garlic producers, of course, responded that the tests weren't meaningful.

Penny stocks of dubious, even non-existent Canadian gold mining companies have long been the staple of the Vancouver Stock Exchange and appeal to sizzle lovers. So, too, do get-rich-quick schemes. And then there are all the get-rich-quick and related self-help books. The purveyors can make good livings and then some selling their strategies as they prey on hopes and dreams. But do many buyers stop to ask, if this guy really knows how to do it, why would he share that priceless knowledge with the rest of the world?

9. Take Advantage of Addictions and Vanity

Catering to addictions and vanity has always been a big money-maker, even more so when they are outlawed. Think of sex and prostitution, the world's oldest profession. Concubines have always been a trapping of political and economic success. The courtesans of Washington, D.C. who frequently embarrass politicians are no different from those in Louis XIV's court. They're just less socially acceptable in America.

While smoking is on the decline, those still hooked will pay almost anything to satisfy their nicotine addictions. On the other hand, don't forget the growing industry of nicotine patches and gums, smoking-cessation clinics, hypnotists and other devices that benefit from smokers' attempts to kick the habit, despite limited success. Then there is caffeine addiction, which has created vast fortunes in coffee and tea. And don't believe soft drink makers when they say they put caffeine in their products to improve the flavor and pep you up. It's mainly to make them habit-forming.

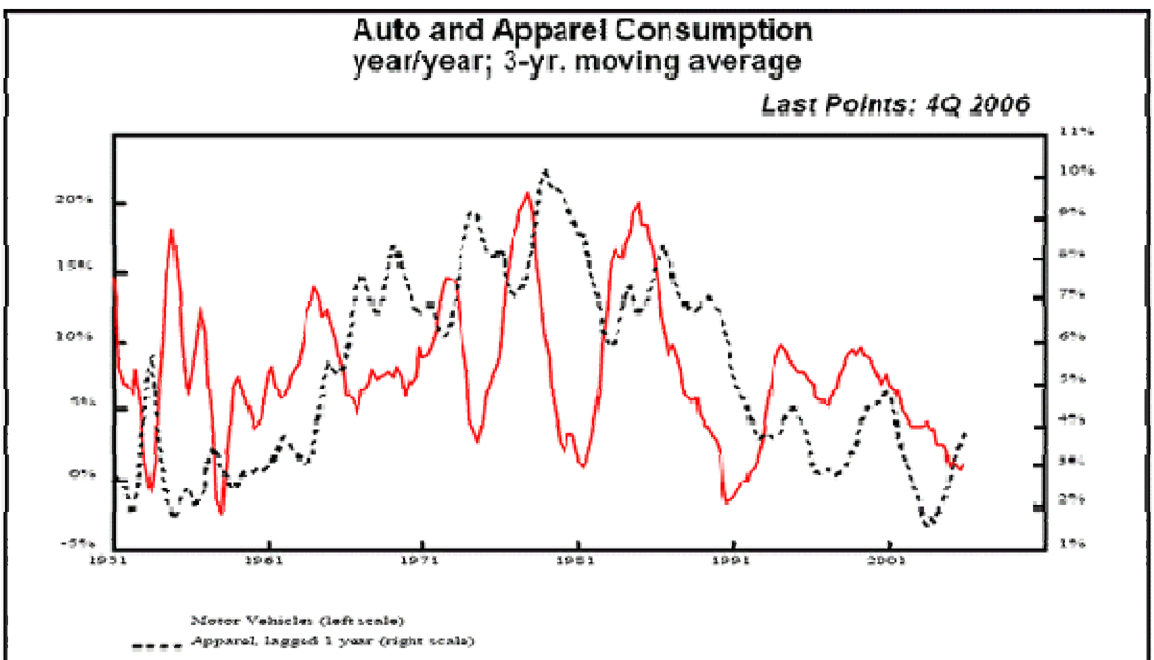
Illegal booze, of course, was the lifeblood of the Mafia during Prohibition, and a high but bloody life it was. Now, illegal drugs are huge money makers. So much so that a major demand for U.S. currency is for $100 bills used in the illegal drug trade. It's practitioners have major problems in laundering the money that is far too much to be employed profitably in their business and must be recycled into legitimate activities. The war-torn economy of Afghanistan has revived due to the poppy industry, under the careful protection of local warlords.

Vanity and Small Luxuries

Appealing to vanity is another lucrative business, and always has been. Think of all the money spent on face creams, hair coloring, botox injections, body slimming gyms, etc. Then there are all the gorgeous clothes to fit on those magnificent bodies.

Small luxuries is a category we discovered decades ago when we noticed that auto and apparel sales are mirror images. When people can't afford new vehicles, they buy new clothes as consolation prizes about a year later.

CHART 12



Source: Bureau of Economic Analysis and A. Gary Shilling & Co.

Consider Hallmark. Greeting cards aren't big expenditures, and for just a buck or two more than the run-of-the-mill supermarket offering, you can tell the recipient that you care enough to send the very best. Starbucks operates on the same small luxuries principle that makes people happy to pay over $3 for a fancy cup of coffee served in a cool atmosphere. But store saturation and competition seems to be taking the stars out of investors' eyes. Dunkin' Donuts has entered the business in recent years, and McDonald's plans to sell the same products for a dollar or so cheaper.

10. Picks and Shovels

Supplying goods and services to a risky but potentially very profitable venture is a time-honored way to clean up. The old story is that few gold miners in the 1849 California gold rush got rich, but those selling them picks and shovels--and Levi pants--sure did.

Today, businesses that prosper as suppliers to those who hope to make gigantic profits are legion. In stock bull markets and especially bubbles, investors have dreams of fabulous riches and will pay heavily to those who serve their needs, aspirations and whims. This includes stockbrokers, investment advisors and mutual fund advisors. Note, however, in the very frothy late 1990s, investors became so confident in nonstop success that they abandoned outside advice. Some garage mechanics ripped out their vehicle lifts to make room for day trading computers.

Those that provide back office, custodian and other services to stockholders are also in the picks and shovels business. And note that almost all areas on Wall Street depend on stock price action. When stocks are rising, mergers and acquisitions, private equity, investment management and IPOs are all vibrant. So, houses involved in all these activities prosper, as they have in recent years.

Real Estate and Ethanol

The residential real estate bubble, until recently, fed armies of brokers, mortgage lenders, builders, appraisers, construction material suppliers and Wall Street houses that generated all those Residential Mortgage-Backed Securities and Collateralized Debt Obligations. In the last year, mortgage lenders continued to promote loans to patently unqualified subprime borrowers because of their lucrative fees.

As discussed earlier, ethanol is all the rage now, but even with huge subsidies, its profitability is vulnerable. High corn prices can rob profits as can low gasoline prices. Every one-dollar increase in the price of corn per bushel adds $0.35 a gallon to the production costs of ethanol.

The picks and shovels purveyors will probably be the winners in the quest for renewable and other energy. Makers of equipment for corn farmers in the case of ethanol. Road builders and suppliers of the huge trucks and other equipment needed to mine and process tar sands. Builders of ships that transport LNG.

11. Get Paid With Money That Isn't The Payer's, Especially If They're Desperate

Small pieces of big pies get bigger and easier to obtain when the buyer of the pie wants it badly and considers the service in question essential to get the deal done. CEOs are often quite free with corporate money in paying bonuses to consultants who *may* help save their companies, even when those outside experts tell them what they already know. Compensation studies by outside consultants almost always conclude that the senior brass is undercompensated. Corporate directors approve lavish CEO compensation and severance packages in part because it isn't their personal money, as noted earlier, and they want to keep the leader happy.

Business-oriented law firms are particularly good at this strategy, especially when their clients face significant class action suits, other substantial legal difficulties or potentially debilitating regulatory problems. Corporate officials will spend almost any amount of their firm's money to stay out of trouble, and lawyers know it.

Of course, the class action lawyers are also getting paid with other than their clients' money since they almost always work on contingency bases. It's the defendant who, in effect, pays them when the usual settlement is reached. The last thing the plaintiffs' lawyers want is a time-consuming trial they might lose.

Soft Dollars

Mutual funds and other managers of others' money used to pay for securities trading, outside research, quote machines and even furniture with brokerage commissions. This was the vast "soft dollar" business, which they preferred to hard dollars, cash payments that came out of their hides while soft dollars were paid from their clients' assets. The result was that some services paid in soft dollars, including lavish entertainment, clearly did not benefit the money manager's clients.

Abuses led the SEC to restrict soft dollars to outside research and other services that clearly benefit the owners of the managed funds. Some fund managers have gone further. Giant Fidelity has made arrangements with several Wall Street firms to pay cash from its own pocket for research. In an era of market-determined commission rates, which continue to fall as trading is increasingly automated, anything an institution pays above bare-bones execution of a few pennies a share has to be justified as a client-benefiting expense. The fun has definitely gone out of the soft dollar business.