



3rd October 2011

Received wisdom

“Mises was infinitely patient and kind with even the most dim-witted of us, constantly tossing out research projects to inspire us, and always encouraging the shiest and most awestruck to speak. With a characteristic twinkle in his eye, Mises would assure them: ‘Don’t be afraid to speak up. Remember, whatever you say about the subject and however wrong it might be, the same thing has already been said by some eminent economist.’”

- From [‘Ludwig von Mises: Scholar, Creator, Hero’](#) by Murray N. Rothbard.

There is hope for all of us in the news that an experiment at CERN may have challenged Einstein’s theory of relativity. It suggests that deep-seated and long-cherished ideas can still be knocked off the pedestal of conventional wisdom. The process may take an age, but as Max Planck observed, Science advances one funeral at a time. If only the study of economics could evolve as quickly. Sadly, the mouthpiece of conventional economic wisdom, the Financial Times, continues to provide the oxygen of relevance to commentators like Martin Wolf, who if his latest article is any guide (“Time to think the unthinkable and start printing again”) has simply gone mad.

Future historians will not look kindly on those who continually and repeatedly advocated the wrong remedies – inflationary money-printing, or the issuance of yet more debt – to a problem in large part caused by unsound money and inordinate debt. Einstein himself defined insanity as doing the same thing over and over again and expecting different results.

Unfortunately for those still toiling in the productive economy, there seems plenty of evidence that the lunatics have taken over the asylum. A small example: UK monetary policy committee member Adam Posen recommends a state-backed bank that could lend to small businesses. But we already have at least three, and they are called RBS, Lloyds TSB and HBOS.

As to why Martin Wolf’s baffling addiction to inflationism is so gallingly wrong, consider Rothbard’s tribute to the Austrian economist Ludwig von Mises cited above:

“An increase in the quantity of money only serves to dilute the exchange effectiveness of each franc or dollar [or pound]; it confers no social benefit whatever. In fact, the reason why the government and its controlled banking system tend to keep inflating the money supply, is precisely **because** the increase is not granted to everyone equally. Instead, the nodal point of initial increase is the government itself and its central bank; other early receivers of the new money are favoured new borrowers from the banks, contractors to the government, and government bureaucrats themselves. These early receivers of the new money, Mises pointed out, benefit at the expense of

those down the line of the chain, or ripple effect, who get the new money last, or of people on fixed incomes who never receive the new influx of money. In a profound sense, then, monetary inflation is a hidden form of taxation or redistribution of wealth, **to** the government and its favoured groups, and **from** the rest of the population.. every change in the supply of money stimulated by government can only be pernicious.”

Inflationists also tend to be stimulus fanatics. Mises had a suitable response:

“The longer the boom of inflationary bank credit continues, the greater the scope of malinvestments in capital goods, and the greater the need for liquidation of these unsound investments. When the credit expansion stops, reverses, or even significantly slows down, the malinvestments are revealed. Mises demonstrated that the recession, far from being a strange, unexplainable aberration to be combated, is really a necessary process by which the market economy liquidates the unsound investments of the boom, and returns to the right consumption / investment proportions to satisfy consumers in the most efficient way.

“Thus, in contrast to the interventionists and statists who believe that the government must intervene to combat the recession process caused by the inner workings of free-market capitalism, Mises demonstrated precisely the opposite: that the government must keep its hands off the recession, so that the recession process can quickly eliminate the distortions imposed by the government-created inflationary boom.”

But as a fellow asset manager recently observed, we are not policy makers, we are stewards of other people’s capital and we are here to outperform. The quotation, or paraphrase, is from an outstanding recent article by [Joshua Brown](#) citing a lunch meeting with DoubleLine’s Jeffrey Gundlach. Other gems:

“I don’t know what’s going to happen in Europe but there is one thing I am certain about – eventually, someone is going to take a big loss. As investors, the most important thing we can do is make sure that we aren’t the parties taking that loss.”

“This glass of water is more worthwhile than a government bond under 5-year duration.”

On emerging market debt:

“A secular improving credit story.. [emerging market debt trades at] twice the yield of developed market debt and triple the fundamentals.”

And finally,

“The bloodless verdict of the market” – “In the end, he who gets it right wins, there are no points awarded for being smart but wrong.”

“Never, ever take counterparty risk” – “It is the one risk you are almost never rewarded for taking. Unless you are running \$800 billion, there is no need to use swaps, synthetics or baskets – trade cash markets and avoid any trades that require a counterparty.”

Having spent the last two weeks in Italy, it is striking how what is portrayed as a grave and seemingly permanent crisis over here might as well not even exist over there. That said, we did come across quite a few Germans, who may or may not have comprised the advance guard.

As to the financial markets, it seems abundantly clear to us that any hopes of a resolution to the crisis remain just that – wishful thinking, notwithstanding the stylish nonchalance of our Italian cousins. The extraordinary oscillations of the stock market do not intuitively feel like anything good, but rather the convulsions and twitchings of a body anticipating an even larger shock. The one bit of good news is that we have an opportunity to buy back into the likes of gold and silver at levels that seem very attractive to us, given the ever-darkening clouds elsewhere.

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3rd October 2011.

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