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Investment value in an age of booms and busts: A reassessment

Remarks by Tony Deden at the Grant's Fall Conference in New York on 9 October 2018 on the occasion of the 35th anniversary of Grant's Interest Rate Observer

Ladies and Gentlemen,

It is delightful to be among you in this inaugural conference of the next 35 years and I am grateful to the editor of *Grant's* for the honor of inviting me to address you today.

It is remarkable that years into a financial world that has abolished the notion of failure, ushered a seemingly everlasting prosperity, and has brought monetary meddling to a level unimaginable by our ancestors, a publication named *Interest Rate Observer* can remain relevant and vibrant. Our world may indeed be unrecognizable to anyone over 60 or so, but *Grant's* remains, always, passionate, principled, erudite, intellectually honest and a genuine inquirer as to the causes rather than symptoms that ail our world.

Reading *Grant's* is like listening to Beethoven. He demands your undivided attention; he grabs you and envelops you. Eventually, you get used to discovering the nuances between the lines—the foresight, the perspective, the relevance, the subtle irony and the underlying principle. It is not hyperbole to suggest that *Grant's* is that rare antidote against the intellectual and moral fatuousness of our times.

So, Jim, after so many years and also on behalf of so many to whom you have given so much, I thank you and look forward to the next 35 years.

Before delving into my topic, I want to give you my perspective. I spent the first half of my professional life as an investment counselor. Long ago, the practice became a very private investment fund and, more recently, an investment holding company. I've come to understand that savings accumulated over a lifetime is something precious and irreplaceable and that in order to protect it one must first respect it. And in seeking to deploy it one must acquire a sense of detachment from the noise of the dance hall and find what is valuable in the context of such irreplaceability. As a fiduciary, the task is very difficult. The idea of a prudent man has been replaced with Microsoft Excel, financial calculus, risk officers and the compliance industry. And the idea of investment value became very fuzzy.

Throughout modern history, savings in the form of money has never ceased to bedevil its owner. In the end, the preservation of its purchasing power has always been extremely difficult. Perhaps some of you will agree with me that in our so-advanced society, such an endeavor borders on the impossible.

A prudent man must seek to satisfy himself about the means to an end. This demands that he must revisit, again and again, the very elemental principles of his craft independent of how others think and act. What is money? What is wealth? What is savings? What is time? What is scarcity? What is value? What is risk? What can we learn from failure? Or from history?

To make the most of my few minutes among you, I will limit my remarks to a summary of summaries. And even though these remarks may be both imperfect and incomplete, I hope they serve as a source of inspiration that leads you to your own reflections.

At a young age, the idea of “value investing” became a fascination for me. I devoured every book and every scholarly paper I could find on the subject. It was rational, neat, purposeful and sensible to a young man who aspired to become a prudent man. But around 1997, after a dozen years in practice, the world seemed so different from the days of Benjamin Graham. Annual accounts suffered with a peculiar sort of innovation that required faith and hope, promises now had their own CUSIP numbers, and finance had supplanted industry as the means to prosperity. The more I reflected on the practice, the more I became convinced that, at the root, value investing, as was practiced, was nothing more than a musical rondo to the idea that Will Rogers first proposed:

“Invest in things that go up. If they don’t go up, don’t invest in them.”

I became convinced that the basic framework of all these mechanistic value-finding ideas in practice, simply led to anticipating the anticipations of others. For me, the means mattered more than the outcome and I became unhappy with the general vacuum in which I acted. I was seeking to define the right thing at a time when central bankers proclaimed a ‘new era’, untethered from the constraints of yesteryear and dismissive of the errors of the past. I became convinced that as a steward of other people’s savings, I had to determine the idea of value in connection with the suitability of the means employed. The giant of the field, Benjamin Graham, seemed to be of little help.

I devoured the monetary writings of the late Murray Rothbard and Wilhelm Röpke to whom I owe much. But I also have a debt of gratitude to James Grant for his brilliant book *The Trouble with Prosperity*. It forced me to re-examine all the bits and pieces of the investment process in light of history, theory and principles. It was the start of an ongoing and ceaseless inquiry as to how I should act and why.

H.L. Mencken once wrote that “the chief value of money lies in the fact that one lives in a world in which it is overestimated.” The point of Grant’s book is that by adding distortions to such ‘overestimation’, falsity, error and risk become impossible to recognize.

The Trouble with Prosperity inspired me to seek an escape from the irrelevant noise of most things financial.

“The future is always unlit...” I quote from the *Grant’s* editor, “but with a body of theory, you can anticipate where the structures might lie. It allows you to step out of the way every once in a while.”

Some of us have stepped out of the way some time ago. And some of us have even left the dance hall altogether.

The subject of value has continued to overwhelm my reflections all the years since. At the root, we all inevitably measure value in terms of money—overlooking the fact that money in itself can never be a measure of value. It made no sense. It seemed to me that there must exist an understanding of value independent of the money in which it is expressed.

One would naturally ask, why?

First, we all talk about financial markets, but we don't have genuine markets in the sense that they are free from coercion or intervention. *Grant's* readers should know. Extensive interventions, directly and indirectly, financialization, regulation, legal uncertainty, the banishment of failure as a natural means to corrections and massive interference in voluntary cooperation and exchange, make the modern notion of markets a mockery.

If we don't have real markets, we have no price discovery.

Our forefathers understood that without a free market in the price of money, all calculation becomes false. Money is the defining element in any economic calculation and once it is destroyed via inflationary policies, the distortions create an unreal framework characterized by the booms that cause the ensuing busts. *Grant's* has been shouting for years: artificial money prices incite investment error. Uncorrected, the errors compound. Yet, why do we insist on using error-induced prices to calculate investment value?

An intelligent man I recently met advises wealthy families and pension funds in the field of private equity. A booming business. He genuinely solicited my views. I simply told him that such asset class didn't exist when I was his age even though people invested in privately-held firms for generations. But I also told him that private equity would not have been possible were it not for another word that also didn't exist back then: EBITDA—a word that owes its very existence and relevance to dishonest money. I suggested that he contemplate the outcome of that certain compound error that undoubtedly undergirds this entire new asset class.

"Well, this is all philosophical," he said at the end.

Indeed, we look to prices on an exchange to reckon value, having failed to see that wealth creation via the stock market does not create resources in the economy. We don't see that booming markets without savings is not an accumulation of resources but an accumulation of claims on existing resources.

We hail growth by looking at a meaningless aggregate such as GDP and we hope for higher prices, dismissing the fact that such aggregate growth in money terms more often than not comes from debt creation and the consumption of our capital. Yet we reckon all this as a modern financial miracle.

We have abolished the idea of failure—nature's cleansing mechanism. As a consequence, we've lost real economic vitality. We've substituted finance for industry as the locomotive of economic growth. In GDP terms, it looks terrific. But it is neither enduring nor real.

A promise to pay is not money. How many really understand this? We dress it up as a bank deposit, a treasury bill or some variation thereto and insist on calling it an asset. But we also laugh at the man who chooses to keep his cash in gold. The price of something becomes our value determinant rather than its characteristics in being real, enduring, or suitable as a means to our objective.

Let's take the notion of 'intrinsic value' as an example. In its essence, it is a sound and necessary idea. Yet, to the extent we wish to quantify it, we end up excluding what is unquantifiable and unseen—the very essence of what concerned the prudent man of old.

We conjure unknown future flows of money, that is, something we guess, from a business whose results are subject to interventions and distortions, or from one that is being hollowed out and sacrificed at the altar of shareholder value, and run by persons who don't quite care if the company is likely to be around in twenty years' time. We then discount it all by a number—a rate of interest that bears no relationship to anything. We get a number and we compare it to the monetary value of an investment instrument. The math can be impressive to the customer, but what does it really mean?

I propose to you that it means absolutely nothing.

Meanwhile, this reckless guessing and mindless number-crunching, prompted by dishonest money, has profound social and cultural ramifications, and not only in business culture.

Paul Cantor in his book *Literature and the Economics of Liberty* writes:

If modernity is characterized by a loss of the sense of the real, this fact is connected to what has happened to money in the twentieth century. Everything threatens to become unreal once money ceases to be real ... inflation is that moment when, as a result of government action the distinction between real money and fake money begins to dissolve ... Money is one of the primary measures of value in any society, perhaps the primary one, the principal repository of value. As such, money is a central source of stability, continuity, and cohesion in any community. Hence to tamper with the basic money supply is to tamper with a community's sense of value.

Once we understand this basic point, it's not difficult to grasp all the other consequences of inflationism. For example, we then see that dishonest money begets dishonest statistics, dishonest accounting, dishonest balance sheets, dishonest means, dishonest objectives, dishonest compensation policies, and dishonest relationships; that it begets ambiguousness and corruption in every aspect of life—from the loftiest of boardrooms down to the lowliest economic agent. We then also come to appreciate the fact that we own claims, promises and debts, which we falsely reckon as wealth. We then see that we trade instruments on financial exchanges that possess no inherent economic value. We trust there will always be a bid.

One of the most nefarious consequences of dishonest money is to destroy our ability and willingness to act responsibly in the light of our own judgments. It has led us to replace common sense by compliance. We have substituted the law for what is moral and what is right. We have substituted audit checklists for an auditor's judgment about what is true and fair. And we have substituted phony mathematics for the judgment we once possessed in understanding the nature of value and that of risk.

Think of your own savings of a lifetime—savings you don't need but can't afford to lose.

I ask you, how shall we deploy them? What measure of judgment can we use that lends itself to answering this question? How do we cope with the unquantifiable and the unseen of our times? Do we seek to find some ingenious formula so as to merely outguess others? Or shall we somehow keep on playing as we always have and hope it all works out?

In the spring of 2010, faced with the momentous change in our monetary landscape, and for all the reasons I outlined earlier, I came to reflect on re-assessing this idea of value.

My subject does not lend itself to summaries. The time I have left this morning is far too brief for even the shortest of them. Yet what I wish to do is share a few of my observations that can perhaps inspire your own reflection in your own practice and your own life.

Firstly, let me start with the notion that there is no such thing as objective value. That is, all value is subjective to the person doing the valuing—and specifically insofar as he acts toward a desired end. What is valuable to me, must be suitable to my ends. Therefore, that something has value, economic or otherwise, to someone, does not necessarily mean that I find it valuable. Conversely, something that I myself find valuable is not necessarily suitable or even interesting to others. And furthermore, what I consider valuable remains so irrespective of what others think about it or how others

price it. Whether we like it or not, all of us, in every aspect of our lives, every single day, weigh different means towards our desired ends. The deployment of our savings, whether in the capital structure of a business, or as minority shareholders in some enterprise, is, by necessity, part and parcel of the same process.

Instead of taking our cues from financial types, let's consider the owner of a long-standing enterprise. He wants to avoid going out of business (and so do I); he is entirely uninterested in what others do (and so am I); he wants to remain competitive, relevant and enduring (so do I). Yes, he aims to be profitable, but he really knows that, in the long run, profit is the result of being successful at what you produce, not the result of chasing higher securities prices. He, too, deploys irreplaceable capital. He, too, considers the scarcity of his resources and the value they reflect in all his actions. He knows the difference between something that has financial value and something that has true economic value (so do I) and he wishes to leave something meaningful to the next generation (so do I and so should all of us).

Modern wealth and investment management, as it is with corporate management, with every bit of its pseudo-scientific razzle-dazzle, can never be a substitute for the very idea that a prudent man's action rests on the principle that his personal and very subjective judgment is responsible to the ends he considers important. In the financial world, there is a bear market in prudent men as there is in real owners. If you look for prudent men, skip the boardrooms of the world of finance.

Secondly, consider the idea of scarcity—something that exists regardless of our material wealth—and the very thing our monetary masters have sought to abolish in money and pretend that we have permanent prosperity. Scarcity is simply the fact that there is never enough of any good to satisfy all human wants that we know depend on it. But something scarce, say, a Stradivarius violin, is not necessarily valuable for everybody. And something valuable for somebody, say, breathing air, is not necessarily scarce. On the other hand, what is valuable to me as an investor, is always scarce.

Scarcity can be seen not only in quantifiable and material considerations but also in a company's culture and ability to endure, survive and adapt. Or it could be its competitive advantage or the aggregate technical skill in some particular field of endeavor that is difficult to duplicate. These are highly subjective but necessary considerations.

Furthermore, value must have a context—a reference, if you may, to a subjective advantage. That is, the goods or securities we consider valuable must be consistent as means to our individual aims.

Lastly, to the extent my savings are deployed in the capital of other companies in which I am a minority owner, I am faced with another issue, and that is the motivation, the character and the objectives of those persons who actually own and run this corporation. Their actions, both seen and unseen, ultimately have an impact on the monetary value of my savings and on their enduring characteristics. Thus, I must come to judge these men as if they were working for me. And it is here, ladies and gentlemen, that scarcity reigns supreme. There are far more original multi-million-dollar Picasso artworks out there than there are company CEOs in whose enterprises I would be willing to deploy the savings of our shareholders.

Today's headlines are full of ominous signs. I need not elaborate. Yet, at the root, we eagerly look to authorities to find solutions to the very problems they created in the first place.

Indeed, many of the problems we face, whether in gigantic financial distortions and imbalances, or in investment practice and in social coordination in general, are intractable. Their ultimate and inescapable resolution is too painful to contemplate. But we do know that the ultimate undoing of massive and compound errors is unavoidable.

How we view investment value must be reassessed in the light of the scarcity of our capital and in the light of what we, individually, consider valuable, as a means to our specific ends.

Two hundred years from now, our descendants will surely laugh at the collective foolishness of our era, just as we laugh at John Law and all the assorted monetary charlatans that have followed in his footsteps.

I believe that in the fog and distorted noise of a world of booms and busts, the sanctity of our savings demands an escape from what is merely financial. The only one I know is that of seeking to find what is scarce and valuable to me. And so it is, subjectively, for each one of us, in his own judgment, and commensurate with his duty to his family and to others—subjective value about what is real and what is enduring.

I thank you for your time.

