Redstone Advisors

Economic and Market Review

First Quarter 2014

"The days have gone down in the west. Behind the hills, into shadow. How did it come to this?"
J.R.R. Tolkien, 'The Lord of the Rings, The Two Towers', "The King of the Golden Hall"

"The best is the enemy of the good."
Voltaire

"You haven't told the truth, Mrs. Crabtree, so you must pay the consequences." And with that familiar punch line, it was time to play the popular 1950s radio and TV show 'Truth or Consequences'. The story of the economic decline of the West, has often been punctuated by periods of great crisis and exigency. In each instance, we have been presented with a choice very much like that of Mrs. Crabtree. And in almost every instance, under the tyrant's plea of necessity, we have chosen to enter upon the wide gate and the broad road of political expediency. Yet history is a hard taskmaster, that time and again demonstrates the truth that those who refuse to learn from history, are destined to repeat it. For as it was for Rome under Diocletian in 301 AD, for France in 1790, and for Weimar Germany in 1923, so it will always be for any empire or nation that refuses to speak the truth regarding the *expediency* of a chosen policy of inflationism. In each instance the point of no return in the inflationary decline of the nation, the point when it becomes self-generating and politically irreducible, occurs in the constant taking of the expedient political option in respect of money - it comes in the failure to speak the truth. As such, the take-off point has never been a financial one, but a moral one. Writing in his book, 'The Fatal Conceit', Austrian economist F.A. Hayek warned; *"We cannot make moral decisions simply by considering the greatest foreseeable gratification."* And we should have no illusions, for despite what the doctors of econometrics would have you believe, [or *"economic tricks"* as Dr. Peter Warburton would say] these are moral choices with moral consequences. Deferring again to the Austrians, it was Murray Rothbard who told us; *"free choice involves moral choice."* Nevertheless, driven by the expedient, we focus only on the immediate, in search of the effective. "*Will it work*" is the only applied criteria, there is no variable for the "*ought*" in the econometric model. In time, the *"best"*, as Voltaire reminds us, becomes *"the enemy of the good."* Utility trumps justice. By relying solely on what can be *counted*, we ignore what really *counts*. For years we have labored to expose the nature of the injustice in the means chosen by the stabilizers. Specifically their avowed preference for the *expedient option in respect of money* and the resulting insidious and destructive impact on the economy and society. Borrowing a phrase coined by the imminent French economist Jacques Rueff, we have labeled this phenomenon of decline, "the monetary sin of the west." And whether our ultimate experience will be one of a near-term, cataclysmic collapse, or a long, slow decline into mediocrity, is surely *a matter capable of question*. However, as the poet Robert Louis Stevenson reminds us, one thing is certain; *"Everybody, soon or late, sits down to a banquet of consequences."*

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Writing in the early nineteenth century, French economist Frédéric Bastiat had much to say about expediency and consequences. In a piece he penned entitled 'That Which is Seen, and That Which is Not Seen', Bastiat wrote;

> *"This explains the fatally grievous condition of mankind. Ignorance surrounds its cradle: then its actions are determined by their first consequences, the only ones which, in its first stage, it can see. It is only in the long run that it learns to take account of the others. It has to learn this lesson from two very different masters—experience and foresight. Experience teaches effectually, but brutally. It makes us acquainted with all the effects of an action, by causing us to feel them; and we cannot fail to finish by knowing that fire burns, if we have burned ourselves. For this rough teacher, I should like, if possible, to substitute a more gentle one. I mean Foresight."*

Experience teaches effectually but its' lessons are necessarily confined to a discrete action. Only foresight can afford the opportunity to navigate the "unseen" consequences. Upon what, then, does this "foresight" depend? Experience? Historical observations? In a word, no. Bastiat's foresight presupposes an *a priori* understanding - principles, a theory, a lens through which to understand experience and observations. In short, foresight presupposes a worldview. Consider briefly the work of the historian. All would agree that the job of the historian should be to accurately and dispassionately report *only the facts ma'am*. Yet is this really possible? Writing on the topic of praxeology (the science of human action) in his magnum opus, the book 'Human Action', Austrian economist Ludwig von Mises observes: *"The course of history is determined by the actions of individuals and by the effects of these actions. The actions are determined by the value judgments of the acting individuals...... However, history can never be scientific because historical understanding depends on the historian's subjective value judgments."*

Perhaps a simple illustration will help to drive home the point. In February of this year, an asset management firm published a piece called 'The Play's the Thing' in their investment newsletter. The piece was essentially a cynical view of all public pronouncements, particularly those of an economic nature. In a section analyzing the Lincoln-Douglas debates of 1858, the author concludes;

> *"Lincoln was playing a game four layers deep! He didn't care about "winning" the debate. He didn't care about winning the crowd. He didn't really care about winning the Illinois Senate election. All of those things would be nice, but it was the fourth level – winning the national Republican primary and the national Presidential election of 1860 – where Lincoln was focused."*

Notice carefully the author's language in reporting on this event. Three times the author declares that *"Lincoln didn't care."* That these debates took place is a historical fact beyond dispute. But how, more than 150 years removed, can the author pretend to "know" what Lincoln's personal "value judgments" (von Mises) regarding his purpose in participating in the debates, really were? We submit that neither the author, nor anyone else, can make such a statement with apodictic certainty. Clearly the author is entitled to his opinion and to all the defense of that opinion that he can muster. But we insist that the author's conclusions are not purely a product of cognitive deduction of historical fact or observations, but are, rather, an outcome of the author's presuppositions and worldview.

What, you may rightfully ask, is the point of this rumination? Deferring again to Bastiat: *"Between a good and a bad economist this constitutes the whole difference—the one takes account of the visible effect; the other takes account both of the effects which are seen and also of those which it is necessary to foresee."* And foresight, as it pertains to complex human action, depends not upon the proper assimilation of observations alone, but upon the *a priori* understanding of the observer. Foresight ultimately depends upon the particular worldview applied to the data. Austrian economist Murray Rothbard put it succinctly; *"Gazing at reams of statistics without prejudgment is futile."*

So precisely what consequences do we pretend to "foresee"? For years, we agitated for a "small present evil", such as the short-lived and now little remembered US Depression of 1921, over a "great evil to come" *a la* Japan's two-decades-and-counting Great Stagnation. Despite the apparent contradiction, we insisted that a correction - whether mild, modest or severe - was eminently preferable to the slow and inexorable "death of a thousand cuts" that, in our view, awaits us as a consequence of a policy of perpetual postponement. And while we have not been the only *voice crying in the wilderness* for a cessation to the policy of inflationism, in one respect we have been somewhat singular. Many have "seen" the immediate consequences of the extraordinary level of intervention by the stabilizers since 2008 - massive asset bubbles, rampant speculation, market corruption, and increasing instability. And as a result, the *many* have regularly "foreseen" a severe correction, a *day of reckoning,* a *great reset* to wipe away all malivestments, after which there will be a return to normalcy. Like the mythical Phoenix, we will rise from the ashes, abandon the "New Normal" and return to a "New Destination." Few, on the other hand, have "foreseen" and associated the subtle, yet relentless trend of decline in economic growth to the 40-plus years of monetary manipulation. Yet as Bastiat reminds us, this *"constitutes the whole difference"* between our position and that of the consensus. For while we will certainly not dispute the possibility of a near-term correction and contraction, we do not concur with the proposition that upon clearing away the malinvestment, we will return to a normative growth and investment environment, and simply begin again. In our opinion, there will be no "do over." Rather it remains our contention that there has been a permanent change in the way the world works. Lifting the fictional line from the movie 'Hunt for Red October'; *"When he reached the New World, Cortez burned his ships."* From this *New World* we foresee, there will be no going back.

The reality is that the stabilizers have been manipulating market prices and distorting global exchange, and so benefitting the "vital few" over the "trivial many" through artificially low interest rates and the expedient use of the printing press, for far longer than just the preceding few years of quantitative easing as suggested by the consensus. This evergreen expansion of credit, coupled with the unwise deregulation of the banking industry, has manifest itself in a seemingly never-ending cycle of **boom-bust-boom**, replete with recurring asset bubbles, rampant leveraged speculation, malinvestments, moral hazard, and severe dislocations in the productive structure of the economy. Each time they are faced with the prospect of a debilitating debt deflation as a result of the collapse of yet another failed credit-induced boom, the stabilizers pursue a **policy of postponement** in an attempt to procure what President Harding, during the Depression of 1921, said could not be procured, an "*instant step from disorder to order.”* And while to the statist who diligently seeks to *“benevolently manage”* the economy so as to bring about such a desired end, the discovery of such a *“philosophers stone”* would no doubt, present itself as a virtue. Nevertheless, as Ernest Lefever suggests in his book of the same name, *"The irony of virtue is that virtue, when untamed by facts or* ***undisciplined by a sober understanding of man and history****, can ultimately lead to disaster."*

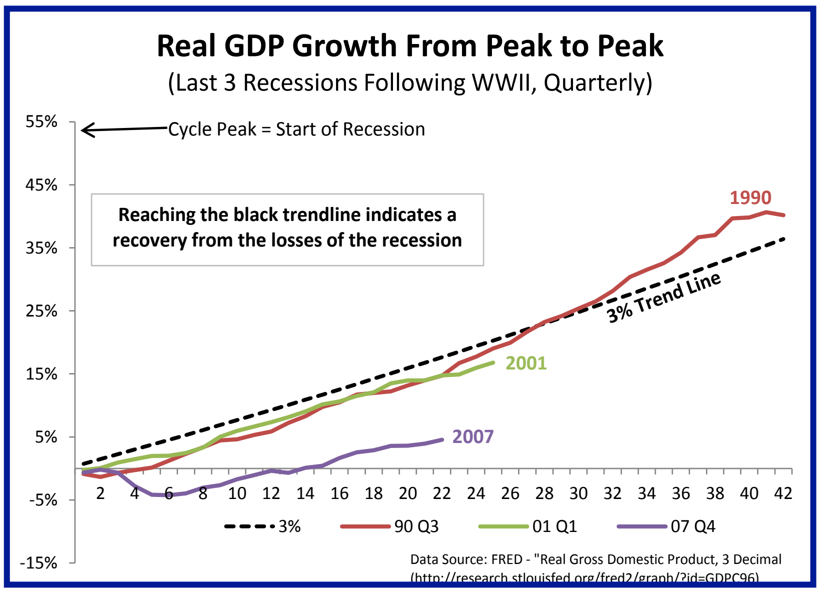
To what understanding or worldview do we plead? The most important "fact" in political economy is this: There is no such thing as ***"something for nothing."*** This simple, yet profound understanding remains a cornerstone of our worldview. While philosophically, the **monetary sin of the west** is the repudiation of a belief in the immutability of the curse, i.e., the relationship between work and income, in practice it is the ascendancy of the belief in *something for nothing*. But how does such rank heresy become orthodoxy? Through the Keynesian worldview that scarcity can be eliminated by the determined will of the state. As we have discussed previously, scarcity is the **"natural arbiter"** in determining what satisfactions we may pursue, the consequence of which is that we are forced to prioritize our wants, out of which arise subjective values which become the basis for all **market prices**. In short, scarcity forces us to choose, and **it is choice that defines cost**. Scarcity determines prices and market prices expressed in money terms become the single most important factor in planning and calculation by all economic actors. The true cost of any chosen alternative is that which we would have taken in its' place. The determination of cost is impossible under the aegis of central planning where there is no *"alternative"*. Where no choice is required we give up nothing in *"choosing"* it, and as such, there appears to be *"no cost"*. This however, is merely a money illusion. For to the extent that market prices are not determined by scarcity, but are instead unduly influenced by the manipulation of money and interest rates, individual wants and societal projects are not prioritized, capital is not rationed, and the structure of production in a market economy will be distorted and riddled with malinvestments. Where once we could only pursue guns ***or*** butter, we are now magically free to pursue guns ***and*** butter. By debauching the integrity of money and credit through its' unlimited emission, scarcity is magically overruled and the attainment of that which was once presumed impossible, namely *something for nothing*, becomes an **entitlement**. Ultimately the Keynesian worldview subsists in nothing more than the chimera that fiat money derives its value, not from the underlying scarcity of the capital that it has a rightful claim upon, but from the official stamp it bears. And that being the case, a determined government may always overrule the niggardly constraint of scarcity with an expedient emission of credit – at least in the short-run. Parroting Bastiat, economist Henry Hazlitt observed; *"The art of economics consists in looking not merely at the immediate but at the long-term effects of an act or policy."* And when we do so, the lesson of history is clear. Voter's who desire *something for nothing*, eventually get stuck with *nothing for something* – they sell their labor and receive depreciating money and a declining standard of living in return. This we have labeled as the **"real taper problem."**

In fact the consequence of a declining standard of living has been the hallmark of our on-going warnings about that which continues *unseen* by the consensus, specifically the long-running secular decline in economic growth which pre-dates the Great Recession of 2007. To establish our bi-partisanship in all things economic, we have previously discussed the work of Dr. Edward Leamer of UCLA Anderson Forecast, and Dr. Robert Gordon of Northwestern University, on the topic of the demise of US economic growth. To this we can now add the work of Dr. Dimitri Papadimitriou, President of the Jerome Levy Economic Institute of Bard College. (We say bi-partisan as

Drs. Leamer, Gordon and Papadimitriou are all ideologically of the Keynesian camp) In each instance, their respective research has uncovered a long-running secular trend of declining US economic growth. And while based on their respective worldviews, they arrive at differing conclusions regarding their predicted paths of future economic growth, all of them are in agreement that the trend is secular in nature, and is not therefore, simply a cyclical by-product of the most recent recession.

As you may recall, Dr. Leamer's work focused specifically on identifying the **marked secular change** which has taken place in the recovery pattern of the three most recent recessions - 1990, 2001 and 2007 - as compared to the previous eight post-WWII recessions. As can be seen in **Figure 1**, a reproduction of one of Dr. Leamer's charts, with the exception of the 1990 recession, US economic growth during the expansion phase of the most recent three economic cycles, is no longer returning to and exceeding, its pre-recession growth level. And while the recovery from the 1990 recession did eventually exceed its pre-recession growth level, it took 28 quarters or **seven full years** for the expansion to return economic growth to its pre-recession trend and fully recover the growth lost during the recession. This represents a time period nearly three-times the average recovery period of all other post-WWII recessions. Conversely, subsequent to the 2001 recession, **the economy never fully recovered the growth lost during the recession**. As a result, the next cycle (2007) began from a level below the previous trend representing a **permanent loss** of economic growth. At down 5-percent, the severity of the 2007 recession was worse than any recession since the Great Depression but most importantly, we can see that to date, there has been no recovery whatsoever relative to the long-term trend. In fact, the gap between the current expansion and trend growth is widening, suggesting not only a **permanent loss of economic growth** but a **deteriorating trend** as well, lending support to our long-running contention of a cascading pattern of permanently declining growth. And while Dr. Leamer attributes the failure of these three-most recent cycles to return to pre-recessionary growth levels to the **absence of super-normal growth driven by pent up demand**, what is critical to understand is that the pattern of the last three recession cycles, and most particularly the recessions of 2001 and 2007, have revealed a **marked departure** from all other post-WWII economic cycles. This, we contend, is due primarily to declining real incomes and increasing levels of indebtedness resulting from the cumulative effects of the monetary inflationism of the stabilizers. As a result, there is simply no means for satiating pent-up demand. It was the Austrian economist Böhm-Bawerk who told us; *"debt if future consumption denied."* To repeat our long-standing contrarian call; this time it is Austrian.

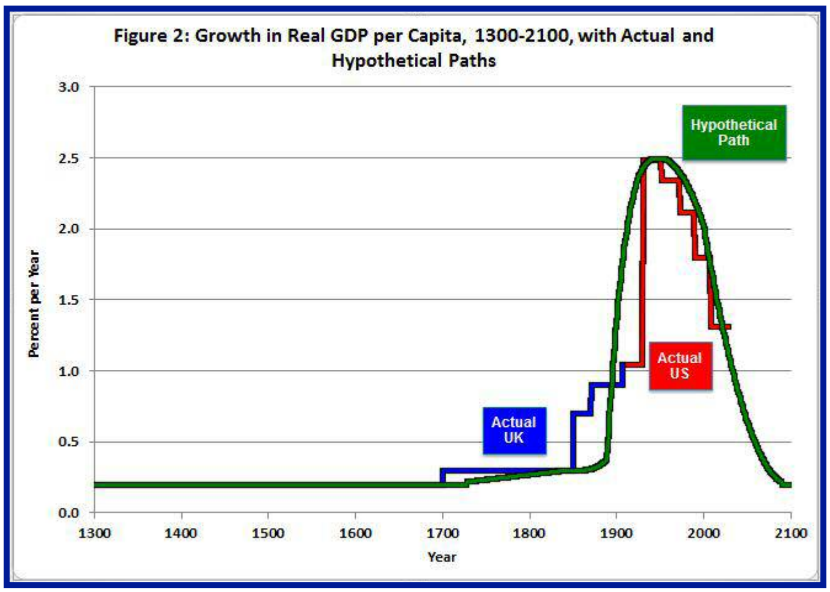
Figure 1



In August of 2012, Dr. Gordon published a paper with the provocative title 'Is US Economic Growth Over?', in which he challenged the universal assumption that ever-increasing economic growth in the US is our birthright. In his paper, Dr. Gordon makes a compelling case that not only has GDP per capita been slowing since the middle of the twentieth century, but citing both serious headwinds confronting the US economy and the potential for diminishing future returns from innovation, he argued that *"the rapid progress made over the last 250 years* [as measured by GDP per capita] *could well turn out to be a unique episode in human history."* His prediction in that paper, specifically that the **future long-term growth rate of real per-capita disposable income of the bottom 99 percent of the US income distribution would average only 0.2 percent per year as compared to its 100-year historical average of 2.0 percent**, caused no small amount of controversy. In response to that controversy, Dr. Gordon published a second paper in February of 2014, entitled 'The Demise of US Economic Growth: Restatement, Rebuttal, and Reflections'. In it he attempts to refocus the debate regarding his predicted slowdown in income away from his more controversial concept of faltering innovation, back onto the **formidable headwinds** which, in his opinion, are acting to reduce future US economic growth.

We have reproduced one of the charts created by Mr. Gordon as **Figure 2**. In this chart, Dr. Gordon presents both the calculated **"actual"** (stepped blue and red line), as well as a **"hypothetical"** (smoothly curved green line) growth path of real GDP per capita, for the period 1300 to 2007 for the actual data, and 1300 to 2100 for the projected growth path. By way of qualification of the data, although Dr. Gordon's focus is on the US, he utilizes the better quality data from the UK from 1300 through 1906 to *bootstrap* the long -term actual trend in per capita growth, utilizing actual US data from 1906 onward. In addition, the hypothetical path is merely a projection serving as a *"visual prop"* to underscore his contention that owing to the many **secular headwinds** facing the US, the assumption of increasing growth in the future is not assured. Most importantly for our purposes, however, we wish to underscore the fact that his research clearly demonstrates that the actual trend in per capita GDP growth has been in a **significant and intractable decline for over 40 years**.

Figure 2

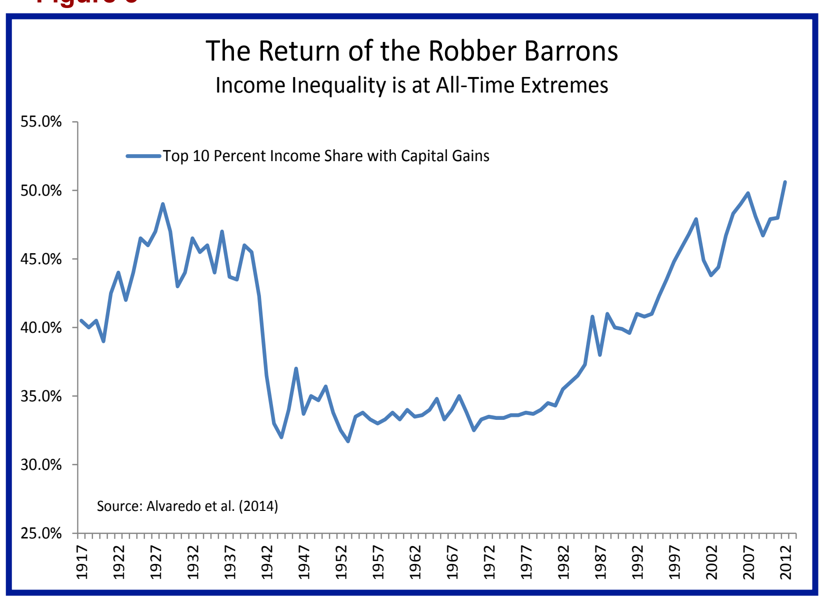


In fact, many of the headwinds that Dr. Gordon identifies are the very same secular forces we have discussed for years. The first headwind, **demographics**, refers specifically to those secular factors now conspiring to shrink the work force, reducing hours worked and ultimately economic output. Key among those factors is the coming retirement of baby-boomers and declining birth rates now below replacement levels as immigration slows and we increasingly become a nation of singles. The next headwind identified by Dr. Gordon, **globalization,** captures what we have referred to as the deleterious impact of **downsizing**, **outsourcing** and **automation** (DOA) on employment in the US as a result of our **Faustian bargain** with low-wage developing nations. Yet another headwind is the **massive overhang of unproductive debt** and the unsustainable growth of unfunded liabilities (legacy costs), the combination of which, augurs for a permanently lower growth rate in disposable income. And finally, Gordon identifies **rising inequality** as the final headwind, calling it *"the most important headwind, quantitatively, in holding down the growth of our future income."*

In our worldview, excepting only demographics, all of these "headwinds" are merely the cumulative "effects" of the long-term trend of increasing intervention and inflationism. As such, we have long-held that the take-away from Mr. Gordon's challenge to Dr. Robert Solow's assumption that *"economic growth is a process that will persist forever",* should be a call to policy makers to *forethink and repent* of the preferred policy of postponement. (Dr. Solow won the Nobel Prize for his work on economic growth in 1987) Driving home our contention that the **point of no return** in the life of a nation experiencing terminal decline occurs in the constant taking of the *soft political option in respect of money*, Jean-Claude Juncker, Prime minister of Luxembourg and President of the Euro Group, tacitly acknowledged as much when he said; *"We all know what to do, we just don't know how to get re-elected after we have done it."*

The most recent addition of research on the paradigm of decline in US economic growth, is a recent analysis by Dr. Dimitri Papadimitriou and associates, of the Levy Economics Institute, dated April of 2014 and entitled 'Is Rising Inequality a Hindrance To The US Economic Recovery?' In their study, the authors state; *"The biggest obstacle to a sustainable recovery of the US economy is the inequality in the distribution of income."* One of the charts they created to illustrate this claim has been reproduced as **Figure 3**. The data, according to the authors, was originally tabulated by Piketty and Saez from tax-return microdata, and was retrieved from the World Top Incomes Database (Alvaredo et al. 2014). Referring to **Figure 3** we can see that subsequent to the closing of the gold window in 1971 and the initiation of the deregulation of the banking industry in the 1980s, the share of income earned by the **richest 10 percent** segment of the population has increased at a rapid rate. In the years leading up to the Great Recession, the income share of the top 10 percent reached the levels achieved by the **"Robber Barrons"** in the years prior to 1929 and the Great Depression. However, and most alarming, unlike the 1930s, the top income share recovered after the most recent crisis and has since resumed its inexorable rise.

Figure 3



Referring to **Figure 4**, which is a reproduction of another chart created by the Levy Institute authors, we can see that the sharp and steady rise in total financial assets as a percentage of GDP has a **near-perfect correlation** with the same preceding series from **Figure 3**, the income share of the top 10 percent. This naturally begs the question; *"Is there a relationship?"* We believe there is, and as such, the lock-step rise of both series subsequent to the abandonment of honest money and the deregulation of the financial industry, is, in our opinion, no coincidence.

According to the authors of the Levy study; *"The increasing share of the income of the richest segment of the population meant that the total income of the remaining part of the population stagnated."* To wit, we consider a final chart reproduced from the Levy study. **Figure 5** clearly illustrates the **40-plus year stagnation** in the average income of the bottom 90 percent of the population. The average income for this group, after increasing steadily in the first three decades after WWII, has stagnated since then. In fact, according to Levy, the real average income of the bottom 90 percent was lower in 2012 as compared to **40 years earlier**. In the same figure, the authors present an index of average personal consumption over the same period. Due to the lack of data, average personal consumption refers to that of the total population, not just the bottom 90 percent. And unlike the average income of the bottom 90 percent, the rate of increase in average consumption has remained effectively unchanged for the entire postwar period, resulting in an **epic gap** between the two series. The authors conclude that *"to the extent that the increase in average consumption was not supported by the top 10 percent, the gap had to be bridged with increased borrowing by the bottom 90 percent."* In fact this was precisely the finding of yet another research

Figure 4

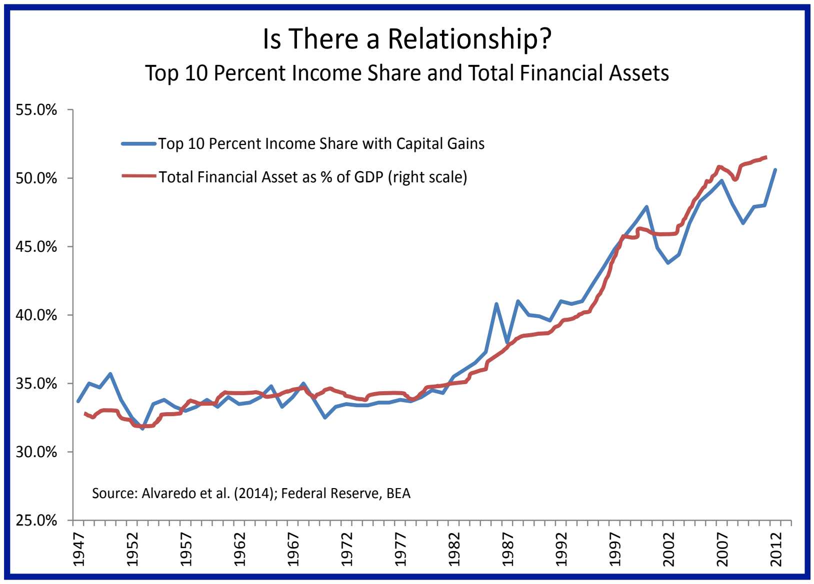
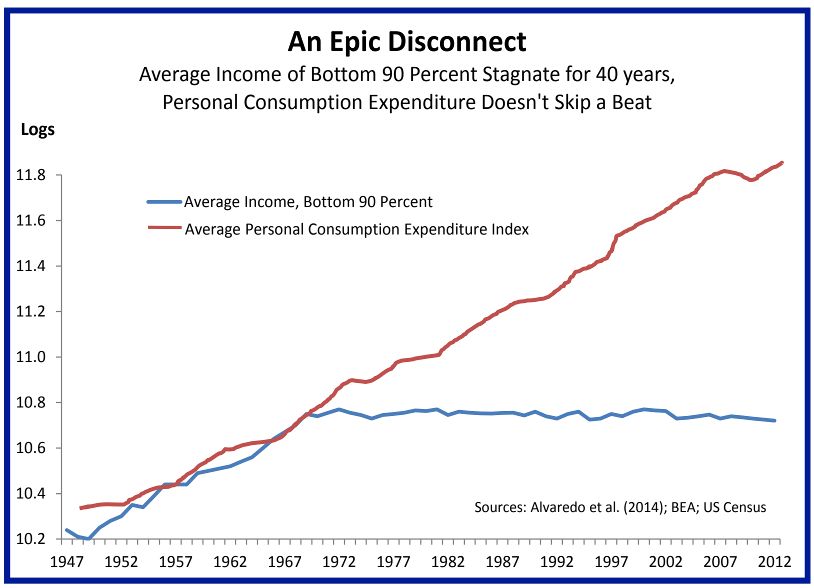


Figure 5



study by Wolff who in 2012 also concluded; *"It appears that middle class households, experiencing stagnating incomes, expanded their debt in order to finance consumption expenditures."* In other words, over the last **40-plus years**, there has been a sharp increase in the level of household indebtedness, with a disproportionate share of this debt having been incurred by the middle class and the poorest households. In addition, the Levy study finds a very strong correlation between the variables, with the disposable income of the top 10 percent rising relative to the income of the bottom 90 percent, and the gross debt of the later group rising relative to the former. Ultimately, the Levy study concluded that *"a change in the income distribution is a necessary condition for sustainable growth in the future. If allowed to continue, it will lead to an era of anemic growth and high unemployment."*

Each of these studies, undertaken by independent authors with differing worldviews have advanced the possibility of a permanent downshift in potential future economic growth in the US, based on the continuation of trends in place for **over 40 years**. Importantly, both Dr. Gordon and Dr. Papadimitriou have specifically identified **income equality** as the *"most important headwind"* and the *"biggest obstacle"* respectively, contributing to the continued downward trend in future economic growth. We have for many years, insisted that the US in particular and the West in general, are facing an economic malaise which we have characterized as a **"rolling recession"** replete with persistent below-potential economic growth, intractable unemployment, an unsustainable level of unproductive debt and a massive **"famine of income."** All of these consequences are the direct outcome of the discoordinating influence of the stabilizers policy of monetary inflation over the past **40-plus years**. The stabilizer-induced boom-bust-boom cycle, both **redistributes** and **destroys** wealth through the debauchment of the currency, but it does not do so evenly. The favored few who receive the new emission of credit first obtain a **"claim"** against existing wealth that did not arise from productive activity. As such they stand in a position to exercise their claim and so command or **"draw off"** existing wealth before any adjustment to the relative price structure can take place. However, those unfortunate enough to possess the new money at the moment of its depreciation will obtain a **smaller gratification** for the same amount and it is in this way that they are **impoverished**, almost imperceptibly, day by day. It is that **"loss"** that small, undetectable act of legalized theft which, **after forty years**, has swollen into a massive deprivation which today threatens many in the US and indeed throughout much of the socialized West, with a **famine of epic proportions**. And while we have consistently advocated for that **"small present evil"**, we now *foresee* that we will instead have the **"great evil to come"** as *the days go down in the West*.

This prospect of long-term stagnation and malaise, as we stated earlier, will result in a permanent change in the way the world works and is the **real taper problem** that investors will need to account for. The consensus is focused on the current taper of the $85 billion per month in asset purchases by the stabilizers. Since the announcement of a reduction in the QE program, the monthly asset purchases by the Federal Reserve has averaged approximately $70 billion per month, down approximately $15 billion per month, or $180 billion per year. Given the temporary improvement in the fiscal deficit due to the impact of the sequester, the fiscal deficit has fallen by roughly $500 billion per year. Therefore it would appear that the Fed has the flexibility to reduce its purchase of Treasury bonds even further without increasing the **net supply of debt** that will have to be purchased by the private sector. Ditto for the Fed's purchase of $40 billion per month in mortgage backed securities as new mortgage originations have recently collapsed by **65 percent year-to-date** according to Black Knight, and are at their lowest level since they began keeping records. And with refinance volume expected to be even lower in 2014 in response to higher mortgage commitment rates, the reduction of mortgage purchases by the Fed may not have any immediate negative impact on interest rates or the market. In addition, the current geopolitical unrest may provide additional temporary support for the dollar and risk-free rates. Finally, increasing domestic energy production should be favorable for the US trade deficit, and by extension for the US dollar.

Nevertheless, the Fed still owns over **35-percent** of all outstanding Treasury bonds on a 10-year duration-equivalency basis, and a substantial amount of mortgage backed securities. Even if the Fed were to completely discontinue the current QE program, the re-investment of the annual maturities, calls and prepayments from their massive $4 trillion portfolio will continue to provide up to $400 billion in tacit support annually. In addition, the improvement to the current fiscal situation is only temporary, and is set to deteriorate rapidly in coming years in response to exploding entitlement obligations. it would be well to remember that the QE program has been discontinued three times since its inception, and each time, after a brief interval, it has been reinstated. Given their current and prospective level of involvement, we continue to maintain that **'Atlas will not shrug.'** As banking consultant Patrick Barron recently suggested; *"Who can print money, will print money."*

To disabuse Francis Schaeffer, *how should we then invest?* Given what we *foresee*, an intractable decline in economic growth anchored by the continuing polarization of income formation, the DNA of economic growth, the stabilizers will continue to wield considerable influence over asset prices and markets, with a particular bias toward stable to rising equity prices. As such, risk will continue to be mispriced and volatility and instability will remain at historically elevated levels. In a recent Market Comment, market analyst John Hussman warned investors that on a quantitative basis, the stock market is now more over-valued than housing was in 2006. Eerily echoing President Harding in 1921, in his opinion, *"there is no painless monetary fix that will shift the allocation of capital toward productive investment and away from distortive speculation."* As we have discussed previously, to varying degrees, almost all investment markets are being and will continue to be, manipulated. The brouhaha emanating from the latest revelation of market rigging by high frequency trading is just the latest in a long line of disclosures over rampant market corruption. Absent the **"return to normal"** predicted by the consensus, return expectations will necessarily be lower than history would suggest. Likewise, interest rates will remain lower, longer than expected. Therefore, with respect to core portfolio holdings, that portion of an investors wealth that they deem irreplaceable, we advocate pursuit of the twin goals of **wealth preservation** and **building par value**. In our opinion, high quality bonds remain uniquely suited to achieve these ends. Writing in a recent investment letter, American billionaire Seth Klarman, founder of the Boston-based private investment partnership, the Baupost Group, wrote; *"If you have the worry gene, if you're more focused on downside than upside, if you're more interested in return of capital than return on capital, if you have any sense of market history, the there's more than enough to be concerned about."* Consensus assures us that every downturn *eventually* comes to an end. But their mentor Keynes has equally assured us, *in the long run, we are all dead*. Sadly, the state causes the poverty it later claims to solve. To answer the rider, *The days have gone down* precisely because the solution remains the problem. We, like Mrs. Crabtree, shall have the consequences.