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The merits of a slowdown

"Cheaper toys 'are Christmas hits' "

- BBC News website, 28 ***October*** 2009.

Stop all the clocks, wrote W.H. Auden once, and he had the right idea. One of the irritations of modern western society is an always-on consumption culture that lives not so much in the here-and-now but in the tomorrow-reported-as-yesterday. Or perhaps, in remembrance of George Orwell, we should allude to his definition of advertising: the rattling of a stick inside a swill bucket. Consumer time, in any case, now moves at an accelerated rate, especially when the forces of retailing, in ever more urgent pursuit of the almighty trading dollar, overcompensate for an economy debilitated by a banking bust. So we have to tolerate Christmas lights going up in Oxford Street before Halloween; newsreaders and politicians vying to be the first to wear their poppies with pride (Armistice Day, commemorated as it always has been, on November 11th); and toys reported as Christmas hits before the end of October.

Markets are not immune to this sense of temporal acceleration; they have always tried to anticipate the future and price it in. But how much future, and what kind of future, is priced in now ? GMO's Jeremy Grantham, who pretty much nailed the March equity lows, now reckons the US market is around 25% overpriced. Pimco's Bill Gross reckons the six-month rally in risk assets (and not just equities, or bonds) "while still continuously supported by Fed and Treasury policymakers.. is likely at its pinnacle." "Doesn't it seem odd," asks Grantham, "that we would be measurably overpriced once again, given that we face a seven-year future that almost everyone agrees will be tougher than normal ?" We can only shrug our shoulders and agree, drawing discrete attention to the new purveyors of moral hazard extraordinaire, namely the western governments that, acting through nominally independent central banks, have engineered interest rates down to zero, and are busily setting up government bond markets for a bust of biblical proportions once the market manipulation known as quantitative easing finally ends. Any individual investors currently being semi-officially ushered in to the stock market given the lack of credible alternatives by way of deposits or government bonds may have cause, in the fullness of time, to ask precisely whose wealth all this unprecedented monetary support has actually protected. Probably not their own, as we may yet see.

It is always difficult to refrain from buying a market when it's going up. Particularly when that market is the stock market, surely Wall Street's and the City's most popular asset class since it can be so profitably and endlessly repackaged for retail investors in so many different ways. Then you merely need the financial media to focus tirelessly on reporting its every twist and (re)turn whilst cheering from the sidelines. And if interest flags, you can always try out some new *opening* bells and whistles to get the punters interested again (see the FT's "LSE rings changes to rival

NYSE's bell show" – that stick in the swill bucket again). As something of an asset class agnostic, it's admittedly painful to report how investors who were agonising over the safety of their bank deposits less than a year ago now have to be forcibly restrained from selling their houses and all their contents just to participate in a momentum-driven, non-fundamentally-supported equity rally.

Fund manager David Einhorn nicely captured the essential problem of our time in a speech to the Value Investing Congress in mid-October. In the interests of brevity and for want of a better phrase, he calls this problem "government".

"As I see it, there are two basic problems in how we have designed our government. The first is that officials favour policies with short-term impact over those in our long-term interest because they need to be popular while they are in office and they want to be re-elected. In recent times opinion tracking polls, the immediate reactions of focus groups, the 24/7 news cycle, the constant campaign, and the moment-to-moment obsession with the Dow Jones Industrial Average have magnified the political pressures to favour short-term solutions. Earlier this year, the political topic du jour was to debate whether the stimulus was working, before it had even been spent..

"The second weakness in our government is "concentrated benefit versus diffuse harm", also known as the problem of special interests. Decision makers help small groups who care about narrow issues and whose "special interests" invest substantial resources to be better heard through lobbying, public relations and campaign support. The special interests benefit while the associated costs and consequences are spread broadly through the rest of the population.

"In the context of the recent economic crisis, a highly motivated and organized banking lobby has demonstrated enormous influence.. our leaders responded by handing over hundreds of billions of taxpayer dollars to protect the speculative investments of bank shareholders and creditors. This has been particularly remarkable, considering that most agree that these same banks had an enormous role in creating this mess which has thrown millions out of their homes and jobs."

The FT's John Kay came to a similar conclusion in his piece last Thursday "'Too big to fail' is too dumb to keep":

"Their activities underwritten by implicit and explicit government guarantee, it is increasingly business as usual for conglomerate banks. The politicians they lobby sound increasingly like their mouthpieces, espousing the revisionist view that the crisis was caused by bad regulation. It was not: the crisis was caused by greedy and inept bank executives who failed to control activities they did not understand..

"The governor of the Bank of England is one of the few public officials to have grasped that the primary purpose of regulation is to protect the public, both as taxpayers and users of financial services, and not to promote the interests of the financial services industry."

In response to last week's commentary ("Rage against the machine"), a reader raised the following question by way of response:

"Why have the younger generation not yet seen through the camouflage of the current 'game' and started to rally support for a return to fundamentals.. somehow the future for our 'way of life' needs to be given a good shaking and the old comfortable and cosy relationships, i.e. lobby groups, need a thorough detailed review to establish whether they (like the MEPs and their tax free salaries) are really justifiable in today's modern world.. the current system under which we live has

gone past its sell-by date and before we lose the plot, we the elders of society have to respond appropriately.."

The original Naked Capitalism piece, which provoked both this commentary and the correspondence which followed, raised two hopeful historical precedents, examples of the ultimate success in the US of popular protest against seemingly intractable problems, namely civil rights for blacks and an end to US involvement in Vietnam. Absent going onto the streets, readers who feel sufficiently outraged at the behaviour of the banks before, during and most offensively after this supposedly resolved crisis may wish to express themselves in the manner most likely to be recognised by bankers and their political enablers: ***by boycotting the banks and their products***.

As to the financial markets, there is still a way through the woods, we believe. In **bonds**, given the uncertainties facing a fundamentally rigged Treasury market, the real value (and likelihood of genuine capital preservation) is surely in the road less travelled of investment grade sovereign debt (though not necessarily in the 'usual suspect' markets of the G7 economies), where meaningful credit spreads and yields still apply. In **equities**, given the rally in all things speculative, extreme defensive value is still very attractively priced, with superior yields to government debt and arguably less to lose if things start to turn turtle again. In **absolute return funds** we favour a) broad asset class diversification and more specifically, b) systematic trend-following funds, the best-performing trading strategy in history, and offering returns uncorrelated with the stock market to boot. Finally, in **real assets**, as protection against further fiat currency devaluation and notwithstanding their recent impressive gains, gold, silver and the other precious metals. The beauty of an approach that takes into account all of these asset types is that it makes your exposure to the vagaries of market timing quite modest. Alternatively, you could entrust your money to politicians, or to the banks, although these days that might just amount to the same thing.

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