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Big Deal **20th July 2020**

"So not a deal of Rooseveltian ambition ? Perhaps not. As both the FT and union boss Len McCluskey acidly observed, Roosevelt's New Deal spawned mega projects such as the Hoover Dam; [Boris] Johnson's list includes the reannouncement of repairs to a bridge in Sandwell."

- Simon Wilson on 'Boris Johnson's New Deal' in *MoneyWeek*, 10th July 2020.

There is a pivotal sequence in Steven Spielberg's 1977 sci-fi classic *Close Encounters of the Third Kind*. Having been herded into an army helicopter near Wyoming's Devils Tower with a number of other seeming eccentrics, electrical maintenance worker Roy Neary (Richard Dreyfuss) suddenly twigs that the cover story they have all been fed by the government – an accidental toxic nerve gas spill – is just that, a cover story. He takes off his gas mask and encourages his fellow masked passengers to escape. While they stare wide-eyed in horror, he gratefully gulps in lungfuls of oxygen and tells them,

> There is nothing wrong with the air !

Those of us under pensionable age with no serious pre-existing conditions may never know just how dangerous Covid-19 is, or ever was. Harold Macmillan reminds us that the greatest challenge for politicians is always "Events, dear boy, events". Who knows how things might have gone down if the chain of events in 2020 had unfurled in a different way – if, say, Covid-19 had first emerged, not in an insanitary, chthonic, authoritarian third world s**thole like China, but in an orderly, democratic country like Switzerland. Chances are surely that Swiss citizens would not have been welded inside their own homes while its government colluded to ensure the deaths of as many inhabitants of the rest of the world as possible.

All somewhat academic, now. Which is indeed part of the problem. Academics and scientific "experts" weren't much use at the beginning of this crisis and the lack of any meaningful consensus – assuming consensus were even valuable under the circumstances – is contributing nothing now, either. Dr John Lee for *The Spectator* addresses the problem:

> At the outset, we were told the virus was so pernicious that it could, if not confronted, claim half a million lives in the UK alone. Its fatality rate was estimated by the World

> Health Organisation at 3.4 per cent. Then from various sources, we heard 0.9 per cent, followed by 0.6 per cent. It could yet settle closer to 0.1 per cent — similar to seasonal flu — once we get a better understanding of milder, undetected cases and how many deaths it actually caused (rather than deaths where the virus was present). How can this be, you might ask, given the huge death toll? Surely the figure of 44,000 Covid deaths offers proof that calamity has struck?
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> But let us look at the data. Compare this April with last and yes, you will find an enormous number of 'excess deaths'. But go to the Office for National Statistics website and look up deaths in the winter/spring seasons for the past 27 years, and then adjust for population. This year comes only eighth in terms of deaths. So we ought to put it in perspective..
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> In medical science there is a well-known classification of data quality known as 'the hierarchy of evidence'.. Right at the bottom of the hierarchy — Level 7 — is the opinion of authorities or reports of expert committees. This is because, among other things, 'authorities' often fail to change their minds in the face of new evidence. Committees, containing diversity of opinion and inevitably being cautious, often issue compromise recommendations that are scientifically non-valid. Ministers talk about 'following the science'. But the advice of Sage (or any committee of scientists) is the least reliable form of evidence there is.
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> Such is the quality of decision-making in the process generating our lockdown narrative. An early maintained but exaggerated belief in the lethality of the virus reinforced by modelling that was almost data-free, then amplified by further modelling with no proven predictive value. All summed up by recommendations from a committee based on qualitative data that hasn't even been peer-reviewed.

But apart from that, everything worked just fine.

Future historians probably won't believe how our government – and others – managed to mishandle the Covid-19 crisis so disastrously. Anybody alive capable of simultaneously walking and chewing gum probably feels the same way. In order to handle a virus of unknown lethality, the British government elected – on dubious advice assisted by serially incompetent epidemiological forecasters – to a) quarantine the healthy and b) shut down the economy.

Wind duly sown. Brace for whirlwind.

Since politicians and the mainstream media are no better at economics than they are at dispassionately handling pandemics, we are now bombarded with propaganda comparing Boris Johnson's new stimulus to FDR's New Deal. This presupposes that FDR's New Deal achieved anything other than perpetuating the Great Depression. Being generous, we could at least concede that at least FDR didn't personally orchestrate the Great Crash of 1929. We wrote the following piece, also for *The Spectator*, some nine years ago:

> The Bank of England's latest announcement of quantitative easing, widely referred to as QE2, prompts as many questions as it does answers — particularly for investors

and pension-holders. Under a QE regime, money printed out of thin air is used to purchase government bonds from banks and other private sector investors. The theory then has it that long-term interest rates will fall, and banks will have more money to lend to eager borrowers.

There's just one problem with this cunning plan: it doesn't work. It did not work in Japan, the first country to flirt with QE. Richard Koo, chief economist of the Nomura Research Institute, calls QE 'the 21st century's greatest monetary non-event'. The reason for his scepticism is that we are not in a normal business-cycle recession, in which the central bank reacts to a disorderly economic boom by hiking interest rates to suppress inflation. Businesses retrench, and as inflationary pressure subsides, interest rates are gradually reduced. Instead, we are in what Koo calls a 'balance-sheet recession': amid the economic uncertainty of the continuing financial crisis, businesses and households are more keen to pay down debt than to take on more, so it doesn't really matter how low you make interest rates, because people aren't really interested in borrowing.

The reason for reintroducing QE is that the Bank of England, like other central banks, is desperate to create economic stimulus, and to support ailing private-sector banks. Policy rates (i.e. the Bank's base rate, which has been at 0.5 per cent since March 2009) cannot realistically go any lower, so QE is pretty much the last bullet in the monetary arsenal.

But in Koo's words, QE with interest rates at zero is like a shopkeeper who cannot sell his store of 100 apples at 100 yen each, so he tries stocking his shelves with 1,000 apples, and when that has no effect, adds another thousand. 'As long as the price remains the same, there is no reason consumer behaviour should change… This is essentially the story of quantitative easing, which not only failed to bring about economic recovery, but also failed to stop [Japanese] asset prices from falling.'

What else, if anything, could the Bank of England do? To some of us, it should simply get out of the way and allow the free market to act. There is a plausible economic argument in favour of laissez-faire — well made by the writer Murray Rothbard in his 1963 study, 'America's Great Depression'. In his view, the more government tries to intervene to delay the free market's adjustment to the accumulated 'malinvestments' of a credit boom, the longer and more gruelling the depression. Unfortunately, government depression policy 'has always aggravated the very evils it has loudly tried to cure'.

If you wanted to perpetuate a depression, suggests Rothbard, the very best way to do it would be to enact the policies the government is pursuing today: prevent widespread liquidation of financial assets by lending money to shaky businesses; deploy as much QE as you can, to ensure that bad banks remain in business like malodorous zombies; inflate further, which prevents a necessary fall in prices; keep wage rates up (thus ensuring permanent mass unemployment); keep prices up (which will create unsaleable surpluses); stimulate consumption and discourage saving — not least, by driving interest rates close to zero.

The Japan that gave the world QE also gave us another alien acronym: Zirp, or zero interest rate policy. This policy is now wreaking havoc on the assets of savers, especially pensioners on fixed incomes. With interest rates near zero, savers are forced either to eat into their own capital or to take risks they might prefer to avoid, namely jumping into the stock market during a period of acute volatility. The artificially low yields on offer from heavily manipulated government bonds are also destroying the value of pension funds, which are normally heavily invested in government debt. Rapidly falling gilt yields have, in turn, slashed the annuity rates on which they are based — the accountants PricewaterhouseCoopers suggest that a toxic combination of falling annuity rates and plunging stock markets has savaged the value of today's private pensions by 30 per cent versus the pensions of those who retired just three years ago.

So what is a saver or investor to do? In the first instance, we should face facts. QE, as a fancy way of printing money, is inherently inflationary. That inflationary pressure may not be visible today (although the retail prices index already sits above the yield available from any British government bond), but give it time. Investors will probably be well served by diversifying into real assets that offer some form of inflation hedge: classic cars, top-end property, jewellery, fine wine, art. If our political and economic leaders eventually rediscover their senses, we may be lucky enough to avoid hyperinflation. If not, those who best navigated the infamous Weimar era hyperinflation put their assets into harder currencies, land, and gold.

Gold is probably the best refuge against the inflationist scoundrels that pass for our economic savants, in that it is the one currency that cannot be printed on a whim in the name of political expediency. Safe havens and higher-income assets are all difficult to find now, but for those who can stomach the price volatility, classic defensive equity investments such as utilities, pharmaceuticals, consumer staples and tobacco stocks all have their place in a balanced portfolio. There is probably an argument, too, in favour of borrowing at current market rates — for as long a fixed term as you can get — because we may not see their like again. We are stuck in an extraordinary and unprecedented financial landscape. Citigroup anticipate another two to three years of QE, along with the ultra-low interest rates the policy implies. But low rates will not be with us forever; future market crises are almost certain.

The great Austrian School economist Ludwig von Mises warned that there was no escape from an economic bust fuelled by a credit bubble. The only question was whether the crisis ended sooner as a result of the voluntary abandonment of further credit expansion, or later, in the form of a complete collapse of the currency system. Given that the Bank of England has voted to keep the credit bubble inflated, investors would be wise to start edging toward the exits.

Nine years ago. As Adam Smith once observed, there's a great deal of ruin in a nation.

Nine years on, the inflationary genie is determinedly out of the bottle. 'Santa' Sunak has seen to that..

Source: *The Daily Telegraph*

Rather than simply articulate a counsel of despair, what are the practical implications of trying to survive the financial environment and investment markets of 2020 ? The first step in dealing with any problem is acknowledging it. Government inflationism is *their* policy but *our* collective problem. And it's by no means limited to the UK. Simon Black for [Sovereign Man], for example, points out how absurdly easy it is to apply for US government bunce – and how grotesquely difficult it is to try and give it back.

Like a growing number of investors, we suspect that inflation is coming back, with a vengeance. From a classical economics perspective, the inflation has already happened, in the form of a monumental increase in what Russell Napier calls printing press money (central bank stimulus) ***and*** fountain pen money (commercial bank money creation through the discretionary issuance of credit). What is widely referred to as inflation (a generalised rise in the prices of goods and services) is "merely" a second order effect.

So bonds – in all forms – are out. As are most forms of listed equities, thanks to the voluntary governmental destruction of functioning economies. Limited exceptions should include those companies whose earnings are unimpaired by the governmental mishandling of the Covid crisis, and where cashflow generation remains robust, and where valuations are unchallenging to begin with (margins of safety ***rock*** during a pandemic and a catastrophic government response). Supplement these 'special situations' with inflation and currency protection (notably gold and silver, the monetary metals – try printing those, Rishi !), and supplement the whole defensive caboodle with uncorrelated funds that provide future-proofing against your own (and our own) overconfidence in what might possibly lie in wait.

Echoes from history.. By the time Franklin Delano Roosevelt took office as President in March 1933, there were at least 15 million unemployed in the United States. Perhaps a quarter of the country was out of work. It may even have been a third. Roosevelt was well aware of the gravity of the situation. The very existence of the republic hung in the balance. Shortly after becoming President, Roosevelt took in a visitor who said to him, "Mr. President, you're either gonna be our greatest president, or you're gonna be our worst president." Roosevelt responded, "No, if, if I fail, I'll be our last president..”

Boris, Rishi – good luck.

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