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The 'terrible trouble' of not just Greece

> The truth is that the government cannot give if it does not take from somebody. Inflation and credit expansion, the preferred methods of present day government openhandedness, do not add anything to the amount of resources available. They make some people more prosperous, but only to the extent that they make others poorer.
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> Ludwig von Mises, *Bureaucracy*, 1983, p 84.

The business of investment and finance thrives and even insists on optimism, most of which is misplaced and silly. But it is also dangerous in that optimism tends to obscure reality and robs us from seeing the necessity of adjusting our affairs in advance, acquiring the skills with which to think and plan for any potential downturns and disasters to come.

In a finance journal of a scholarly bent, I recently found a rather absorbing article on supercycles—the Kondratieff- and Elliott-wave varieties. Amusing as such scientism is to me, I marvel at man's keen desire to discover order chiefly where it does not exist. He looks to quantify the unquantifiable and he formulates variables and equations with which to extrapolate future events in the vain quest for prescience—despite ample empirical evidence of the impossibility of this task. I often imagine some learned man around the beginning of July 1914, sitting at his desk and contemplating the future. How inconceivable it would have been to forecast the course of events that took place in the following five years! Even more recently, who would have thought possible that the credit rating of Greece would become worse than that of Pakistan? We just don't know how things will turn out.

Often, we have clues as to the consequence of certain trends, and we are able to estimate, though imperfectly, one or two of the many variables that constitute life's grand differential equation. To solve for time may seem somewhat possible at times, even if the answer itself is expressed in terms of variables. Yet to try solving for any of those variables is a silly task when they are all simply functions of the unpredictable nature of man.

During the evening of my contemplation on the life and times of Nikolai Kondratieff, the eyes of the world became fixed on Greece. According to news reports, an existential threat was upon the world and "terrible trouble" would come should the Greek parliament vote the wrong way. It reminded me of the threatening "end-of-the-world" scenario the American authorities also recently used to justify the grandest wealth transfer in history. Not surprisingly, the news reports failed to explain exactly who would find themselves in such trouble.

Grave and intractable as the problem has become, it is rather ironic that the impact of Greece's financial demise would be so inversely proportional to its size or, frankly, its importance. How does one go from unending growth, apparent prosperity and an AAA rating to insolvency, chaos and junk so swiftly?

During a panel discussion at a conference I attended a few weeks ago, a man rose to ask a question. "Why is it," he said, "that despite all the monetary malevolence, interventionism and state interference of the last forty years or so, we have all witnessed the greatest rise of the standard of living in history?" He was inferring that, somehow, man is able to survive and prosper despite the obstacles. One of the panelists suggested he should imagine how greater our progress could have been without such impediments. It was not a bad answer but perhaps somewhat inadequate.

In my view, the rise of our apparent standard of living is the result of several factors, most central among them that we have financed it not only by eating our existing capital but by borrowing even further from future generations. This is hardly celebratory nor sustainable. On the contrary, it is a fact whose consequences are both painful and unavoidable.

By seeking to bandage the problem, whether in Greece, Portugal, Ireland, America or elsewhere, we are aggravating and postponing that very existential threat we fear most. The problem of Greece is minuscule and irrelevant when compared to the hollowness of an economic order whose most certain demise will scuttle our vaunted standard of living and with it (hopefully) ruin the cancerous and corrupt political and economic ideas of our times. If much of our past growth was plundered from the future, and if the future is now, we must now then come to terms not only with our borrowings but also with the consequences of our collective income statement and the social ramifications of having to renege on the absurd and unjust promises of social justice.

Margaret Thatcher once said, "Socialist governments traditionally do make a financial mess. They always run out of other people's money." As arithmetic goes, this may be true, but it does not address the extent of the problem which is rooted in corrupt political ideals fueled and enabled by what Thomas Jefferson described as "a permanent engine of corruption," that is, central banking—money based on debt.

Rationalizations, denials and other reactions

We tend to think in terms of countries and regions: we talk about the PIIGS, about Europe or America and so on, generalizing our observations to fit the statistics or the political illusions that fuel them. The difficulty of concluding anything useful from such geographic observations is that we fail to examine the unseen ingredients of cultural distinctions such as social cohesion, the capacity to compete, universal respect for honesty, the historical character of a region and so forth. We lump it all in a few aggregates, comparing debt to GDP ratios and other simplistic figures in abstract and useless terms. Our failure to distinguish the root causes leads to denial, wishful thinking and misplaced hope. To that end, statistical aggregates such as GDP tell us so very little of what is most important.

The fact remains that there are horrible consequences for eating our capital and borrowing from the future, whether the purpose is, as in Greece, to live the good life, retire a few years after puberty and fund the net worth of the corrupt political class and their cronies, or, as in the USA, to finance imperialism, endless war and a culture of mercantilism. In both cases, the end result of eating tomorrow’s capital today is the same: a growing dependence on external capital, an emasculated private sector, a deeply embedded culture of corruption, monstrous bureaucracy, lawlessness and injustice, political patronage, and a society where dependency and envy have become a way of life.

While the land of Zorba has become the object of worldwide scorn and has upset the grandiose foolishness of the parasitic crowd in Brussels, the burden of its debt (and that of others) must be understood not only within the context of its balance sheet and income statement, but also within the framework of such cultural distinctions that create or destroy a people’s natural inclination to collective economic relevance. The price of misunderstanding is terribly high.

"The pumps will buy you time..." said Thomas Andrews, the tragic architect of the *Titanic* to Captain Smith "... but minutes only. From this moment, no matter what we do, *Titanic* will founder."

The captain's reaction was eerily that of Mr. Trichet or Mrs. Merkel: "But this ship can't sink!"

Mr. Andrews was in no mood for denial or illusions. "She is made of iron, sir. I assure you she can. And she will. It is a mathematical certainty." The dialogue is from a movie, an ironic documentary of sorts.

The misplaced and silly optimism of those unwilling or unable to see the mathematical certainty of consequences always starts with denial. Denial is followed by wishful thinking: pretend there is no problem, raise taxes, kill the rich, shut down the pesky (and yes, incompetent) ratings agencies, cut benefits, raise the retirement age, print some money, borrow some more, restructure, confiscate pension funds, consider austerity, and so forth. There is an infinite number of possibilities that can sustain the hope of a miracle that is "made of iron."

Looking ahead

In regard to the insolvent sovereign sector in Europe, it comes as no surprise that no one seriously contemplates or even discusses the market solution: Default, Argentina-style. The physical resources would remain and the debts would vanish. The creditors would bear the loss and most banks would collapse. After a short but very painful adjustment, everyone would again learn to live within their means and their own ability to produce. Forget retirement. The Greek GDP per capita would get back into line with that of Bulgaria and that of Spain—to what it used to be before the age of free money.

Well, perhaps it is not so simple, but the principle remains true that in an unhindered market, the price of all things finds a natural equilibrium; the trash is discounted and sold at a clearing price. The free market is self-curing. Indeed, no one discusses such notions. A Greek default, we are told, would precipitate the default of Spain and, God-forbid, Italy and perhaps even, well, France? Surely, this could be the end, no? Imagine 80 million Germans, whose labor has long been plundered in the cause of solidarity, waking up to learn that their banks are bust and most of their very own savings and pensions have disappeared into thin air.

There is yet another subject that no one contemplates or discusses: that of making the pie bigger instead of endlessly debating how to divide it up. Nowhere in the Greek deliberations is there talk about dismantling the tyrannical and asphyxiating obstacles to private investment, nor is there any change of mind in the man on the street concerning the "evil profits" of the private sector. It seems that Jefferson's "engine of corruption," coupled with the worst attributes of the Mediterranean temperament, have sentenced to impoverishment whole generations to come.

Frankly, the American situation is not far behind, and given the country's lack of social cohesion, the undoubtable consequences are horrifying to imagine. The numbers—trillions and trillions—are so impossible to even fathom, and, well, let's not forget all these American missiles out there. America is the big black bear in the closet that no one wants to talk about. But it suffers from precisely the same diseases afflicting the Greeks: the cumulative effects of borrowing from the future (via foreign creditors) to finance present consumption (and war), the atrophied, diminished and shackled productive class, the insolvency of its big financial institutions inclusive of the central bank, the decimation of its middle class and, not least, a complete unwillingness to make any adjustments. And so, if the Greek GDP per capita is to find its old ratio with that of Bulgaria, the American adjustment is likely to be profoundly more unsettling and violent.

There is no painless escape from the consequences of the problem in which we find ourselves. As Ludwig von Mises wrote in his magnum opus *Human Action*, from which I make no apologies for quoting over and over again, "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of a voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved."

As for Europe, and at the risk of prosecution for writing anything derogatory, it has become obvious that no one is in charge and that those who pretend are clearly buffoons who make things up as they go along. Their talk about cautiousness concerning inflation is empty rhetoric. What is most unnerving to them is the rising unemployment in the southern shores (read: social unrest), the insolvency of the big financial institutions including the central bank, and the rising prices of sovereign credit default swaps.

On the other side of the Atlantic, despite the electioneering theatrics concerning budgetary discipline and the so-called debt limit, the American authorities are just as clueless. (Recently, Mr. Bernanke, in a rare moment of candor, even acknowledged as much publicly.) While encouraging asset inflation, they pay endless lip service to avoiding price inflation, all the while having in place a grand policy of inflationism and currency debasement.

Where we stand

Our investment practice is unique both in what concerns us and what does not. We are uninterested in most things that preoccupy most others. Yield spreads, put/call ratios, earnings estimates, consensus opinions, day to day changes in oil inventories, corn production and so forth are of no use to us. We are uninterested in the kind of prosperity and growth that is rooted in the dishonest use of debt or the get-rich-quick theory of life. We see it as impermanent and fictitious.

Distinguishing between the productive and unproductive has become difficult since financial activity, often for its own sake, dominates the business landscape and has deluded folks into believing that debt creation is "wealth creation" and that the ultimate end is money in itself. To make matters worse, much of what passes for prices on a day to day basis is the product of untold and often covert suppression, manipulation and distortion. Meaningless prices beget meaningless conclusions and a frantic race to nowhere. In contrast, we look not to today's events but to the trends that give us clues as to the value of what we possess some five years down the road. And we insist that such value is of the subjective kind that is, our own idea as to what is valuable.

Two important things concern us: first, the nature of money and its value to us, and second, the nature of our assets in terms of their economic viability, enduring substance and liabilities thereto. I know of only two or three other fund managers who are similarly preoccupied.

In seeking to protect our own savings—a formidable task even under normal conditions—we recognize the need first to be brutally honest about the circumstances in which we find ourselves. Yes, I am optimistic of man's ability to adapt, and indeed, we have been through far greater calamities in times past. Still, our optimism must be cognizant of the intractable issues we face and a bit fearful of the extent to which the State will go to perpetuate its own power and status.

We need to accept the fact that the old regime of ever-rising standards of living is now dead. Our entire debt-based money system is at its last breath. There is no possible way for all the debts to be paid back or the promises made to be kept. It is a mathematical certainty. A new era is upon us and its implications are daunting.

The money price of gold and, by extension, foreign exchange rates, continue to dominate the periodic tallying of our net asset value. It is quite normal that we are filled with contentment when it goes up in terms of money or perhaps with a bit of doubt when it goes the other direction. Two good things happen when one focuses his view ahead of that of others. First, he is spared the anguish that prevails in the short-term, and second, he is pleased when others eventually come to his original conclusions.

We find few and small opportunities to add to our collection of equity investments. Most of what we consider worthwhile in owning seems to be priced as if the world were just perfect. Our patience will be rewarded in time to come.

It is worth noting, again, that we consider each and every asset in our books to be purposeful as to the whole. Ours is not a portfolio that seeks outperformance in money terms. Consider this: If the root of our evil starts with money, it follows that the price of money is of far larger concern to us than the price of anything else in terms of money. Admittedly, this kind of obstinate logic does not bring us into comparison with others. At least not in the short-term. But we can sleep soundly in that we have, for all practical purposes, managed to insulate ourselves from the kinds of risks that end up becoming terrible trouble. (TD)