

## *The Sausage Factory*

Many years ago some hungry but enterprising individual decided that instead of mixing up another batch of dog food, he would grind up all those guts and other animal parts lying around the butcher shop floor, throw in some salt and other spices, and create a tasty new food product. Sausage was born. When meat production was scaled up during the Industrial Revolution, slaughterhouses were able to make enormous profits just by cleaning up all the leftover mess and throwing it into the hoppers. For many years, the details of what went on in these meat factories remained relatively secret. But in 1904 a young writer decided to go undercover and get a job at one of Chicago's meatpacking plants. He told the world about what he saw in his famous book, *The Jungle*:

There was never the least attention paid to what was cut up for sausage; there would come all the way back from Europe old sausage that had been rejected, and that was moldy and white—it would be dosed with borax and glycerine, and dumped into the hoppers, and made over again for home consumption. There would be meat that had tumbled out on the floor, in the dirt and sawdust, where the workers had tramped and spit uncounted billions of consumption germs. There would be meat stored in great piles in rooms; and the water from leaky roofs would drip over it, and thousands of rats would race about on it. It was too dark in these storage places to see well, but a man could run his hand over these piles of meat and sweep off handfuls of the dried dung of rats. These rats were nuisances, and the packers would put poisoned bread out for them; they would die, and then rats, bread, and meat would go into the hoppers together. This is no fairy story and no joke; the meat would be shoveled into carts, and the man who did the shoveling would not trouble to lift out a rat even when he saw one— there were things that went into the sausage in comparison with which a poisoned rat was

a tidbit.<sup>1</sup>

President Theodore Roosevelt was so shaken up by what he read that he launched a government investigation, then established the USDA to police America's meat industry. For the most part, this government agency has been fairly effective at preventing the abuses that were once a common practice.

The SEC, charged with policing the financial industry, has had a much more difficult time of things. Foul financial instruments, though they abound in the warehouses of Wall Street, don't always give off a readily recognizable stench like rotten meat. Routine inspections often fail to spot a lot of the underlying filth. Fortunately, there are whistle-blowers who from time to time come forward and report what is really going on behind the scenes.

On March 14, 2012 Greg Smith, a high-ranking director at Goldman Sachs, shocked the financial world by publishing an exposé of how this prestigious investment firm really operates. His comments about how customers are viewed and treated is very revealing:

I attend derivatives sales meetings where not one single minute is spent asking questions about how we can help clients. It's purely about how we can make the most possible money off of them. If you were an alien from Mars and sat in on one of these meetings, you would believe that a client's success or progress was not part of the thought process at all. It makes me ill how callously people talk about ripping their clients off. Over the last 12 months I have seen five different managing directors refer to their own clients as "muppets," sometimes over internal e-mail.<sup>2</sup>

Most of the big investment firms have been engaged in sausage-making for a long time. They butcher real economic entities such as businesses and farms, grind up the by-products and squeeze them into little packages (tranches) with a lot of

---

<sup>1</sup>Upton Sinclair. *The Jungle*. Available at *The Literature Network*. 10 June 2013. <[http://www.online-literature.com/upton\\_sinclair/jungle/](http://www.online-literature.com/upton_sinclair/jungle/)>: 14:5.

<sup>2</sup>Greg Smith. "Why I Am Leaving Goldman Sachs." 14 March 2012. 10 June 2013. <[http://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html?pagewanted=all&\\_r=0](http://www.nytimes.com/2012/03/14/opinion/why-i-am-leaving-goldman-sachs.html?pagewanted=all&_r=0)>

additives. They then sell these products to unsuspecting consumers, calling them such things as derivatives, structured asset backed securities, collateralized debt obligations, and the like. The strange names help disguise what they really are, kind of like using the term “sweetbreads” when serving people guts at a fancy dinner party. All of this is legal, of course, except when the products are laced with poison, which they often are. Like the meat packers that would buy sick or dead animals, these firms can chop up sick, dying businesses, repackage them into some type of obscure financial product, then purvey them to investors with promises of high returns. When this happened on a grand scale during the recent financial crisis, a lot of people got “cleaned out” in a massive bout of diarrhea.

The government did its best to investigate and appease an outraged public, but real reform is difficult when there is a revolving door between the policing agency and the firms it’s supposed to be overseeing. High-ranking officials at the SEC commonly switch careers and start working for the big investment firms. Likewise, veteran directors at these firms will do a stint of public service at the SEC or other government agency after receiving their golden parachutes.

The best thing you can do as an investor is to avoid consuming the products these firms produce. Stick to the financial equivalent of organic, grass-fed beef raised by a rancher you trust. In other words, buy quality stocks of “healthy” companies run by competent and honest managers who distribute the majority of the profits back to the owners (i.e., the shareholders). If you want to buy bonds, buy real bonds from financially sound entities—not some artificial product that has been “cloned,” “genetically modified,” or “derived” from them.