EDELWEISSJOURNAL

17 October 2012 www.edelweissjournal.com Issue 9

The loss of trust and the Great Disorder

By Dylan Grice

At its most fundamental level, economic activity is no more than an exchange between strangers. It depends, therefore, on a degree of trust between strangers. Since money is the agent of exchange, it is the agent of trust. Debasing money therefore debases trust. History is replete with Great Disorders in which social cohesion has been undermined by currency debasements. The multi-decade credit inflation can now be seen to have had similarly corrosive effects. Yet central banks continue down the same route. The writing is on the wall. Further debasement of money will cause further debasement of society. I fear a *Great Disorder*.

I am more worried than I have ever been about the clouds gathering today. I hope they pass without breaking, but I fear the defining feature of coming decades will be a Great Disorder of the sort which has defined past epochs and scarred whole generations.

"Next to language, money is the most important medium through which modern societies communicate," writes Bernd Widdig in his masterful analysis of Germany's inflation crisis, *Culture and Inflation in Weimar Germany* (2001). His may be an abstract observation, but it has the commendable merit of being true... all economic activity requires the cooperation of strangers and therefore, a degree of trust between cooperating strangers. Since money is the agent of such mutual trust, debasing money implies debasing the trust upon which social cohesion rests.

So I keep wondering to myself, do our money-printing central banks and their cheerleaders understand the *full* consequences of the monetary debasement they continue to engineer? Inflation of the CPI might be a consequence both seen and measurable. A broad inflation of asset prices might be a consequence seen, though not measurable. But what about the consequences that are unseen but unmeasurable—and are all the more destructive for it? I feel queasy about the enthusiasm with which our wise economists play games with something about which we have such a poor understanding.

If you take a look around you, any artefact you see will only be there thanks to the cooperative behaviour of lots of people you don't know. You will probably never know them, nor they you. The screen you watch on your terminal, the content you read, the orders which make the prices flicker... the coffee you drink, the cup you hold, the bin you throw it in afterwards... all your clothes, all your accessories, all the buildings you've been in, all the cars... you get the idea. *Without exception* everything you own, everything you want to own, everything you need, and everything you think you need embodies the different skills and talents of a mind-boggling number of complete strangers. In a very real sense we constantly trust in strangers to a degree, as strangers trust us. Such cooperative activity is to everyone's great benefit and I find it is a marvellous thing to behold.

The value strangers put on each other's contributions manifests itself in prices, and prices require money. So it is through money that we express the extent of our appreciation for the many different talents embedded in each thing we consume, and through money that our skills are in turn valued by others. Money, in other words, is the agent of this anonymous exchange, and therefore money is also the agent of the hidden trust on which it depends. Thus, as Bernd Widdig reflects in his book, money "is more than simply a tool for economic exchange; its different qualities shape the way modern people think, how they make sense of their reality, how they communicate, and ultimately how they find their place and identity in a modern environment."

Debasing money might be expected to have effects beyond the merely financial domain. Of course, there are many ways to debase money. Coin can be

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clipped, paper money can be printed, credit can be created on the basis of demand deposits which aren't there... The effects are ultimately the same, though: the implied trust that money communicates through society is eroded.

To see how, consider the example of money printing by authorities. We know that such an exercise raises revenues since the authorities now have a very real increase in purchasing power. But we also know that revenue cannot be raised by one party without another party paying. So who pays?

If the authorities raise taxes explicitly and openly, voters know exactly why they have less spending power. They also know how much less spending power they have. But if the authorities instead raise money by simply printing it, they raise the revenue by stealth. No one knows upon whom the burden falls. People notice only that they can't afford the things they used to be able to afford, or they can't afford the things which everyone else can afford. They know that something is wrong, but they just don't know what, why, or who is to blame. So inevitably they look for someone to blame.

The effects are ultimately the same, though: the implied trust that money communicates through society is eroded.

The dynamic is similar to that found in the well-worn plot line in which a group of strangers are initially brought together in happier circumstances, such as a cruise, a long train journey or a weekend away. In the beginning, spirits are high. The strangers exchange jokes and get to know one another as the journey begins. Then some crime is committed. They know it must be one of them, but they don't know who. A great suspicion ensues. All trust between them is broken down and the infighting begins...

So it is with monetary debasement, as Keynes understood deeply (so deeply, in fact, that it's ironic so many of today's crude Keynesians support QE so enthusiastically). In his 1919 book *The Economic Consequences of the Peace*, he wrote:

"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," who are the object of the hatred.... the process of wealth-getting degenerates into a gamble and a lottery. ... Lenin was certainly right. There is no subtler, no surer means of overturning 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."

Lessons from history

History is replete with Great Disorders in which currency debasement has coincided with social infighting and scapegoating. I have written in the past about the Roman inflation of the Third Century AD. During what is known as the Third Century Crisis, turnover of emperors reached an alarming rate: The second half of the century witnessed the succession of 31 emperors, more than twice that of the previous 50 years. As trade declined, crops failed and the military suffered what must have seemed like constant defeat, it wasn't difficult for a successful or even popular general to convince the rest of the empire that he'd make a better fist of governing.

But this political turnover was accompanied by what may be history's first recorded instance of systematic currency debasement. With the empire no longer expanding and barbarians being forced westwards by the migrations of the Steppe peoples, Rome's borders were under threat. But the money required to fund defense wasn't there. Successive emperors therefore reached the same conclusions that kings, princes, tyrants and democratically elected governments would later reach down the ages when faced with a perceived "shortage of money": they created more by debasing the existing stock. In the second half of the third century, the silver content of a denarius shrunk from over 40% to zero. Copper coins disappeared altogether.

So the Romans turned on their Christians with a great violence which lasted throughout the period of the currency debasement but peaked with Diocletian's edict of 303 AD. The edict decreed, among other things, that Christian meeting places be destroyed, Christians holding office be stripped of that office, Christian freedmen be made slaves once more and all scriptures be destroyed. Diocletian's earlier edict, of 301 AD, sought to regulate prices and set out punishments for "profiteers" whose prices deviated from those set out in the edict.

A similar dynamic seems evident during Europe's medieval inflations, only now, the confused and vain effort to make sense of the enveloping turmoil saw the blame focus on suspected witches. Charting the UK price index over the period with the incidence of witchcraft trials reveals that the peak of trials coincided with the peak of the price revolution.

Were the same dynamics at work during the French Revolution of 1789? The narrative of Madame Guillotine and her bloody role is well known. However, the execution of royalty by the Paris Commune didn't begin until 1792, and the Reign of Terror in which Robespierre's Orwellian-sounding "Committee of Public Safety" slaughtered 17,000 nobles and counter–revolutionaries didn't start until well into 1793. In the words of guillotined revolutionary Georges Danton, this is when the French revolution "ate itself." But the coincidence of these events to the monetary debasement is striking.

The political violence was justified in part by blaming nobles and counter-revolutionaries for galloping inflation in food prices. It saw "speculators" banned from trading gold, and prices for firewood, coal and grain became subject to strict controls. According to Andrew Dickson White, author of *Fiat Money Inflation in France* (1896), "economic calculation gave way to feverish speculation across the country."

However, the most tragic of all the inflations in my opinion, and certainly the starkest example of a society turning on itself was the German hyperinflation. Its causes are well known. Morally and financially bankrupt by the First World War, the reparation demands of the Allies (which Keynes argued vociferously against) followed by the French occupation of the Ruhr served to humiliate a once-mighty nation, already on its knees.

And it really was on its knees. Germany simply had no way to pay. The revolution following the flight of the Kaiser was incomplete. Concern was widespread that Germany would follow the path blazed by Moscow's Bolsheviks only a year earlier. A de facto civil war was being fought on the streets of major cities between extremist mobs of the left and right. Six million veterans newly demobilized, demoralized, dazed and without work were unable to support their families. The great political need was to pay off the "internal debts" of pensions, life insurance and welfare support in any way possible. The risk of printing whatever was required was well understood. Bernhard Dernberg, vice chancellor in 1919, found himself overwhelmed with promises to pay for the war disabled, food subsidies, unemployment insurance, etc., but everyone knew where the money was coming from: "A decision of the National Assembly is made. On its basis, Reich Treasury bills are printed and on the basis of the Reich Treasury bills, notes are printed. That is our money. The result is that we have a pure assignat economy."

But print they did. Prices would rise by a factor of one trillion. At the end of the war, Germany owed 154 billion Reichmarks to its creditors. By November 1923, that sum measured in 1914 purchasing power was worth only 15 pfennigs.

It is difficult to comprehend the psychological trauma inflicted by this episode. Inflation inverted the efficacy of correct behaviour. It turned the ethics of thrift, frugality and notions such as working hard today to bring benefit tomorrow completely on their heads. Why work today when your rewards would mean nothing tomorrow? What use thrift and saving? Why not just borrow in depreciating currency? Those who had worked and saved all their lives, done everything correctly and invested what they had been told was safe, were mercilessly punished for their trust in established principles and their inability to see the danger coming. Those with no such faith who had seen the danger coming had benefited handsomely.

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Everything, in other words, was dependent on one's ability to speculate, recalling what Dickson White observed of the French Revolution and Keynes's reflections more generally. Erich Remarque is best known for his anti-war novel *All Quiet on the Western Front* (1929) but perhaps his best work was the *The Black Obelisk* (1956) set in the early Weimar period, a penetrating meditation on the upside-down world of inflation. The protagonist Georg poignantly captures this speculative imperative when he sits down and lets out a long sigh: "Thank God that it's Sunday tomorrow… there are no rates of exchange for the dollar. Inflation stops for one day of the week. That was surely not God's intention when he created Sunday."

Perhaps the most eloquent chronicler of the Weimar hyperinflation was Elias Canetti, whose mother moved him from the security of Zurich to Frankfurt in 1921 to take advantage of cheaper living. Canetti never forgave her, and his life's work shows what a lasting impression the move from heaven to hell made: "A man who has been accustomed to rely on [the monetary value of the mark] cannot help feeling its degradation as his own. He has identified himself with it for too long, and his confidence in it has been like his confidence in himself... Whatever he is or was, like the million he always wanted, he becomes nothing."

More tragic still was what German society became during the inflation. Like other Axis countries on the wrong side of the War and now in the grip of hyperinflation, Germany turned viciously on its Jews. It blamed them for the surrounding evil as Romans had blamed Christians, medieval Europeans had suspected witches, and French revolutionaries had blamed the nobility during previous inflations. In his classic *Crowds and Power* (1960), Canetti attributed the horror of National Socialism directly to a "morbid re-enaction impulse":

"No one ever forgets a sudden depreciation of himself, for it is too painful. ... The natural tendency afterwards is to find something which is worth even less than oneself, which one can despise as one was despised oneself. It is not enough to take over an old contempt and to maintain it at the same level. What is wanted is a dynamic process of humiliation. Something must be treated in such a way that it becomes worth less and less, as the unit of money did during the inflation. And this process must be continued until its object is reduced to a state of utter worthlessness. ... In its treatment of the Jews National Socialism repeated the process of inflation with great precision. First they were attacked as wicked and dangerous, as enemies; then, there not being enough in Germany itself, those in the conquered territories were gathered in; and finally they were treated literally as vermin, to be destroyed with impunity by the million."

All this is very disturbing stuff, but testament to a relationship between currency devaluation and social devaluation. Mine is not a complete or in any way rigorous analysis, I know. I emphasize that it's not in any way meant as some sort of crude mapping on to today's environment. My point is to show that money operates in many social domains beyond the financial, and that tying currency devaluation to social devaluation might have some merit.

Consider some recent and less extreme currency inflations. The 1970s bear market in equities saw relatively mild inflation which was also characterized by relatively mild but nevertheless real fractionalization of society. An ideological left-vs-right battle played out between labour and capital, unions and non-unions and perhaps most bizarrely, between rock and disco. As already stated, money implies a trust in the future. It implies that today's money can be used in the future. So in the era of punk, did the Sex Pistols' cry of "No future" provide the most concise commentary of the malaise?

Credit inflation in recent decades

Despite the CPI inflation of the 1970s receding, our central banks have continued to play games with money. We've since lived through what might be the largest credit inflation in financial history, a credit hyperinflation. Where has it left us? Median US household incomes have been stagnant for the best part of twenty years.

Yet inequality has surged. While a record number of Americans are on food stamps, the top 1% of income earners are taking a larger share of total income than since the peak of the 1920s credit inflation. Moreover, the growth in that share has coincided almost exactly with the more recent credit inflation.

These phenomena are inflation's hallmarks. In the Keynes quote above, he alludes to the "artificial and iniquitous redistribution of wealth" inflation imposes on society without being specific. What actually happens is that artificially created money redistributes wealth towards those closest to it, to the detriment of those furthest away.

Richard Cantillon, writing decades before Adam Smith, was the first to observe this effect (hence the "Cantillon effect"). By thinking through the effects in Spain and Portugal of the influx of gold from the new world, he showed how those closest to the money source benefited unfairly at the expense of others:

"If the increase of actual money comes from mines of gold or silver... the owner of these mines, the adventurers, the smelters, refiners, and all the other workers will increase their expenditures in proportion to their gains. ... All this increase of expense in meat, wine, wool, etc. diminishes of necessity the share of the other inhabitants of the state who do not participate at first in the wealth of the mines in question. The altercations of the market, or the demand for meat, wine, wool, etc. being more intense than usual, will not fail to raise their prices. ... Those then who will suffer from this dearness... will be first of all the landowners, during the term of their leases, then their domestic servants and all the workmen or fixed wage-earners … All these must diminish their expenditure in proportion to the new consumption."

In other words, the beneficiaries of newly created money spend that money and bid up the price of goods with their higher demand. Those who suffer are those who have to pay newly higher prices but did not benefit from the newly created money.

> The 99% blame the 1%, the 1% blame the 47%, the private sector blames the public sector, the public sector returns the sentiment… the young blame the old, everyone blames the rich… yet few question the ideas behind government or central banks.

The credit inflation analog to the Cantillon effect has played out perfectly in recent decades. Central banks provided cheap money to banks, the cheap money artificially inflated asset prices, artificially inflated asset prices made anyone connected to those assets rich as we became a nation of speculators, those riches were achieved at everyone else's expense, and "everyone else" has now realized what has happened and is understandable enraged. As Keynes explained, "Those to whom the system brings windfalls… are the object of the hatred."

And now the social debasement is clear for all to see. The 99% blame the 1%, the 1% blame the 47%, the private sector blames the public sector, the public sector returns the sentiment… the young blame the old, everyone blames the rich… yet few question the ideas behind government or central banks.

I'd feel a whole lot better if central banks stopped playing games with money. But I can't see that happening anytime soon. The ECB has thrown the towel in, following the Swiss National Bank last year in committing effectively to print unlimited amounts of money for the greater good. The Bank of England and the Fed have long since made a virtue of what was once considered a necessity, with what was once the unconventional conventional. As James Bullard told everyone a few weeks before the last Fed meeting, lest there be any doubt: "Markets have this idea that, there's QE1 and QE2, so QE3 must be the same as those previous ones. It's not that clear to me that this is the way this is going … it would just be to do balance sheet policy as the exact analogue of interest rate policy." In other words, the central banks' balance sheets are the new policy tool. As interest rates embarked on a multi-year decline from the 1980s on, central bank balance sheets are set to embark on a multi-year climb.

So as Nobel Prize winning experts in economics punch the air because inflation expectations have been rising since the policy was announced, "It's the whole point of the exercise" (Duh!), the Bank of England admits that QE has mainly benefited the rich, but vows to continue anyway.

All I see is more of the same—more money debasement, more unintended consequences and more social disorder. Since I worry that it will be a Great Disorder, I remain very bullish on safe havens.

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From causes to consequences

By Tony Deden

Our past investment record is merely the result of many small and big decisions over the years. Fundamentally, it is the result of taking present events and trends to their logical conclusion and that of striving to reason from causes to consequences.

The late Leonard Read once wrote, "Neither the striving for truth nor the resistance against nonsense are natural traits of man. They do not exist as human qualities. They must be rationally willed." Such is the necessity of purposeful action that is rooted in reasoning and correct theory.

The editor of *Grant's* agrees: "The aging Ben Bernanke has been saying one thing, your aging editor another for a decade. We persist because he persists, and because ideas have consequences." We would all do well to heed Richard Feynman's maxim: "The first principle is that you must not fool yourself—and you are the easiest person to fool." As for Mr. Bernanke, James Grant counts him a fool for disregarding the wisdom of the ages. In the same 7 September

2012 issue, he writes: “All of us learn by doing. To learn how to ride a bicycle, we pedal. But money has been circulating for millennia, and there is a voluminous monetary record. It is there to be read. Did the chairman or his staff consult the wisdom of the ages before deciding to muscle around the yield curve, manipulate asset values, materialize dollars by the hundreds of billions and, in general, to short-circuit the price mechanism? Not on the evidence of the four-and-a-half-page bibliography appended to the Bernanke text. To judge by his reading list, the chairman consulted no authority published before 1965. He cites relatively few sources published before the onset of the 2007 financial cave-in. His favorite authors are his employees at the Federal Reserve Board.”

It is not so with us. As you know, we have long anticipated both the arrival and the futility of the resort to inflationism (they call it “reflation” and “Quantitative Easing” and other clever names). And now, we are here. It is official: “QE to infinity.” This email from a wise colleague sums up the frustration of any honest man: “I continue to find myself utterly astonished at what the Fed is doing. It’s a level of craziness I don’t think I have the words for. The dismay is endlessly bewildering to me and I can’t quite put my finger on why some things have a unique ability to move—like the clouds turning pink as the sun sets over the Mediterranean. You never tire of seeing it, and each time you do something stirs as though it’s the first time. In fact, even just recalling the experience can be distracting, but in an odd way, I feel something similarly moving when I see some of the stuff these economists believe. It’s so utterly baffling and beyond my own comprehension that it almost takes on a bizarre beauty of its own, like the world’s other natural wonders. I alternate between marveling at it, and wondering if I’m sane.”

Sometimes we want to believe that complete lunacy has been permanently eradicated, like the bubonic plague. Sadly, if the Nobel Prize in Economics is any indicator, bad ideas rule our world. Thomas Sowell described it eloquently: “Some of the biggest cases of mistaken identity are among intellectuals who have trouble remembering that they are not God.”

The official government language that has recently accompanied the promises of QE-to-infinity (whether from the Fed, the ECB or the BOJ) is rooted, we sense, in nothing more than their terrifying observation that the magnitude of the problem is far larger than they ever understood or ever anticipated. It’s either that or just plain foolishness. And yet, they are seen as heroes. The irony is not lost on Vincent Reinhart of Morgan Stanley, who writes, “The longstanding problem at the Fed has been that while each policymaker more or less agreed that guiding policy by a rule made sense, they could not collectively agree on the rule. At its September meeting, the Fed effectively evaded the issue by setting QE off in a general direction, much in the same way Columbus pointed his three ships West and expected eventually to land in India… The history books admire the audacity of a man with a vision. Columbus sailed in the direction toward the known world’s end. Of course, he also sailed further than expected and landed on a completely different continent than planned.”

> When the owner of savings does not learn to understand the importance of ideas, eventually he will find himself a slave of the ideas of those intent to embezzle his savings.

Even the *Financial Times* acknowledges that perhaps gold bugs were right all along. At least for now. But the apparent absence of price inflation in consumer goods confuses many into thinking that these clowns are up to something unique in the annals of economic history. They surmise, we guess, that central planners have managed to abolish this loathsome notion of scarcity. The truth is that this road to ruin has no exits. As to why so many prominent folks can be so wrong and so dangerous? Arrogance and nonsense. In his 1959 book *The House of Intellect*, historian and philosopher Jacques Barzun has this to say: “Intellect deteriorates after every surrender to folly: unless we consciously resist, the nonsense does not pass by us but into us.”

And this is exactly why, as owners of savings, our thoughts and actions ought not be directed toward what others do or what others think. Rather, we ought to strive to reason from causes to consequences while resisting the dreaded nonsense that envelops our world.

The starting point of a doctor’s skill is correct diagnosis. A faulty one gives rise to an inappropriate and unsuitable treatment no matter how sound and exact such treatment may be. Physicians will agree that diagnosis is, in fact, not as simple as it sounds because it demands not only knowledge but judgment—an understanding of sorts that is as personal as it is scientific.

By inference therefore, if judgment is such a profound quality within the well-ordered setting of a scientific endeavor, its importance with respect to savings is considerably more crucial since matters of money are ultimately complicated by our own wishful thinking, our infinite ability to fool ourselves, our emotions, our incomplete knowledge, the absurdities of modern life, and the not-so-subtle conflicts of interest at the root of the commercialism that permeates our world.

Let us not forget that when the owner of savings does not learn to understand the importance of ideas, eventually he will find himself a slave of the ideas of those intent to embezzle his savings.

This essay is comprised of edited excerpts from the Edelweiss Holdings Third Quarter report to shareholders.

Outsmarting Goethe's Devil

By Michael Weeks

"Beware the Faustian bargains of central banks," reads the title of a *Financial Times* article from earlier this year (21 August), alluding to the relevance of Goethe's two-hundred-year-old classic in today's world. Part II of *Faust* tells the all too familiar story of a failing, indebted empire: poverty resulting from a "lack of money" and a magician's solution to these woes through paper notes. It also tells of the public elation and ultimately of their subsequent ruin. In a world of perpetual credit creation intended to stimulate consumer spending, we think the comparison is apt.

The central planner and chief counterfeiter in Goethe's story is Mephistopheles, an agent of the Devil, who first suggests that the empire's troubles originate from a lack of money. He claims that the empire is credit-worthy on account of the vast treasures buried deep in the mountains of the realm: *In veins of mountains, walls far underground, Gold coined and uncoined can be found*.

The clever Mephistopheles is not planning a mining expedition. Instead, he dons the magician's cloak and invents paper claims against the unmined gold, conjuring the money out of thin air. And so he makes good on the emperor's debts and pays off the army. The citizenry, now free from their terrible want of money, can buy and sell once again.

The old emperor, even bewildered that these notes are accepted simply on faith, ultimately embraces the magic money:

My people take it for good gold, you say?
In camp, in court, sufficient as full pay?
Although amazed, still I must give assent.

He is not alone in his assent. The emperor's steward observes:

The flight of notes we could nowise prevent;
Like lightning notes were scattered on the run.
The changers' shops open wide to everyone;
And there all notes are honoured, high and low,
With gold and silver—at a discount, though.
From there to butcher, baker, tavern hasting,
One-half the world seems thinking but of feasting,
The other in new raiment struts and crows;
The draper cuts the cloth, the tailor sews.

What do we make of this today? Some think themselves wealthy because the money is flowing and asset prices rising. *A notelet in one's breast is lightly carried*, Mephistopheles says, and our central planner's liquidity-driven recovery depends on it. But is this really wealth? Most others believe the devil's lie: *nor gold nor pearls are half as handy as such paper. Then a man knows what he what he has*. They feel secure in their wealth because it can be neatly tallied in dollars, euros or pounds, without considering whether their savings command anything of substance—or even any assets at all. Woe to them both should this confidence erode! The rest of us can only share in Faust's amazement:

Imagination in its highest flight,
Strain as it may, can't soar to such a height.
Yet spirits, fit to fathom the unsounded,
Have boundless confidence in the unbounded.

More amazing than the devil's deceptions, however, is how we've improved upon his work. Our modern monetary policy also consists of conjuring up money out of thin air, but without even the pretense of being a claim on anything remotely real. That's progress that outsmarts the Devil himself.

Excerpts from Goethe's Faust *are translated into English verse by George Priest.*

We read

The end result of all experiments in wealth redistribution, whether by the acolytes of Carl Marx or the many others that have littered the pages of history, has been utter failure. But not only that. They have rained misery, ruin and destruction in whole societies. One can't help but think of the sheer illusion rooted in the policies of the more modern, ostensibly different, but essentially similar policies of contemporaries such as Kim Jong-un, Obama, Chavez, Hollande, and many others. We read this appropriate summary by Anthony de Jasay:

"Any government that would falter in the progress toward complete equality should be voted out and replaced by its rival that promised to go further. How come, then, that there is no trace of any strong trend toward income equality? To all appearances, governments and their oppositions fight their main battles over redistributive measures, vast programmes to that effect are constantly born or reshaped, yet the statistics do not show that inequality is being ironed out."

—Anthony de Jasay, "Incomes: Equilizing or Churning?" Read the whole article here: http://tinyurl.com/ej-jasay.

Reuters reports that during a 2009 keynote address at the Edinburgh Television Festival, James Murdoch called the profit motive fundamental to the "quality, plurality and independence" of the media. However, more recently, Elizabeth Murdoch (his sister) said that profit with no purpose is a "recipe for disaster." Indeed.

We have forever avoided investments in companies whose only seeming purpose is to engage in acquisitions and reorganizations simply in the pursuit of growth. The vast bulk of most acquisitions end up enriching the advisers and bankers while never quite offering any permanent rewards from the elusive synergies and other nonsense that were promised or expected. Many examples come to mind. Frankly, it is extremely rare to find an outstanding company built by acquisitions. Extraordinariness is a culture (a way of thinking) that can't be acquired or made up by executive fiat. Happily, we now read that the "hot new growth strategy" is, well, corporate breakups. And so it is that another cycle of capital destruction comes to an end. Bullish news indeed for stock market junkies.

Read the article here: http://tinyurl.com/ej-breakups.

We love the story of Hamdi Ulukaya, a Turkish immigrant to America who has quietly unsettled a whole industry and made a fortune for himself in making yogurt. That is, Greek-style yogurt. The irony is delicious and the entrepreneurship marvelous.

Read the story here: http://tinyurl.com/ej-yogurt.

"I meet good people every day—genuinely good people. They know something is wrong, that they didn't sign up for this, but they can't put their finger on it. When I explain what I think is wrong, and what we should be doing as an industry, I can see a light go on in their heads. There are many people who want to do good and genuinely want to do the right thing by savers but haven't had the occasion or perhaps even the inclination to sit down and think it through. They haven't been able to articulate exactly what is wrong, or what they can do about it. I sense the winds of change."

—Correspondence with a friend in the money business.

"The environment is a good one. High prices, lots of volatility, a lot of dislocation, tightness, a lot of arbitrage opportunities." So said Chris Mahoney, Glencore's director of agriculture trading. The statement sparked the ire of socialists everywhere who urged action against large agricultural firms and their profiteering. UK's *The Independent* quoted an Oxfam spokesperson's response: Companies like Glencore are "profiting from the misery and suffering of poor people who are worst hit by high and volatile food prices," and "If we are going to fix the ailing food system then traders must be part of the cure." As to feeding the masses with good intentions, where has Africa or North Korea gone wrong?

If your son or daughter is contemplating a career in the investment industry, you may insist that they reconsider. It may in fact be a very bad option for the future. This is the reason:

$$P_{>K} = \frac{\alpha + (K - \alpha K)\, {}_2F_1\left(\frac{1}{2}, \frac{\alpha+1}{2}; \frac{3}{2}; -\frac{K^2(\alpha-1)^2 B\left(\frac{\alpha}{2}, \frac{1}{2}\right)^2}{4\alpha^2}\right)}{2\alpha}$$

So calculates Nassim Taleb, author of *The Black Swan*, in his scholarly-minded "Why It is No Longer a Good Idea to Be in The Investment Industry."

Download the article here: http://tinyurl.com/ej-taleb.

Many years ago we met the CEO of a successful and very conservatively operated company who, in a brief moment of personal candor, admitted that he was under enormous pressure from his wife to imitate the financial engineering of a certain other highly leveraged competitor. It turned out that his wife was friendly with the wife of his competitor and quite jealous of her seemingly higher income, nicer dresses, automobiles, airplanes and holiday destinations. Despite the compelling pillow talk, our man didn't budge. Perhaps he would be pleased to read that academics now discover that companies with no financial leverage ultimately win. From the summary of this academic paper we read:

"This paper documents the puzzling evidence that a substantial number of large public non-financial US firms follow a zero-debt policy. Over the 1962–2009 period, on average 10.2% of such firms have zero debt and almost 22% have less than 5% book leverage ratio. Neither industry nor size can account for such puzzling behavior. Zero-leverage behavior is a persistent phenomenon, with 30% of zero-debt firms refraining from debt for at least five consecutive years. Particularly surprising is the presence of a large number of zero-leverage firms that pay dividends. They are more profitable, pay higher taxes, issue less equity, and have higher cash balances than their proxies chosen by industry and size. These firms also pay substantially higher dividends than their proxies and thus their total payout ratio is virtually independent of leverage. Firms with higher CEO ownership and longer CEO tenure are more likely to follow a zero-leverage policy, especially if boards are smaller and less independent. Family firms are also more likely to be zero-levered. Our results suggest that managerial and governance characteristics are related to the zero-leverage phenomena in an important way."

—Ilya A. Strebulaev and Baozhong Yang, "The Mystery of Zero-Leverage Firms" (2012). Read it here: http://tinyurl.com/ej-leverage. Thanks to Sean Corrigan for the link.

"What I worry about is that when problems are not addressed, people will not know who is responsible. And when the problems get bad enough... some one person will come forward and say 'Give me total power and I will solve this problem.' That is how the Roman Republic fell. Augustus became emperor... because he promised that he would solve problems that were not being solved. ... If we don't know [who is responsible for poor government performance]... the day will come when somebody will come forward and we and the government will in effect say, 'Take the ball and run with it. Do what you have to do.' That is the way democracy dies, and if something is not done to improve the level of civic knowledge, that is what you should worry about at night."

—Former U.S. Supreme Court Justice David Souter. Watch the video here: http://tinyurl.com/ej-souter.

The Economist spoke with Alan Newman, the design chief for the giant currency printer De La Rue, on the nature of money printing: "Their challenge is to provide hundreds of millions of perfect copies of a product that is cheap to make but impossible to fake. Designs need to blend aesthetics with durability and security. There is no strict formula but some broad rules apply... Notes are often folded in half, so the security strip should never be in the middle. Paper currencies have no intrinsic value and need the appearance of worth to inspire public confidence. 'It can't look like a theatre ticket.'"

Read the whole article here: http://tinyurl.com/ej-delarue.

"In the case of Kodak, they took some of their patent proceeds and cash flow and invested in a printer business, which is another declining business model. They ended up being decimated by their own invention of digital photography. When analyzing Kodak as a short candidate, valuation was almost the last aspect that we considered because, as I said, some of the best short ideas can look cheap from a valuation standpoint."

—Jim Chanos, from an interview in Graham & Doddsville*, a Columbia Business School investment newsletter, Issue XV.*

Alistair Darling, Member of Parliament, a certifiably ignorant but well-meaning British busybody, suggested that one of the solutions to the problem of lack of growth would be to do some more house-building. Idiotic as it sounds, it is no different from the policies pursued on the other side of the Atlantic by ol'Ben and his friends on the Hill. Our friend Tim Price, writing in his weekly commentary, takes them all to task. He suggests that they should consider the following factors: "(1) An obsession with home 'ownership' (with a 100%+ interest only mortgage—hence the inverted commas) was part of the cause of the financial crisis; (2) In the most successful economy in Europe—Germany—less than half the population own their home; and (3) No one has ever managed to export a house."

Sense and nonsense

- "I kind of view my job as making a pizza, and I want the pizza to be the same every time: good sauce, good dough and good cheese. And then depending on what part of the world they live in, if you want spicy stuff, we'll put spicy sausage on there and we'll get the best sausage. If you want vegetables, we'll get the best vegetables."
  —*UBS CIO Alexander Friedman*

- "All men's miseries derive from not being able to sit in a quiet room alone."
  —*Blaise Pascal (1623-1662)*

- "Can an economy that has become dependent on lies, misrepresentation, 'fudging' of numbers, fraud, embezzlement and a multitude of skimming and scamming operations escape the moral and financial black hole it has created? The self-evident answer is 'no.'"
  —*Charles Hugh Smith, 28 August 2012*

- "The world may one day look back and conclude the first half of September was either a turning point for the global economy, or the final nail in the coffin of the doctrine of central bank omnipotence."
  —*Greg Ip, writing for* The Economist

- "Because interest rates are very low, people are investing in gold. But the poor should never invest in gold for whenever they have purchased gold, it either lands up in the temple or in the hands of the moneylender or, at the most, it may be given away during a daughter's marriage."
  —*K.C. Chakrabarty, Reserve Bank of India Deputy Governor, as quoted in* The Times of India

- "Tyranny is always better organized than freedom."
  —*Charles Péguy (1873-1914)*

- "This election is kind of funny. It seems like we can either choose between going downhill gradually, or going downhill fast."
  —*a 17-year-old protester on the U.S. election, as reported by* The Independent

- "Insanity in individuals is something rare—but in groups, parties, nations and epochs, it is the rule."
  —*Friedrich Nietzsche (1844-1900)*

- "You have a company [Vestas] with little cost control, inadequate capital control and in some of their factories no operational control. It is business school 101 on how not to run a company."
  —*Martin Prozesky, Bernstein Research analyst quoted in the* FT *(3 September 2012) about Vestas, the celebrated Danish wind turbine maker that would never have even existed apart from the false economics of subsidies. As a consequence, it never developed a culture of responsibility or accountability.*

- "People are beginning to realize that the apparatus of government is costly. But what they don't know is that the burden falls inevitably on them."
  —*Frédéric Bastiat (1801-1850)*

- "The expected value from any activity is the product of the gains available from doing it right multiplied by the probability of doing it right, minus the potential cost of failing in the attempt multiplied by the probability of failing."
  —*Howard Marks, Memo to Oaktree clients, 11 September 2012*

- "There is all the difference in the world between treating people equally and attempting to make them equal."
  —*F.A. Hayek (1899-1992)*

- "If you need 8% growth to keep the society stable, there's something wrong with the society."
  —*Professor Yasheng Huang*

EDELWEISSJOURNAL

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Publisher: Edelweiss Holdings Ltd., 31 Victoria St., Hamilton HM 10, Bermuda