



9th February 2009

Sleepwalking to oblivion

“..any collectivist system is necessarily self-defeating no matter what its specific policies or leaders. After all, if Johnny is in your group and he can’t read or write very well, you’ll be getting Johnny’s grades.”

- Karen De Coster, [Groupthink and You](#).

Someone close to me once confessed that their Economics degree, taken prior to a successful career as a bond trader, had been a complete waste of time. Beyond an awareness of the inviolable laws of supply and demand, and of the somewhat more subjective but no less critical market attributes of greed and fear, the contents of the course had, my source suggested, offered no practical value within the context of a dealing room.

As every year passes, the futility of an Economics degree in the face of a career in finance seems less and less of a surprise. My own choice of degree course (English language and literature, for the record) has not obviously hindered my investment career, nor my original role as a bond salesman. But one can at least make something of a special case for the bond market, in that it does appear to be a more broadly logical and rational arena for investment and speculation, governed in large part by the macro factors of inflation, monetary policy and economic “fundamentals”, compared to the Gothic bazaar that is the stock market, where tips, rumours, stories, the flimsiest of opinions, and all strata of pond life hold uneasy sway.

But what fills me with growing concern is the suspicion that there is a broad consensus – among economists and market observers – that there is no alternative to the gargantuan bail-outs being granted to the western financial system. Indeed, there seems to be a growing clamour for more and yet more of the same, to an even broader constituency of obviously specially unique economic interest groups. Nor, for that matter, does there seem to be overmuch questioning at the wisdom of deploying all sorts of fiscal materiel to suppress the prospect of imminent recession. Nor at the increasingly tokenistic and saver-impoverishing rate cuts, like last week’s from the Bank of England, despite the well-acknowledged fact that what matters is not the **price** of credit but its **availability**.

Diapason Commodities Management strategist Sean Corrigan has a nice line in criticising the authorities’ unwillingness (or inability ?) to liquidate bad banks. This would have had the benefit of reducing over-capacity in a systemically and not to say horrifically over-leveraged industry,

“But rather than encouraging full and early disclosure of each [banking] entity’s true status and then applying a rigorous practice of *triage* – thereby making room for the remaining healthy banks to continue to serve sound borrowers at an economic rate of interest – the authorities have so contrived it that almost the entire industry has now come to be dependent upon the public purse

and / or the central bank printing press, with regulators also conniving in a relaxation of reporting standards and capital adequacy testing at precisely the moment when the cancer of distrust – of *discredit*, if you will – is poisoning the system, to the detriment of all. The only purpose this seems to be serving is that of keeping the plague victims alive for just long enough to pass the infection on to the healthy.”

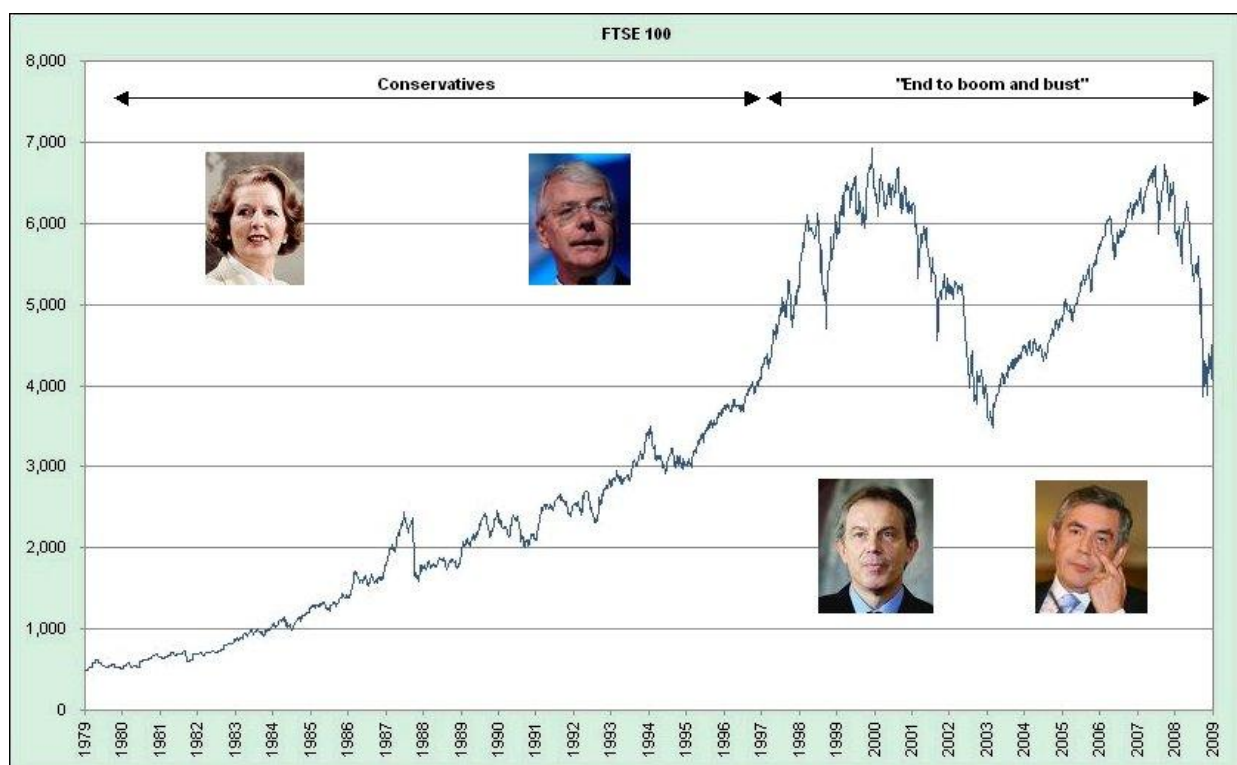
Corrigan also cites the notable economist and philosopher [Ludwig von Mises](#), whose ‘Human Action’ of 1949 reads like a road map to the parlous state we seem to be destined for:

“The dearth of credit which marks the crisis is caused not by contraction, but by the abstention from further credit expansion. It hurts all enterprises – not only those which are doomed at any rate, but no less those whose business is sound and could flourish if appropriate credit were available. As the outstanding debts are not paid back, the banks lack the means to grant credits even to the most solid firms. The crisis becomes general and forces all branches of business and all firms to restrict the scope of their activities. But there is no means of avoiding these secondary consequences of the preceding boom.

“As soon as the depression appears, there is a general lament over deflation and people clamour for a continuation of the expansionist policy.. entrepreneurs enlarge their cash holding because they abstain from buying goods and hiring workers as long as the structure of prices and wages is not adjusted to the real state of the market data. Thus ***any attempt of the government or the labour unions to prevent or to delay this adjustment merely prolongs the stagnation.***”

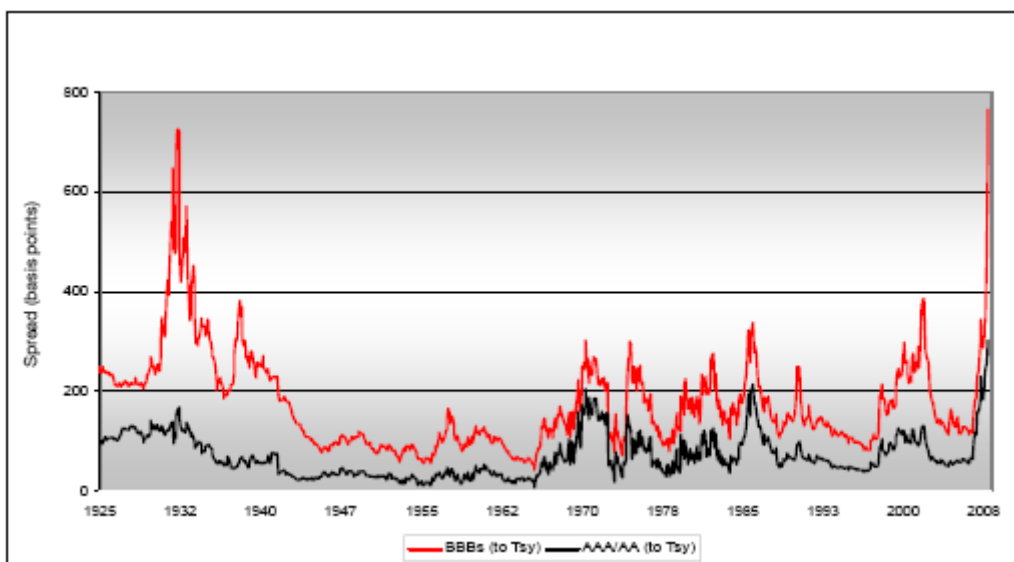
And yet both the financial and political worlds have collectively swarmed, almost as one, to the Keynesian interventionist and pump-priming banner. One wonders whether the spirit of Keynes has already won the battle, but the likelihood is that the spirit of Mises will “win”, albeit in pyrrhic manner, the depression – because the damage, not least in the form of an unnecessarily protracted and grievous economic slowdown, will have been well and truly done by then.

No cheap political point-scoring, please



That slowdown is likely to involve much higher tax rates and much higher unemployment. Both straitened workers and the new unemployed will cut outgoings, thus amplifying the negative impact on the economy and on consumer spending (roughly 70% of Anglo-American GDP) – Baur will not be the last retail business to collapse. And it is not just Iceland that faces a slide into irrelevance. Near namesake Ireland has, according to Bedlam Asset Management, a ratio of banking assets to budgeted government revenue of 26 times. The equivalent figures for the UK and US are 5.3 and 5.9 respectively. Staggeringly, the ratio of Ireland’s banking assets to foreign reserves is 3,117 times. So how much is that bank guarantee really worth ? It is probably premature to regard equity markets as cheap – because it is only those businesses whose franchises are bullet-proof even in a consumer slowdown that are worthy of consideration for an absolute return investor. Having little or no indebtedness will naturally help. And staying with the topic of debt, few could argue with the thesis that whereas the story for government paper is starting to look a little frayed, the backdrop for high quality corporate paper is altogether more constructive (see below):

Corporate bonds are CHEAP: US corporate bond spread over 10 year US government bonds



Source: Morgan Stanley

Perhaps the last word should go to another economist and philosopher we find increasingly worthy of citation – Murray Rothbard, also of the Austrian school (the Austrians are to Economics what Value Investors are to Investment. Discuss.) -

“It is no crime to be ignorant of economics, which is, after all, a specialized discipline and one that most people consider to be a ‘dismal science’. But it is totally irresponsible to have a loud and vociferous opinion on economic subjects while remaining in this state of ignorance.”

After a recent commentary criticising the extent and ultimate value of the UK government’s support for the banking system, and the danger that the scale of the economic bailout might actually exacerbate rather than prevent a serious depression, a reader suggested that I email my MP to share those thoughts. I duly dispatched a brief message to one Glenda Jackson. I have yet to hear a response.

Tim Price
Director of Investment

PFP Wealth Management

9th February 2009.

Email: tim.price@pfp.co.uk

Weblog: <http://thepriceofeverything.typepad.com>

Bloomberg homepage: PFP <GO>

Important Note:

PFP has made this document available for your general information. You are encouraged to seek advice before acting on the information, either from your usual adviser or ourselves. We have taken all reasonable steps to ensure the content is correct at the time of publication, but may have condensed the source material. Any views expressed or interpretations given are those of the author. Please note that PFP is not responsible for the contents or reliability of any websites or blogs and linking to them should not be considered as an endorsement of any kind. We have no control over the availability of linked pages. © PFP Group - no part of this document may be reproduced without the express permission of PFP. PFP Wealth Management is authorised and regulated by the Financial Services Authority, registered number 473710.