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The Great Suppression **4th May 2020**

"Katie and Jim DiGangi, who run a dairy farm in Wisconsin, have spent the last several weeks dumping as much as 20,000 gallons of milk a day. In California, Jack Vessey, a lettuce and leafy green farmer, has destroyed 350 acres of his crop by ploughing his tractor through unharvested fields.

"The two farms are almost 2,000 miles apart but both have become examples of the damage done by the coronavirus outbreak to the complex supply chains that bring food from farms to tables in the US.

"As restaurants, hotels and schools have closed, farmers and ranchers who supplied them have lost customers. But redirecting their production to grocery stores has proved difficult because of the differing demands of commercial food operations and people cooking in their kitchens.

"The result has been scenes out of the Great Depression: farmers destroying their products as Americans line up by the thousands outside food banks. While officials maintain there is no immediate threat of food shortages, no one is sure how long it will take to re-engineer supply chains so more food can reach stores and farmers can earn their keep.

"We haven't seen anything like this in our lifetime," said Mr DiGangi, a seventh-generation dairy farmer."

- Aime Williams, 'US restaurant closings spur farmers to destroy food', *The Financial Times,* 22nd April 2020.

The Great Depression, we wrote in our 2016 book *Investing Through the Looking Glass*, is something that economists continue to argue about to this day:

> A generally accepted account of its definite origins may never be established. Roosevelt's New Deal is widely credited with engineering a partial recovery in the later 1930s; many today would argue that it was only America's entry into World War II which brought the country conclusively out of the Depression.

But certain facts are undeniable. After the Wall Street Crash of 1929, US GDP contracted by 10% in each of the subsequent three years. An economic slump of that magnitude had never happened before and has never happened since [at least until now]. The Keynesian perspective puts the blame for the Depression on a collapse in "animal spirits" that sent the economy into a downward spiral of lost confidence and underconsumption. The monetarist perspective has it that an ordinary recession was exacerbated by policy mistakes instituted by the central banks, notably the US Federal Reserve, which caused the money supply to contract and inflicted grave damage upon the banking system.

Keynes [in his essay *The Great Slump of 1930*] was right to warn about the baleful prospects for wealth. The Great Depression would run on for the best part of a decade. But words matter, and their meanings matter. [Keynes famously wrote that

"we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. The result is that our possibilities of wealth may run to waste for a time—perhaps for a long time."]

Keynes' metaphor of economy-as-machine is not just inaccurate, it's inappropriate. The economy is not some simple machine; it is as complex as human nature because the economy is human interaction on a global scale. *The economy is us*. And by extension, the financial markets are us, too.

The *economy as a machine* metaphor is invalid, just as Walrasian economics is invalid. The great insight of the so-called Austrian or classical economic school, inspired by the likes of Ludwig von Mises and Friedrich Hayek, is that the economy is far too complex to be compared to a simple mechanism. The economy is subject to all of the hopes, fears, frailties and illogicalities of human beings. Good luck modelling that. Not that it has stopped economists from trying.

A key prediction of traditional economics, for example, is that the economy as a whole must at some point reach equilibrium – a prediction made by both the general equilibrium theory of microeconomics as well as by standard macroeconomics. So how long does it take for the economy to reach that equilibrium?

"In the 1970s, the Yale economist Herbert Scarf determined that the time to equilibrium scales exponentially with the number of products and services in the economy to the power of four. The intuition behind this relationship is straightforward: the more products and services, the longer it takes for all the prices and quantities to adjust… if we optimistically assume that *every* decision in the economy is made at the speed of the world's fastest supercomputer (currently IBM's Blue Gene, at 70.72 trillion floating-point calculations per second), then using Scarf's result, it would take a mere 4.5 quintillion years (4.5×10^{18}) for the economy to reach general equilibrium after each exogenous shock. Given that shocks from factors such as technological change, political uncertainty, weather and changes in consumer tastes buffet the economy every second, and the universe is only about 12 billion years old (1.2×10^{10}), this clearly presents a problem."

The essential problem of traditional economics is that it assumes a largely closed system of, in Beinhocker's words, incredibly smart people in unbelievably simple worlds. The reality, as modern commentators tend to agree, is that the economy is closer to being a complex, adaptive, dynamic system – not unlike a living organic being, vulnerable to illnesses and other sudden exogenous outbreaks.

The yin to Keynes' yang is the great Austrian economist Ludwig von Mises. As part of his magnum opus, *Human Action*, Mises wrote about the impossibility of economic calculation in the centrally planned economy.

Central planning cannot work because it rips out a fundamental characteristic of the economic structure, what Mises calls "economic calculation". As he puts it, the planned economy is just a system of groping about in the dark. How, for example, can a state planner or team of planners know what the correct supply of shoes, cars, mobile phones, or anything else in the economy, should be? The central planner can't. But the free market can, through a process of trial and error if nothing else. Entrepreneurial risk-takers can. Central planning, on the other hand, is actually the elimination of conscious and purposive action. In the planned economy in its idealised state of equilibrium, there is no role for the entrepreneur. But as Mises saw the world, the entrepreneur was essential. In 'The Ultimate Foundation of Economic Science' (1962), von Mises also addressed the problem of economic forecasting: "Statistics provides numerical information about historical facts, that is, about events that happened at a definite period of time to definite people in a definite area. It deals with the past and not with the future. Like any other past experience, it can occasionally render important services in planning for the future, but it does not say anything that is directly valid for the future."

There are fundamental limitations to economic and investment theory, not least because they can only ever tell you about the past. They can never give you an accurate picture of the future. They have no predictive value. Mises was making the point that you can only use the techniques of natural sciences such as physics if you can use things like empirical observation drawn from scientific experiments and then apply mathematical techniques to analyse the data. But financial data – prices, if you will – are the result not of physical phenomena but of human action (Mises' magnum opus was titled *Human Action* for good reason), which is in turn caused by human decision making, which is influenced in turn by human emotion. So the business of investing is behavioural, not physical.

As Guy Fraser-Sampson puts it: "[Finance] is at best a social science studying human behaviour, like psychology or sociology, and can never be a physical science such as physics. It is for this reason that neither observation nor mathematical techniques can ever offer any valid universal guide to future outcomes."

Keynes was looking for a lever to move the economy. But the lever does not exist. The economy as machine does not exist. The metaphor he used is not grounded in objective reality.

Perhaps the biggest danger associated with traditional Keynesian economics is that it remains unaware of its fundamental limitations, of its overconfidence in a scientific reality that does not exist.

So let's quickly recap. In responding to forecasts and warnings about the nature of the Covid-19 pandemic from scientists that we might now generously describe as unreliable, the governments of the developed world have ***voluntarily*** put their citizenry under virtual house arrest and crashed their economies at vast and indeed immeasurable expense. There are clearly credible scientists in the field who disagree profoundly with the lockdown measures taken to date. Paying for however we manage to extract ourselves from this self-imposed Great Depression (our thanks to Sean Corrigan for his suggested alternative coinage, 'The Great Suppression') is going to be unfathomably painful, involving, as it inevitably will, some form of flirtation with various forms of deflation, inflation, stagflation, higher taxes, financial repression, and debt 'jubilees' / restructurings / defaults of some kind or other.

Our analysis of this mess concludes straightforwardly that now is the time for all investors to prioritise real assets over fiat ones, more defensive value stocks over now unrealistically priced growth stocks, and uncorrelated assets over traditional ones. *Investing Through the Looking Glass* goes into more detail on each of the above.

In August 2019, we wrote about the Paramount Network series *Waco*, which covers the real-life 1993 siege of the Texas-based Branch Davidian sect by the FBI. The two primary sources are *A Place Called Waco* by a survivor of the experience, David Thibodeau, and *Stalling for Time: My Life as an FBI Hostage Negotiator* by Gary Noesner.

Noesner is played by Michael Shannon (reliable as ever). The sect's leader, David Koresh, is played by Taylor Kitsch (outstanding).

The mission of the FBI – a US government agency – is to "protect the American people and uphold the Constitution of the United States". *Waco* strongly suggests that in this case, it failed in both cases, spectacularly, and in some cases acted outside the law – murderously so.

The series makes for gripping, if grim, entertainment. It recalls the American obliteration by bomb, rocket and napalm of the South Vietnamese town Ben Tre in February 1968 during the Vietnam War. Associated Press reporter Peter Arnett covered the attack:

U.S. advisers said the heavy allied firepower hurled on the city to drive out the Viet Cong probably contributed largely to the deaths of at least 500 civilians and possibly 1,000. South Vietnamese officials say the enemy dead totalled 451. About 50 Vietnamese soldiers died, along with more than 20 Americans…Lt. Col James Dare of Chicago, commander of U.S. Advisory Team 93, said "we will never know for sure" the number of civilians who died…Maj. Chester L. Brown of Erie, Pa., spent hours over the city as an Air Force forward air controller directing helicopter and fighter-bomber attacks. "It is always a pity about the civilians," he said.

The massacre gave rise to an infamous, and since much disputed quote:

> It became necessary to destroy the town in order to save it.

We look forward to the inevitable *post mortems* into how governments "handled" the coronavirus pandemic crisis of 2020. One wonders whether our politicians will do so with quite the same level of enthusiasm.

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