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14th April 2014

Madness

"Central bankers control the price of money and therefore indirectly influence every market in the world. Given this immense power, the ideal central banker would be humble, cautious and deferential to market signals. Instead, modern central bankers are both bold and arrogant in their efforts to bend markets to their will. Top-down central planning, dictating resource allocation and industrial output based on supposedly superior knowledge of needs and wants, is an impulse that has infected political players throughout history. It is both ironic and tragic that Western central banks have embraced central planning with gusto in the early twenty-first century, not long after the Soviet Union and Communist China abandoned it in the late twentieth. The Soviet Union and Communist China engaged in extreme central planning over the world's two largest countries and one-third of the world's population for more than one hundred years combined. The result was a conspicuous and dismal failure. Today's central planners, especially the Federal Reserve, will encounter the same failure in time. The open issues are, when and at what cost to society ?"

- James Rickards, 'The death of money: the coming collapse of the international monetary system', 2014.

"Sir, On the face of it stating that increasing the inheritance tax allowance to £1m would abolish the tax for "all except a very small number of very rich families" (April 5) sounds a very reasonable statement for the Institute for Fiscal Studies to make, but is £1m nowadays really what it used to be, bearing in mind that £10,000 was its equivalent 100 years ago ?

"A hypothetical "very rich" person today could have, for example, a house worth £600,000 and investments of £400,000. If living in London or the South East, the house would be relatively modest and the income from the investments, assuming a generous 4 per cent return, would give a gross income of £16,000 a year, significantly less than the average national wage.

"So whence comes the idea that nowadays such relatively modest wealth should be classified as making you "very rich" ? The middle-aged should perhaps wake up to the fact that our currency has been systematically debased, though it may be considered impolite to say so as it challenges the conventional political and economic wisdom. To be very rich today surely should mean you have assets that give you an income significantly higher than the national average wage ?"

- Letter to the editor of the Financial Times from Mr John Read, London NW11, 12 April 2014.

“The former coach house in Camberwell, which has housed the local mayor’s car, was put on the market by Southwark council as a “redevelopment opportunity”. At nearly £1,000 per square foot, its sale value is comparable to that of some expensive London homes.”

- ‘London garage sells for £550,000’ by Kate Allen, The Financial Times, 12 April 2014.

“Just Eat, online takeaway service, slumped below its float price for the first time on Tuesday as investors dumped shares in a raft of recently floated web-based companies amid mounting concern about their high valuations..

“Just Eat stunned commentators last week when it achieved an eye-watering valuation of £1.47 billion, more than 100 times its underlying earnings of £14.1 million..

““They have fallen because the company was overvalued. Just Eat was priced at a premium to Dominos, an established franchise that delivers and makes the pizzas and has revenues of £269 million. Just Eat by comparison is a yellow pages for local takeaways where there is no quality control and no intellectual property and made significantly less revenues of £96.8 million. A quality restaurant does not need to pay 10 per cent commission to Just Eat to drive customers through the door,” Michael Hewson, chief market analyst at CMC Markets said.”

- ‘Investors lose taste for Just Eat as tech stocks slide’ by Ashley Armstrong and Ben Martin, The Daily Telegraph, 8 April 2014.

Keep interest rates at zero, whilst printing trillions of dollars, pounds and yen out of thin air, and you can make investors do some pretty extraordinary things. Like buying shares in Just Eat, for example. But arguably more egregious was last week’s launch of a €3 billion 5 year Eurobond for Greece, at a yield of just 4.95%. UK “investors” accounted for 47% of the deal, Greek domestic “investors” just 7%. Just in case anybody hasn’t been keeping up with current events, Greece, which is rated Caa3 by Moody’s, defaulted two years ago. In the words of the credit managers at Stratton Street Capital,

“The only way for private investors to justify continuing to throw money at Greece is if you believe that the €222 billion the EU has lent to Greece is entirely fictional, and will effectively be converted to 0% perpetual debt, or will be written off, or Greece will default on official debt while leaving private creditors untouched.”

In a characteristically hubris-rich article last week (‘Only the ignorant live in fear of hyperinflation’), Martin Wolf issued one of his tiresomely regular defences of quantitative easing and arguing for the direct state control of money. One respondent on the FT website made the following comments:

“The headline should read, "Only the EXPERIENCED fear hyperinflation." Unlike Martin Wolf's theorising, the Germans - and others - know only too well from first-hand experience exactly what hyperinflation is and how it can be triggered by a combination of unforeseen circumstances. The reality, not a hypothesis, almost destroyed Germany. The Bank of England and clever economists can say what they like from their ivory towers, but meanwhile down here in the real world, as anyone who has to live on a budget can tell you, every visit to the supermarket is more expensive than it was even a few weeks ago, gas and electricity prices have risen, transport costs have risen, rents have risen while at the same time incomes remain static and the little amounts put aside for a rainy day in the bank are losing value daily. Purchasing power is demonstrably being eroded and yet clever - well paid - people would have us believe that there is no inflation to speak of. It was following theories and forgetting reality that got us into this appalling financial mess in the first place. Somewhere, no doubt, there's even an excel spreadsheet and a powerpoint presentation with umpteen graphs by economists proving how markets regulate themselves which was very convincing up to the point where the markets departed from the theory and reality took over. I'd rather trust the Germans with their firm grip on reality any day."

As for what "inflation" means, the question hinges on semantics. As James Turk and John Rubino point out in the context of official US data, the inflation rate is massaged through hedonic quality modelling, substitution, geometric weighting and something called the Homeowners' equivalent rent. "If new cars have airbags and new computers are faster, statisticians shave a bit from their actual prices to reflect the perception that they offer more for the money than previous versions.. If [the price of] steak is rising, government statisticians replace it with chicken, on the assumption that this is how consumers operate in the real world.. rising price components are given less relative weight.. homeowners' equivalent rent replaces what it actually costs to buy a house with an estimate of what homeowners would have to pay to rent their homes – adjusted hedonically for quality improvements." In short, the official inflation rate – in the US, and elsewhere – can be manipulated to look like whatever the authorities want it to seem.

But people are not so easily fooled. Another angry respondent to Martin Wolf's article cited the "young buck" earning £30K who wanted to buy a house in Barnet last year. Having saved for 12 months to amass a deposit for a studio flat priced at £140K, he goes into the estate agency and finds that the type of flat he wanted now costs £182K – a 30% price increase in a year. Now he needs to save for another 9 years, just to make up for last year's gain in property prices.

So inflation is quiescent, other than in the prices of houses, shares, bonds, food, energy and a variety of other financial assets.

The business of rational investment and capital preservation becomes unimaginably difficult when central banks overextend their reach in financial markets and become captive to those same animal spirits. Just as economies and markets are playing a gigantic tug of war between the forces of debt deflation and monetary inflation, they are being pulled in opposite directions as they try desperately to anticipate whether and when central bank monetary stimulus will subside, stop or increase. Central bank 'forward guidance' has made the outlook less clear, not more. Doug Noland cites a recent paper by former IMF economist and Reserve Bank of India Governor Raghuram Rajan titled 'Competitive Monetary Easing: Is It Yesterday Once More ?' The paper addresses the threat of what looks disturbingly like a modern retread of the trade tariffs and import wars that worsened the 1930s Great Depression – only this time round, as exercised by competitive currency devaluations by the larger trading economies.

"Conclusion: The current non-system [a polite term for non-consensual, non-cooperative chaos] in international monetary policy [competitive currency devaluation] is, in my view, a source of substantial risk, both to sustainable growth as well as to the financial sector. It is not an industrial country problem, nor an emerging market problem, it is a problem of collective action. We are being pushed towards competitive monetary easing. If I use terminology reminiscent of the Depression era non-system, it is because I fear that in a world with weak aggregate demand, we may be engaged in a futile competition for a greater share of it. In the process, unlike Depression-era policies, we are also creating financial sector and cross-border risks that exhibit themselves when unconventional policies come to an end. There is no use saying that everyone should have anticipated the consequences. As the former BIS General Manager Andrew Crockett put it, ‘financial intermediaries are better at assessing relative risks at a point in time, than projecting the evolution of risk over the financial cycle.’ A first step to prescribing the right medicine is to recognize the cause of the sickness. Extreme monetary easing, in my view, is more cause than medicine. The sooner we recognize that, the more sustainable world growth we will have.”

The Fed repeats its 2% inflation target mantra as if it were some kind of holy writ. 2% is an entirely arbitrary figure, subject to state distortion in any event, that merely allows the US government to live beyond its means for a little longer and meanwhile to depreciate the currency and the debt load in real terms. The same problem in essence holds for the UK, the euro zone and Japan. Savers are being boiled alive in the liquid hubris of neo-Keynesian economists explicitly in the service of the State. Doug Noland again:

“While I don’t expect market volatility is going away anytime soon, I do see an unfolding backdrop conducive to one tough bear market. Everyone got silly bullish in the face of very serious domestic and global issues. Global securities markets are a problematic “crowded trade.” Marc Faber commented that a 2014 crash could be even worse than 1987. To be sure, today’s incredible backdrop with Trillions upon Trillions of hedge funds, ETFs, derivatives and the like make 1987 portfolio insurance look like itsy bitsy little peanuts. So there are at this point rather conspicuous reasons why Financial Stability has always been and must remain a central bank’s number one priority. Just how in the devil was this ever lost on contemporary central bankers?”

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14th April 2014.

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