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Spooky

"The years of war saw the mark lose three quarters of its purchasing power. The years of peace saw the process speed up, as the borrowing continued, and at first it had its friends. 'I am not afraid of inflation,' said Walter Rathenau, tycoon and minister, later murdered by two proto-Nazis. 'People are wrong when they say that printing money is bringing us to ruin. We ought to print money a bit faster, and start construction works.' He has his followers today."

- Christopher Fildes, reviewing 'The downfall of money: Germany's hyperinflation and the destruction of the middle class' by Frederick Taylor in *The Spectator*, 7th September 2013.

Readers may enjoy our recent State of the Markets podcast with the legendary IFA Alan Steel of Alan Steel Asset Management, recorded on Sunday 22 September 2019

Autumn naturally lends itself to a mixture of retrospection and introspection. The bright and sunny certainties of summer are replaced by the cloudier anticipations of the winter to come. As the crops are gathered in, the days darken, and chill. And as animal spirits start to wane with the weakening sun, problems that swelled up during the heat of summer – Thomas Cook; Ireland's growing political hostility to the UK; the prospect of global trade wars; socio-economic stability in China – start finally to decay and reveal themselves. As readers will be well aware, Halloween 2019 happens to coincide with Britain's putative departure from the EU. This year, expect a degree more fear and a degree less certainty during the mistier days of the month, as decades' worth of the market's ***and politicians'*** shadowy errors start to walk abroad.

'£63 billion wiped off UK blue-chips amid global bloodbath' was the breathless declaration of an anonymous sub-editor at The Daily Telegraph on Wednesday, following a 3.2% decline that day in the value of the FTSE 100 stock index. If a 3.2% decline is justifiably termed a 'bloodbath', how to describe the 22.6% intra-day decline of the Dow Jones Industrial Average on 19th October 1987 ? Financial genocide ? The financial media are now cheerfully playing the insoluble but timeless game of asking 'Why did it happen ?' Their presumed conclusion appears to be, on the basis of the FT's efforts, a confused amalgam of poor US jobs data, weak manufacturing reports and that reliable old chestnut, "geopolitical fears". The real answer: "Nobody really knows" is unlikely to be printed in the financial pages anywhere anytime soon.

This is just more anecdotal evidence of the Gell-Mann Amnesia effect at work in the mainstream media, defined by the blockbuster author Michael Crichton as follows:

> You open the newspaper to an article on some subject you know well. In Murray's case, physics. In mine, show business.
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> You read the article and see the journalist has absolutely no understanding of either the facts or the issues. Often, the article is so wrong it actually presents the story backward – reversing cause and effect.
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> I call these the 'wet streets cause rain' stories. Paper's full of them.
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> In any case, you read with exasperation or amusement the multiple errors in a story, and then turn the page to national or international affairs, and read as if the rest of the newspaper was somehow more accurate about Palestine than the baloney you just read. You turn the page, and forget what you know.

Trust in media has been a key victim of the now three-and-a-bit years' agony of the Brexit process, matched only by the comparable victimhood of trust in all forms of the establishment and trust in the financial system (this last belief system may admittedly never have existed to begin with). Analyst and financial historian Russell Napier, in his latest *The Solid Ground* newsletter, points to the uniformity of opinion among institutional investors unaware, for example, that "six of the world's nine most highly geared countries are in the Eurozone", and secondly, blithely complacent in that "nine out of ten fund managers believe that President Trump will strike a trade deal with China as this is essential for him to win an election !"

Russell's suggestion is a contrarian one – namely, that the creature known as *homo economicus* does not actually exist, and that sometimes politicians push at emotional hot buttons, like appeals to patriotism, that are more powerful than any economic ones will ever likely be:

> I was sitting in the sunshine on Park Lane last Friday admiring Mies van der Rohe's Seagram Building when I got a notification from Bloomberg to let me know that 'White House Weighs Limits on US Portfolio Flows into China'. It would be difficult to imagine a clearer signal of a move to a China containment [as opposed to engagement] policy. Apparently not, however, as this is still just seen as another attempt to gain leverage on a trade deal, at least based upon the follow-up flurry of emails from investors ! Well, perhaps, but when one considers there is now a capital, trade, intellectual property and military escalation against the Chinese Communist Party, one does wonder if this may be part of something bigger than a drive to sell more soya beans.
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> This news on possible restrictions on the free movement of capital to China will come to be seen as a crucial turning point in the history of this century. It will be seen as a turning point of a magnitude commensurate with the free movement of capital across borders that ultimately defined what globalisation is, rather than the free movement of goods.. Since the Global Financial Crisis, *The Solid Ground* has argued that this era is coming to an end and for many people, primarily those living in emerging markets that have now imposed capital controls, it has already come to an end..

> I left for North America puzzled as to why almost everyone thinks that President Trump will strike a trade deal with China. However, that puzzlement has lifted somewhat during the week as I increasingly realised that the opinion on the likelihood of a trade deal is being reinforced by every major bank that issues investment research. Given these institutions' investments in China, and their hope for business from China, one should not expect a full and frank assessment of the outlook for US / China relations from that quarter. Companies and executives expressing too frank a view on the appropriate relationship between the People's Republic of China and Hong Kong have already paid a heavy price for voicing such opinions.

Investment banks riddled with conflicts of interest ? Who could possibly have known ?

Six years ago, the FT's Gillian Tett asked (in an article titled 'Insane financial system lives post-Lehman') whether our financial system was any safer or saner, five years after Lehman Brothers went bump in the night. Some of her conclusions: that the big banks are now bigger, not smaller (and were, as the title of Andrew Ross Sorkin's best-selling book alludes, already too big to fail in 2008); that the system depends more than ever on faith in central banks.

Ms Tett noted that these unresolved issues

> are a potent illustration of the law of unintended consequences, and a powerful reminder of the vast amount of work still to be done before we have a financial world that looks both safe and sane.

She gracefully conceded,

> ..what sparked this piece is simply a realisation that some things which I thought would "obviously" happen after 2008 did not happen –i.e. as a journalist, some of my predictions were wrong. I expected banks to shrink, the shadow banking world to decline, bankers to be prosecuted and the backlash against the elite to swell. It didn't happen.

Our own primary function is not to make political or social forecasts, but to protect our clients' capital. And it is clear that some of our own predictions, or fears, if you like, have so far proven to be somewhat premature –most notably, that as central banks engaged in a competitive race to the bottom in currency devaluation, and pledged ever greater amounts of stimulus by way of printed money, then gold (and closely related assets) would act as a store of value that would protect our investors' purchasing power in a way that paper money never can, or will. Those fears have come to be partly realised. And the game is not yet over, and we would hate to abandon a strategy on the basis that over the shorter term, the market price action has yet to fully vindicate that strategy. Our core investment policy remains underpinned by three discrete investment types: unconstrained 'value' equities predicated entirely on quality and undemanding multiples (and, since we raise the topic, no current exposure to China); uncorrelated assets, in our case systematic trend-following funds pursuing pure price momentum strategies; and real assets, notably the monetary metals, gold and silver, and related mining interests, again at undemanding multiples, but with sound underlying earnings ***and*** earnings growth.

We maintain that the 'fundamentals' behind the ownership of such investments remain supportive: extravagant and unsustainable sovereign debt loads; colossal uncertainty over both sovereign and banking sector solvency –particularly in the euro zone –and an unprecedented faith in central bankers that is increasingly unlikely to be justified. As Ms Tett also pointed out,

> ..these days all manner of assets are now being propped up by a sunny investor belief that central bankers know what they are doing with quantitative easing; even though nobody has tried it on this scale before, or knows how to exit.

"I am not afraid of inflation," said Walter Rathenau..

But we are. And we are also afraid of the impact on all risk assets when the tide for government bonds finally turns. So we see every reason to maintain the highest levels of pan-asset diversification, and to focus exclusively on deep valuation as the primary driver for ownership of "traditional" investments such as international equities. Ten years after Lehman, banks are still at risk. 20 years after LTCM, shadow banks are still at risk. Most ominously, nearly 30 years after sterling's ERM disaster, governments and their central banking stooges – not least in the euro zone – still seem to believe that in a fight between the state and the markets, the state will win. We are not so sure. Voltaire said that doubt was uncomfortable but certainty was ridiculous. Any investor with certainty today is delusional. We still think the future is extraordinarily uncertain, and our portfolios are positioned accordingly. Some comfort, at least, as the days start to cool, and the nights draw in.

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