Investment sanity, shot through the heart

"Protip: When someone uses the term 'hoarding' instead of 'saving', it means deep down they believe that others are more entitled to your money than you are."

- Jay Hughes, in response to Kenneth Rogoff's article 'The sinister side of cash' in The Wall Street Journal, 25 August 2016.

In his 1999 book 'Fail-safe Investing', the author and libertarian Harry Browne advocated a four-factor portfolio that would protect any investor "no matter what the future brings". Such a portfolio would have to cater, at least in part, to four separate economic outcomes:

- *Prosperity*: a period during which living standards are rising, the economy is growing, business is thriving, interest rates are typically falling, and unemployment is declining;

- *Inflation*: a period during which consumer prices are typically rising;

- *Tight money* or recession: a period during which the growth of the supply of money in circulation is slowing. This usually leads to a recession;

- *Deflation*: a period in which consumer prices are declining and the purchasing power of money grows.

Just four types of investments would cover all these separate bases in Browne's so-called 'Permanent Portfolio':

Cash would be most profitable during a period of tight money – as a liquid asset offering purchasing power when income and investments might be coming under pressure.

Bonds would also perform tolerably well during a period of prosperity but would come into their own during a deflation.

Stocks would thrive during a period of prosperity.

Gold could be expected to perform well during times of intense inflation, though less well during periods of prosperity, tight money or deflation.

The investor simply needed to allocate 25% of his capital to each investment – and keep it there.

For an extended period, the 'Permanent Portfolio' approach served its investors well. For the nearly three decades between January 1970 and December 1998, for example, the portfolio delivered average returns of 9.9% per annum, a comfortable 4.5% per year above inflation.

The portfolio continued growing through every economic environment it faced. It even gained in real terms during the inflationary 1970s.

The portfolio was also remarkably stable. In the course of 29 years the portfolio lost value in only three: it lost 6.2% in 1981, 0.7% in 1990, and 2.4% in 1994. Those happened to be years in which most investors suffered poor returns. But each of the portfolio's three losing years was followed by gains that quickly erased the small losses it had previously incurred.

On October 19, 1987, when the Dow Jones Industrial Average fell by 22.6% in a day, the Harry Browne portfolio lost 4.3% of its value. It still returned a gain of 5.3% for the year.

And maintenance of the portfolio would be simplicity itself:

"For most investors, this portfolio requires no more than one short day to set up. Thereafter, you need to monitor it only once a year – merely to determine whether changes in investment prices have unbalanced the portfolio's mix of investments."

The fail-safe portfolio didn't require any insight into the future; it didn't require market-timing of any kind; it didn't require any form of switching investments at all.

For over 40 years, Harry Browne's 'Permanent Portfolio' has served investors well.

And now the central banks have shot it through the heart.

In a world of zero or negative interest rates, a portfolio that allocates fully 50% of its capital to cash and bonds is no longer fit for the purpose of capital preservation or income.

This isn't Harry Browne's fault. He died in 2006. Never in his wildest imaginings would he likely have foreseen what central banks would do to depositors or bond investors during the decade after his death.

Of the 'Permanent Portfolio' and its original four asset classes, only two now make any real sense, in large part because they are themselves real assets: stocks, and gold.

Stocks because there can be no investment rationale for owning negative-yielding bonds – and because stocks offer fractional ownership of real, productive businesses.

(We favour value stocks as the next logical step across a minefield of opportunities: escape the financial repression of nominal assets by embracing the most attractive, as in, least obviously overpriced, investments by way of productive, real assets.)

Gold because there is still every reason to expect further inflationism and monetary debauchery from the world's major central banks. But nominal assets make no sense when nominal rates are the plaything of increasingly desperate policy makers, and heading inexorably below what was previously thought to be an absolute lower bound constrained at the level of zero.

It comes to something when the concept of something as simple, democratic and socially beneficial as cash faces ongoing assault from academic economists. The latest trial balloon from the establishment comes via Kenneth Rogoff in his fascistic essay 'The curse of cash', which advocates the abolition of cash on the fatuous premise that it can be used for the purposes of crime.

This is not, of course, the fundamental justification for abolishing cash, just a convenient excuse to be marketed to the gullible. The fundamental reason for neo-Keynesian economists to lobby for the abolition of cash is as a necessary precursor to the imposition of negative interest rates. Savers will, rightly, be resistant to the idea of paying banks for keeping cash on deposit. The answer is to remove their right to hold money in the form of cash in the first place.

We have gone a long way down the rabbit hole since the Global Financial Crisis. Clearly our monetary authorities have more experiments planned. As the writers at The Daily Bell point out,

"Giving a small group of individuals the power to decide on the value and volume of money is a ludicrous concept from any standpoint. But the problem is abetted by the mainstream narrative that never discusses the underlying lack of logic.

"And so we observe Jackson Hole, which is presented to us as a conclave of elite thinking but which is actually nothing more than high-brow propaganda for a system that has already failed and – as compensation for its failings – now contemplates even more radical "solutions" that will give rise to even worse problems.

"Conclusion: The mechanism of central banking is purposeful ruin. The end-result of this ruin is global governance. In the short-term this goal is disguised by an academic patina. But the long-term goal, an increasingly apparent one, is a brutal restructuring of the lives of seven billion people to benefit a handful of elite controllers."

Harry Browne's 'Permanent Portfolio' managed to survive the stagflationary 1970s, the Crash of 1987, even the death of Communism (in Soviet Russia at least, if not yet among the ivory towers of US economists). But it has been dealt a devastating blow by the financial repression of the past eight years, which has effectively dismantled two of its four pillars.

In November, we'll present our own solution to the challenges for today's investor trying to navigate this Alice-in-Wonderland financial environment, in the form of a new book:

'Investing Through the Looking Glass: A Rational Guide to Irrational Financial Markets'.

Economists – especially the neo-Keynesians – get a chapter all to themselves. But they don't come out of it terribly well.

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