

PRICE VALUE PARTNERS

Watch bonds

“Childs: Fire's got the temperature up all over the camp. Won't last long though.

MacReady: Neither will we.

Childs: How will we make it?

MacReady: Maybe we shouldn't.

Childs: If you're worried about me..

MacReady: If we've got any surprises for each other, I don't think we're in much shape to do anything about it.

Childs: Well, what do we do?

MacReady: Why don't we just.. wait here for a little while.. see what happens?”

- From *The Thing*, screenplay by Bill Lancaster, story by John W. Campbell Jr.

John Carpenter's 1982 classic *The Thing* is the last great hoorah for pre-CGI special effects in film, courtesy primarily of creature effects maestro Rob Bottin. Everything you see on screen is “real”, in a way that digitised extra-terrestrial gore will never quite manage to be – the same way some folk prefer vinyl over CD. The premise is straight from the Cold War deep freeze. A crashed UFO long buried deep in the Antarctic is uncovered and its pilot, none too happy at the turn of events, thawed out. Said pilot possesses the creepy ability to mimic and replace **exactly** any life form it encounters. Exactly, and messily. Pretty soon the dozen-strong members of an American research station start to look at each other with fresh eyes – in some cases, quite literally. Before long, the base disintegrates into a chaotic stew of paranoia, mutual distrust, and the most unnervingly revolting special effects ever committed to a mainstream movie. (At one particularly notorious point, for example, a disembodied head grows legs like a spider and scuttles away from the flaming corpse that once housed it.) Clark, the base's dog handler, becomes an early suspect as someone who is not quite what he appears. One of the team, Blair (A. Wilford Brimley), sees the existential threat posed by the alien if it ever makes it out to civilisation and starts to demolish the base's radio room. As he

is bundled out into a makeshift cell, he sighs, “I don’t know who to trust,” and he grimly adds a warning:

Watch Clark. Watch him close.

We live in a culture in which the glue is trust. As the historian Yuval Harari points out in [this conversation](#), and in his excellent book *Sapiens*, trust is the raw material from which all types of money are minted. Money is, in fact,

the most universal and most efficient system of mutual trust ever devised.

The downside to this social construct, and its fundamental flaw, is that it is entirely intangible: “the crucial role of trust explains why our financial systems are so tightly bound up with our political, social and ideological systems..”

So what happens to the value of money when trust in our political, social and ideological systems flies out the window ? Stay tuned.

“I’ve had all the fun I can stand in investment banking..”



Courtesy Universal Pictures

Autumn 2018 has been a festival of awkward financial anniversaries. It is 20 years since the smartest guys in the room and their hangers-on economics laureates did a dress-rehearsal for crashing the financial system. It is 10 years since the main event. Cue 10 years of increasing monetary weirdness, which will plausibly end in a chaotic stew of paranoia, mutual distrust and revolting special effects. For some in the financial markets, their entire careers have been

spent in a Potemkin village of make-believe valuations, with central banking wizards casting ever more ludicrous acronymic spells as they inadvertently – or perhaps even quite deliberately – destroy trust in money: QE. ZIRP. OZ..

We recently highlighted Ben Hunt's [Things Fall Apart](#) thesis – in which the “widening gyre” of US politics pulls the overall electorate into a wider and wider state of polarisation in which centrist politics essentially dissolves out to the extremities. At the same time, the financial markets have essentially coalesced into some kind of neutron star in which the S&P 500 core “works” but just about every other risk asset underperforms or fails, either in relative or absolute terms. The rise of unthinking “passive” investment has doubtless played a role in this bifurcation between cost-effective share ownership (good) and grotesque lack of discrimination at the top of an incredible bull market (not, perhaps, quite so good).

Ben has followed up with the equally inspiring [Clear Eyes, Full Hearts, Can't Lose](#). Notwithstanding the polarised electorate and the monolithic market, and as per Harari, we still seek a narrative by which we can understand the investment world. Unfortunately, none of the prevailing narratives really make much sense, and there is no single, overarching narrative by which we can all find a way through the woods.

The insoluble problem is that our monetary elites have perhaps fatally tainted the well. They have, quite literally, **abused our trust**. It turns out that if the Swiss central bank can simply print money out of thin air and use it to buy Apple stock, while the rest of us are obliged to convert the sweat of our brow to the same end, a growing number of rational investors will rightly revolt at this abuse of the monetary standard (and manipulation of the price of Apple stock and its various peers). If the game is fixed by the referee, why continue playing ?

The mills of God may grind slowly, yet they grind exceedingly small. We have been forced to watch for over three decades as governments displayed shameless market abuse by pumping up the bond supply and printing sufficient unbacked, illusory money to enable them to do so. This shabby parlour trick may have reached its denouement. The skies are finally darkening, accompanied by the clattering hooves of bond market vigilantes riding back into town. The three decade bond market bull run gives every sign of being conclusively **done for**. Since the declining rate cycle powered other risk assets, notably property and common stocks, dramatically higher, then its ultimate reversal carries stark implications for those same risk assets. Property, especially high-end property, being somewhat bond-like as an asset, hardly looks especially appealing today – unless you're trying to short it.

There is process, and there is outcome. We cannot control the outcome, certainly not in the short run, but we can at least influence it by way of a sound process. In the absence of complete foreknowledge as to the future, we spread our portfolio risk across only the soundest and most compellingly attractive ‘value’ stocks; uncorrelated funds; and hard, real assets. In the absence of foreknowledge, sound diversification is the **only** intellectually and mathematically defensible market response. But beyond anything else – **watch bonds**.



Tim Price is co-manager of the [VT Price Value Portfolio](#) and author of 'Investing through the Looking Glass: a rational guide to irrational financial markets'. You can access a full archive of these weekly investment commentaries [here](#).

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