

Market Commentary

By Art Cashin

Prepared by UBS Financial Services Inc.

Statistics:

Fair Value	=	N.A.
Buy Program	=	N.A.
Sell Program	=	N.A.

Cashin's Comments

An Encore Presentation

(Today we will revisit one of the most devastating economic events in recorded history. It all began with the efforts of a few, well-intentioned government officials.)

Originally, on this day (+1) in 1922, the German Central Bank and the German Treasury took an inevitable step in a process which had begun with their previous effort to "jump start" a stagnant economy. Many months earlier they had decided that what was needed was easier money. Their initial efforts brought little response. So, using the governmental "more is better" theory they simply created more and more money.

But economic stagnation continued and so did the money growth. They kept making money more available. No reaction. Then, suddenly prices began to explode unbelievably (but, perversely, not business activity).

So, on this day government officials decided to bring figures in line with market realities. They devalued the mark. The new value would be 2 billion marks to a dollar. At the start of World War I the exchange rate had been a mere 4.2 marks to the dollar. In simple terms you needed 4.2 marks in order to get one dollar. Now it was 2 billion marks to get one dollar. And thirteen months from this date (late November 1923) you would need 4.2 trillion marks to get one dollar. In ten years the amount of money had increased a trillion fold.

Numbers like billions and trillions tend to numb the mind. They are too large to grasp in any "real" sense. Thirty years ago an older member of the NYSE (there were some then) gave me a graphic and memorable (at least for me) example. "Young man," he said, "would you like a million dollars?" "I sure would, sir!", I replied anxiously. "Then just put aside \$500 every week for the next 40 years." I have never forgotten that a million dollars is enough to pay you \$500 per week for 40 years (and that's without benefit of interest). To get a billion dollars you would have to set aside \$500,000 dollars per week for 40 years. And a....trillion that would require \$500 million every week for 40 years. Even with these examples, the enormity is difficult to grasp.

Let's take a different tack. To understand the incomprehensible scope of the German inflation maybe it's best to start with something basic....like a loaf of bread. (To keep things simple we'll substitute dollars and cents in place of marks and pfennigs. You'll get the picture.) In the middle of 1914, just before the war, a one pound loaf of bread cost 13 cents. Two years later it was 19 cents. Two years more and it sold for 22 cents. By 1919 it was 26 cents. Now the fun begins.

In 1920, a loaf of bread soared to \$1.20, and then in 1921 it hit \$1.35. By the middle of 1922 it was \$3.50. At the start of 1923 it rocketed to \$700 a loaf. Five months later a loaf went for \$1200. By September it was \$2 million. A month later it was \$670 million (wide spread rioting broke out). The next month it hit \$3 billion. By mid month it was \$100 billion. Then it all collapsed.

Let's go back to "marks". In 1913, the total currency of Germany was a grand total of 6 billion marks. In November of 1923 that loaf of bread we just talked about cost 428 billion marks. A kilo of fresh butter cost 6000 billion marks (as you will note that kilo of butter cost 1000 times more than the entire money supply of the nation just 10 years earlier).

How Could This All Happen? – In 1913 Germany had a solid, prosperous, advanced culture and population. Like much of Europe it was a monarchy (under the Kaiser). Then, following the assassination of the Archduke Franz Ferdinand in Sarajevo in 1914, the world moved toward war. Each side was convinced the other would not dare go to war. So, in a global game of chicken they stumbled into the Great War.

The German General Staff thought the war would be short and sweet and that they could finance the costs with the post war reparations that they, as victors, would exact. The war was long. The flower of their manhood was killed or injured. They lost and, thus, it was they who had to pay reparations rather than receive them. Things did not go badly instantly. Yes, the deficit soared but much of it was borne by foreign and domestic bond buyers. As had been noted by scholars....."The foreign and domestic public willingly purchased new debt issues when it believed that the government could run future surpluses to offset contemporaneous deficits." In layman's English that means foreign bond buyers said – "Hey this is a great nation and this is probably just a speed bump in the economy." (Can you imagine such a thing happening again?)

When things began to disintegrate, no one dared to take away the punchbowl. They feared shutting off the monetary heroin would lead to riots, civil war, and, worst of all communism. So, realizing that what they were doing was destructive, they kept doing it out of fear that stopping would be even more destructive.

Currencies, Culture And Chaos – If it is difficult to grasp the enormity of the numbers in this tale of hyper-inflation, it is far more difficult to grasp how it destroyed a culture, a nation and, almost, the world. People's savings were suddenly worthless. Pensions were meaningless. If you had a 400 mark monthly pension, you went from comfortable to penniless in a matter of months. People demanded to be paid daily so they would not have their wages devalued by a few days passing. Ultimately, they demanded their pay twice daily just to cover changes in trolley fare. People heated their homes by burning money instead of coal. (It was more plentiful and cheaper to get.)

The middle class was destroyed. It was an age of renters, not of home ownership, so thousands became homeless. But the cultural collapse may have had other more pernicious effects. Some sociologists note that it was still an era of arranged marriages. Families scrimped and saved for years to build a dowry so that their daughter might marry well. Suddenly, the dowry was worthless – wiped out. And with it was gone all hope of marriage. Girls who had stayed prim and proper awaiting some future Prince Charming now had no hope at all. Social morality began to collapse. The roar of the roaring twenties began to rumble. All hope and belief in systems, governmental or otherwise, collapsed. With its culture and its economy disintegrating, Germany saw a guy named Hitler begin a ten year effort to come to power by trading on the chaos and street rioting. And then came World War II.

We think it's best to close this review with a statement from a man whom many consider (probably incorrectly) the father of modern inflation with his endorsement of deficit spending. Here's what John Maynard Keynes said on the topic:

By a continuing process of inflation, governments can confiscate, secretly and unobserved, an important part of the wealth of their citizens. By this method they not only confiscate, but they confiscate arbitrarily; and, while the process impoverishes many, it actually enriches some.....Those to whom the system brings windfalls....become profiteers.

To convert the business man into a profiteer is to strike a blow at capitalism, because it destroys the psychological equilibrium which permits the perpetuance of unequal rewards.

Lenin was certainly right. There is no subtler, no surer means of over-turning the existing basis of society than to debauch the currency. The process engages all the hidden forces of economic law on

the side of destruction, and does it in a manner which not one man in a million is able to diagnose...By combining a popular hatred of the class of entrepreneurs with the blow already given to social security by the violent and arbitrary disturbance of contract...governments are fast rendering impossible a continuance of the social and economic order of the nineteenth century.

Luckily, given the disastrous results of the Weimar experiment, no central bank has been foolish enough to target inflation and/or fiddle with the money supply. A lesson well learned.

It is trade, not inflation that seems to obsess markets these days. Pre-opening, Bloomberg had suggested that China was ready to do a "partial deal" (they buy lots of agriculture stuff and we activate none of the looming scheduled tariffs). That was enough to gap stocks higher on the opening bell. Those trade hopes kept a bid under stocks until final hour, when Reuters said the preliminary talks had not gone well and that their Chinese sources were not optimistic. That clipped the market in the final twenty minutes of trading.

The influence of the Yom Kippur holiday was quite evident as Wednesday saw the second slowest volume of any full session this year.

The sell at Rosh Hashanah, buy back after Yom Kippur seemed to work well this year. You sold them at the close on the last trading day before Rosh Hashanah (Friday 9/27; Dow 26820; S&P 2961.80) and buy back at the opening this morning for what looks to be a profitable trade. Sometimes sanctity pays.

Overnight And Overseas – Asian equity markets closed mixed in generally light trading. Tokyo was modestly higher, while Hong Kong saw fractional gains. Shanghai had a moderate rally but India closed lower.

London and Frankfurt are fractionally lower, while stocks in Paris are slightly higher.

Among other assets, Bitcoin has rallied, trading around \$8500. Gold and crude are marginally lower. The euro is stronger against the dollar and yields are unchanged.

Consensus – Equity futures had a wild and wooly night. Amid rumors that the talks would end abruptly, the Dow futures were down over 300 points only to return to neutral after the rumors were denied.

As we go to press, the futures are neutral to down slightly. The markets are very finicky on the topic of trade, so one tweet could prompt a major move.

Monday will be Columbus Day for many. While the stock market will be open, many government officials may not be at their desks and that brings us one day closer to the October 15th tariff trigger.

Stick with the drill – stay wary, alert and very, very nimble.

Trivia Corner

Answer - The three 3 letter words across we got were "BAY", "ICE" and "GET" making the vertical set - "BIG", "ACE" and "YET".

Today's Question - Play it again Sam! - The notes of the musical scale run A, B, C, D, E, F, G. If that's correct, can you play at least 3 words of 7 letters or more?

NO COMMENTS FRIDAY

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