Black Swan Plc

New Years Letter 2011

Human beings like certainty, we like structure. Because of this people tend to believe, against the odds, anything, which supplies that certainty and promises a future of a structure in which they want to be. That "structure" is currently being offered in the West at the moment by the politicians suggesting that somehow there will be a return to what there was before: there won't.

"The chess game of the euro: the directors of the ECB are on the sun loungers in the background"

I am afraid therefore, this New Years note is a return to the Black Swan Plc themes of 2006/7, as now that we are three years into the "recession" I would have expected the majority of commentators to have picked up on the fact that this is anything but. What has occurred is a one off structural shift in where the power lies in the world economy, and that power has shifted inevitably and inexorably to Asia and specifically China. Amongst the "Western economies" the only survivor of this shift will be Australia: all the others are heading for the storm.

At the World Economic Forum last year there was much talk of Asia being the engine of growth that would pull the world out of recession but the critical and barely reported exchange came towards the end. Let me quote from the FT where this was reported:

"Perhaps the sharpest exchange came in response to a question about the quality of life in the west. Was it bound to decline following the financial crisis? (asks a conference participant). Not at all, says Behravesh. After all, Japanese living standards have not fallen through two decades of stagnation. **But even though time was tight, Xia Bin, an economic adviser to China's state council, insisted on intervening: "I disagree. The quality of life has to decline after the crisis. The quality of life [in the west] has to decline because the balance sheets are in such a poor state."**

My view is that this understates massively what lies ahead: there simply is no money. Decades of promises of healthcare, education, pensions, care for the elderly, improved infrastructure etc etc are not going to be kept. Even now no real restructuring has taken place. Greece's "austerity packages" have not even begun to bite, everything is being expressed in big changes for.....five years time. In England, where the normal response is supine whining, students rioted recently, yes rioted, about a minimal increase in tuition fees. But wait: it wasn't an ACTUAL increase, merely an indication of an increase in five years time that these students will never have to pay.

The sentient have of course spotted what is going on. Even Britain's Prime Minister (who is only on the second job he has had in his life, the first being a Public Relations executive) floated the idea of means tested pensions. Cue howls of derision from the Socialists but this is the way things are inevitably going for most of Europe.

As regards the Euro, this is a crisis that will never be solved. Much smarter people than me have proposed various solutions but none of them are politically palatable for all concerned. There will never be a "solution" as such so expect serial Euro crises throughout the year(s) with financial band-aids being applied to the broken limbs of the peripheral Euro economies. The idea that Germany will leave the Euro and return to the Deutschemark is unlikely for two reasons: firstly, the DM would soar against the Euro thus damaging German exports and secondly, Deutschebank would be insolvent; because Deutsche is the biggest lender to Greece. I'm sorry I thought you all knew that, you see that is where all this PIIGS debt actually is: in the balance sheets of the European banks.

For Europe and the US the rhinoceros in the room remains inflation. I have heard comments that after the massive injections of money into the Western economies following the dot com collapse that inflation remained under control. That is an illusion as it was kept under "headline control" by measuring the wrong things: the price of a loaf of plastic bread and a bottle of ketchup in Bradford or Knoxville are irrelevant to the vast asset price inflation which occurred yet which was not, and still is not, a component of the inflation indices. In our gut we all know that prices rose massively: houses, transport costs, healthcare, school fees etc. When my eldest son, Amory, worked at Barclays Wealth, they had their own model of inflation where you could key in income, costs, assets, school fees etc. and it would produce your own inflation index. Unsurprisingly for most people in the mid 2000's this turned out to be 11-12%. Inflation will strike again in all the economies where quantitative easing has been eased through.

So are there any rays of light? Not for the West, no, Xia Bin was right in what he said. Of course there will always be a Gstaad and we will still be lunching at Greens but out in the streets they will be rioting and it is that collapse of law and order, which I fear most, more than the collapse of currency.

Investments? Commodities in general (again), potash (obviously!) but full on for gold. I am a $5,000 an ounce man.

If it seems strange at the end of that to wish you a Happy New Year, it isn't. Things are much clearer now than they were in 2007 and as a result everyone can take clearer decisions about what needs to be done for the world and for themselves. Whether they actually do it is another matter altogether.

Very best to all for 2011 and, as always, watch out for the colour of the Swans.