



JIG'S UP

It's a fascinating world – this world of centralized management of the world's economy. A scant eight years ago, investors were shunning the particularly poorly managed countries of Portugal, Italy, Greece, and Spain, to which they ascribed the derisive acronym of PIGS (using the first letter of each of these maligned economies). The result was incredibly high interest rates as investors fled these markets in droves. Seeing that centralized fiscal mismanagement had failed, the central banks decided that centralized monetary mismanagement was in order. And it worked. Rates tumbled, and then they tumbled more. They actually went into negative territory, a territory unimaginable even for stellar credits a mere decade earlier. And low rates revived speculative spirits, sent stock, bond and real estate markets into the stratosphere, which in turn goosed the economies. And all of this led to no increase in the measured rate of inflation. All hail the central planners!

But, **alas, their success was short-lived**. A whole host of Austrian economists have long preached that gains caused by credit creation must bust, and a bust is what seems to be emerging. Several hundred years ago, Richard Cantillon, using a river as an analog, suggested that inflation of the money stock winds its way through the system unevenly in terms of time and magnitude. In our words, it is migratory, as opposed to transitory. Historically, the inflationary symptoms first appear in financial assets, making asset owners happy. Then they migrate beyond financial assets, into things that negatively impact peoples' cost of living. The price of necessities such as food, energy, and services eventually soar in price. In the current case, as the saying goes, these adverse inflationary symptoms came slowly and then suddenly. We agree with the consensus view that central banks are in a bind. Their current bolstering of interest rates appears to have landed us in recession but failure to have done so would have let inflation and speculation spiral out of control. Why they didn't start correcting course a year earlier, when the problem was increasingly clear to most, is a matter of conjecture.



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At any rate, here we are, temporarily without the central banks' backstop. The PIGS are in trouble again. We would suggest caution. But, more importantly, after almost a decade and a half, the acronym is wanting an update. First of all, the undisputed leader in fiscal and monetary mismanagement appears to be Japan, a country that has seen debt spiral to almost two-and-a-half times the size of its economy. Japan deserves to be front and center. **Replacing the P with a J, PIGS becomes JIGS.**



Source: World Economics, as of 9/28/2022

Debt-to-GDP Ratio (% of GDP): All Countries	Latest Data
Japan	240%
Greece	157%
Lebanon	131%
United States	124%
Italy	122%
Singapore	120%
Cabo Verde	117%
Portugal	106%
Canada	101%

The table above lists the countries with the dubious honor of having debt level greater than **100%**. **This is a level from which many believe that there is no return.** As the chart dictates, we are changing our acronym with the proposed substitution of Singapore for Spain, a country that isn't in the top ten. But wait, what country is that in fourth place and rising quickly? Certainly, that deserves a prominent place in our acronym of shame. It seems hard to argue against adding a U, and not letting Portugal off the hook, bringing back the P. Adding the UP to the end gives us JIGS UP, an apropos description for the central bank planned economy. Many of you have probably heard the saying 'the jig's up.' If not, we've inserted a couple definitions from dictionaries.

Definition of the jig is up

US, informal + old-fashioned

used to say a dishonest plan or activity has been discovered and will not be allowed to continue

The meaning of "the jig is up" is that someone discovered your ruse, trick, or plan.

So, in other words, you're no longer fooling anyone.

When someone tells you that the jig is up, it means that they uncovered your behavior and plans.



After a four-decade long period when central bankers were increasingly idolized and revered, it appears that someone has pulled back the curtain and announced - the jig's up! It appears that stocks and bonds have entered a bear market. The economy is stagnating, even as inflation plods ahead despite a massive correction in commodities. A lot of the drivers of the "Goldilocks" markets are long gone (low interest rates, low inflation, unipolar world without major conflict, increasing free trade, laissez faire government policy, increasing acceptance of capitalism, and so forth). We have entered a new paradigm. What's an investor to do?

Investment Strategy

I've been fortunate. The entire four decades during which I've had the privilege to manage portfolios have been a nonstop bull market in bonds and, with a few hiccups, stocks. For a road map as to what has worked during periods of rising interest rates, investors have to go back a half-century - to the 1970s. I recently presented this concept at the London Value Investor conference. During that periods of rising rates, stocks and bonds (especially) were decimated and that the only safe harbors were stores of value such as agricultural land, gold, energy, and other commodities. Resource-rich emerging markets also performed notably well. We suggest that the recent correction in these very "stores of value" is a godsend. We are eagerly repurchasing many of the energy stocks that we'd sold over the past year. Precious metals stocks are back to our maximum 25% of the portfolio. Emerging markets (EM) have garnered an increasingly larger share as well.

While we couldn't be happier with the bargains and opportunities in the portfolio, we hear the understandable concern about the "threat" posed to commodities by rising interest rates and the "strong" dollar. Our rebuttal to these concerns is warranted. I wrote a piece, back in the Tradewinds days, discussing relative motion. When a train gets passed at night by a faster moving train, passengers may feel like they are going backwards. **Similarly, planets such as Mars are said to be retrograde (moving backwards), when they are in fact moving forward, during periods when they appear to be going backwards due to the Earth's faster motion.**

Likewise, fiat currencies tend to lose value over time. This has always been the case, especially during times of lax monetary policy (such as quantitative easing, i.e., QE). During my lifetime, most things seem to have gone up in price 50 times, plus or minus. This means that the dollar has lost 98% of its purchasing power. (If one trusts the government issued CPI numbers, it has only lost 90% of its value.)

Since the Global Financial Crisis, the Federal Reserve has increased the money supply tenfold. Probably it's no coincidence that the NASDAQ-100 is up tenfold over that period also (even post the recent 30% correction). In other words, it takes ten times as many dollars to buy the NASDAQ as it would have in early 2009. The dollar is dropping. Likewise, it takes many times more dollars to buy houses, art, services, crypto, medicine, food, energy, etc. The dollar has dropped rapidly relative to almost anything that matters. Because the yen, Euro, Canadian dollar, Aussie dollar, won, yuan, and most EM currencies have lost purchasing power at an even faster rate, the dollar is said to be strong. It feels like it is going up only because the other currencies are going down at a faster rate of speed. We feel that this is a dangerous misperception. The table on page 2 suggests that the debt level will cause monetary inflation to return soon. And the inflation of the past three years is still migrating through the system. Debt must be paid off through hard work and austerity (rare in democracies) or defaulted on, either outright or through devaluation. Democracies choose the latter. Debt levels of 124% of GDP are ominous for the US. The dollar may stay "strong" versus the yen, but very likely will fall hard versus hard assets.

Another worthy point is that the crowd is wrong to assume that rising nominal rates are bad for gold. In the 1970s, arguably the last similar period to the current era, rates rose from several percent to over twenty percent. Did gold plunge? In actuality,



the price rose from \$35/oz to over \$800/oz. Though rates rose rapidly, until late in the decade, they remained below the inflation rate (meaning that real rates were negative.) This is certainly the case now. Augmenting the argument, during the 1980s and 90s, rates plunged and so did the price of gold. This was because rates were higher than the inflation rate. **It is real rates that matter, not nominal**, and usually with a lag.

A final point worth making is that during the decade when gold prices rose from \$35 to \$800, the price actually fell during 10 of the 40 quarters, including 7 quarters in a row from Q3 1974 through Q2 1976. The size of the temporary loss wasn't important. All that mattered was maintaining the gold holding so as not to have missed the huge gains. The same was true for most commodities. It is interesting that gold has been behaving similarly over the past several years.

In conclusion, we recommend that the out-of-date PIGS acronym be replaced with the more up to date and relevant moniker – JIG'S UP. This reflects the countries with the most alarming levels of debt in comparison to the size of their economies: Japan, Italy, Greece, Singapore, United States, and Portugal. Certainly, it seems that the jig's up for the central bank-led four decades of lower interest rates and the "implied put option" against market losses. As such, it seems clear to us that sovereign bonds of the JIG'S UP countries should be avoided. This applies to most stocks as well. Stagflation is here. The TINA (there is no alternative) ellipsis is now better applied to hard assets and stores of value than to broader stock indices (as formerly applied). **We recommend agricultural land, energy, metals (especially precious metals), and stocks domiciled in resource-rich economies. Emerging markets look particularly enticing.** These all portend attractive returns. But, while the meme stock players may have their "diamond hands," hard asset investors may need "nerves of steel." Revisit charts from the 1970s. The gains are quick and pronounced. Don't be shaken out at inopportune times.

Wishing everyone a safe and sane fourth quarter during this particularly challenging year.

All the best,

David B. Iben, CFA
Chief Investment Officer
September 2022

(The price of gold during the similar decade of the 1970s)



Source: Bloomberg



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