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Bull and Bear Markets in International Tensions

INTRODUCTION

When reflecting upon the last 30 or so years, strategists will likely focus on the 1980–1982 period, which marked a milestone in asset markets with the end of accelerating consumer price inflation, a peak both in commodity prices (January 1980) and in interest rates (September 1981), a major low in US equity prices (August 1982), and the beginning of a disinflationary trend which, according to the "deflationists", may continue. Only seldom are these economic and financial trends brought into the context of political events, such as the end of the Vietnam War (1973), China's introduction of the Open Door Policy (1978), the end of the socialist and communist ideology, culminating in the breakdown of the former Soviet Union in 1989, and the end of India's policies of self-reliance and hostility towards foreign investments in the early 1990s. The consensus holds that the West "won" the Cold War because of President Reagan's military build-up in the early 1980s, which intimidated the Soviet Union and led to its demise. However, one could also argue that, under normal conditions, the military build-up of one super-power would lead to a similar increase in military spending by a rival super-power and that, therefore, factors other than President Reagan's Star Wars initiative may have been at work, leading to the demise of the Soviet Union and bringing about a period of diminishing international tensions and the much talked about "peace dividend".

BEAR MARKETS IN INTERNATIONAL TENSIONS

One reason the Russian economy is doing so well today may be because of the increase in commodity prices — notably the quintupling of oil prices since 1998. Rising oil prices have led to trade and current account surpluses, and a soaring stock market (from its 1998 low at less than 50, the stock market index is now at over 1,400 — see Figure 1), and have boosted Vladimir Putin's international prestige and power. Consequently, if rising commodity prices have had a miraculous impact on the Russian economy over the last few years, we can safely assume that declining commodity prices and the collapse in oil prices in 1985/1986 must have dealt a serious economic blow to the former Soviet Union. Hence, I could argue that the catalyst for the demise of the Soviet Union wasn't the US military build-up in the 1980s, but the decline in commodity prices, which crippled its economy.

Nikolai Kondratieff observed empirically that in the course of the long wave cycles (which last for between 45 and 60 years from peak to peak), the downward waves (1810–1817 to 1844–1851, 1870–1875 to 1890–1896, 1914–1920 to 1940–1945) are "accompanied by a long depression in agriculture" (Nikolai Kondratieff, *The Long Wave Cycle*, Richardson & Snyder, 1984). Kondratieff showed that during the downward waves, the prices of industrial goods also slumped, but that the decline in agricultural prices far exceeded the decline in industrial goods prices and, therefore, "the purchasing power of those commodities decreased". Now, I'm not sure why Kondratieff didn't also make reference to the price movement of industrial commodity prices compared to finished goods prices during the downward waves (I suppose that since, during the 19th century, agriculture was by far the most important economic sector in every country, he simply focused his

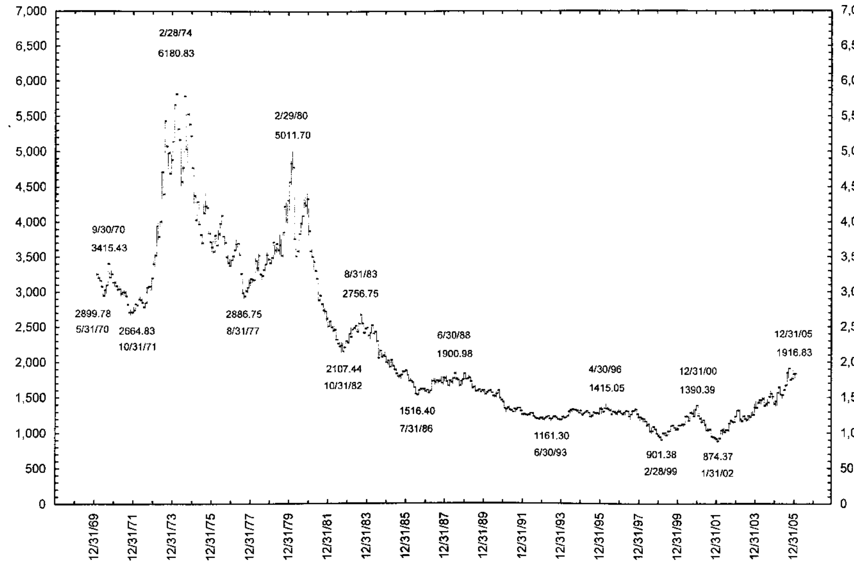
Figure 1 **Russia Stock Exchange Index (RTSI) in USD, 1997–2006**

Source: Bloomberg

study on agricultural prices), but if we look at the 1980–2000 period it is obvious that there wasn't only a *relative* depression in agriculture, but a devastating collapse in commodity prices in real terms (inflation adjusted — see also Figure 2).

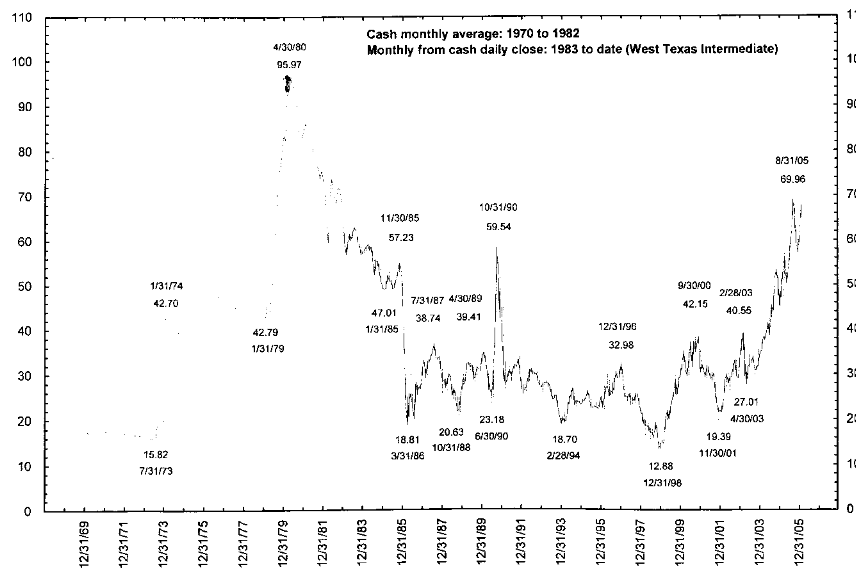
Thus, I can argue that with the onset of the decline in commodity prices in 1980 (note from Figure 2 that, in real terms, commodities had already peaked out in 1974), economic and political power shifted from countries that were natural resource producers (the Soviet Union, OPEC, and Latin America) to the industrial world (the US, Western Europe, and Japan), which were already large importers of commodities (especially oil) and hence benefited from their price declines (see Figure 3). (Note the total collapse of oil prices between November 1985 and March 1986 and the ultimate low in real terms in 1998.) Another beneficiary was the corporate sector, as input prices and interest rates, which follow commodity price cycles over longer periods of time, both declined and allowed profit margins to expand (see Figure 4). I am purposely not mentioning China here as a beneficiary of declining commodity prices, since its economy was then still so small that it was largely commodities self-sufficient. (It became a net importer of oil in 1994.)

Figure 2 **S&P Commodity Index (adjusted for inflation using the Consumer Price Index – all items), 1969–2005**



Source: www.thechartstore.com

Figure 3 **Crude Oil ($ per barrel – adjusted for inflation by the CPI – all items), 1969–2005**



Source: www.thechartstore.com

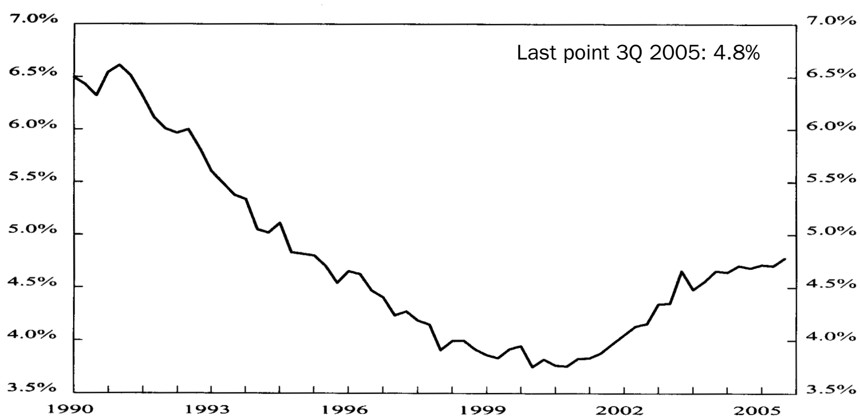
Therefore, we can conclude that following 1980, the decline in commodity prices had several important consequences. It led to the demise of the Western world's arch-rival, the Soviet Union, and in conjunction with the decline in interest rates it boosted asset markets in the industrialised countries (including Japan, South Korea, and Taiwan, which were in the midst of their industrialisation). Falling oil prices, rising asset values, and a disinflationary environment lifted consumption in the US and brought about strong economic growth. Rising asset values also lifted economic growth rates, because they contributed to the secular decline in the US saving rate beginning in the early 1980s. At the same time, the end of the Cold War and rising US GDP in the 1990s allowed defence spending as a percentage of GDP to decline, which, according to Gary Shilling, further reinforced the disinflationary trend that began after 1980 (see Figure 5). Declining oil prices after 1985 had two further consequences. Capital spending by oil companies declined and freed capital for other economic purposes. Moreover, again according to Gary Shilling, declining energy prices led to declining fuel oil expenditures as a percentage of US personal consumption and boosted, as indicated above, consumer spending on goods and services (see Figure 6).

Declining oil prices in the 1980s and 1990s had another important consequence for the US economy.

Figure 4 **30-year US Treasury Bond Yield, 1940–2005**

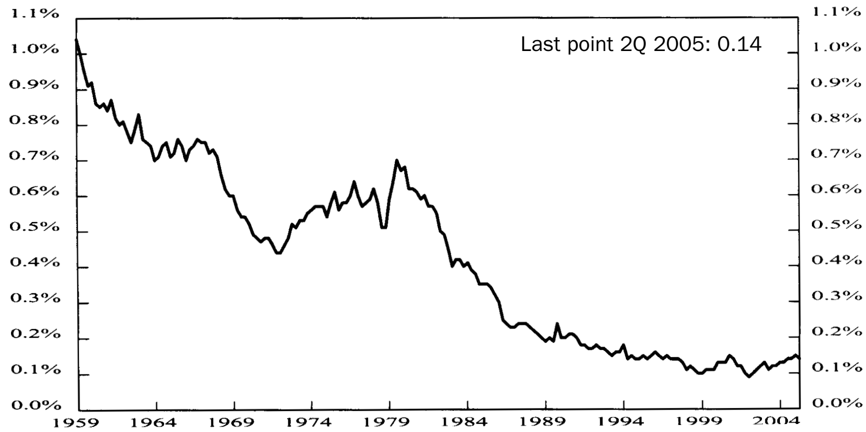
Source: www.sharelynx.com

Figure 5 **Defence Spending as a % of GDP, 1990–2005**



Sources: Bureau of Economic Analysis; www.agaryshilling.com

Figure 6 **Fuel Oil Expenditures as a % of US Personal Consumption, 1959–2005**



Sources: Bureau of Economic Analysis; Energy Information Administration; www.agaryshilling.com

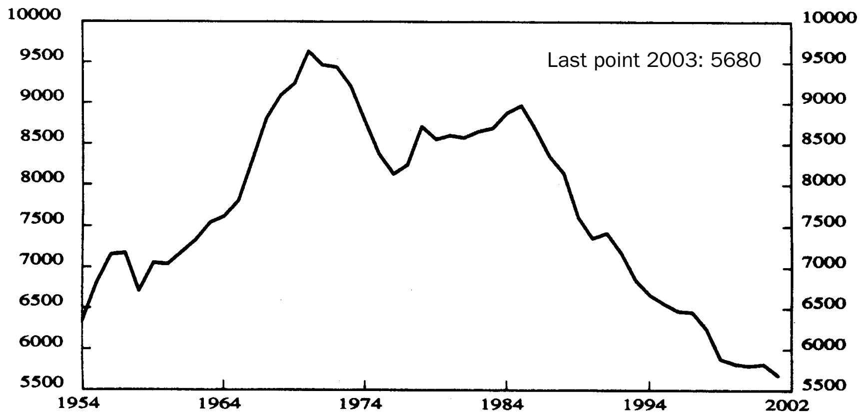
Faced with a global oil glut, US policy makers either didn't pay attention or were simply not concerned that America's oil production had begun to decline after 1971 (see Figure 7) and that the US was becoming increasingly dependent on oil imports (see Figure 8). As an aside, Figure 8 shows how the US economy is today much more vulnerable to oil supply shocks because oil imports as a percentage of total supplied oil have risen from 20% in 1969 to over 60% at present. It's no wonder the US isn't going to leave Iraq any time soon!

In sum, I note that in the 1980s and 1990s, the decline in commodity prices — and especially in oil prices — diffused international tensions significantly by shifting economic and political power to the industrialised countries, and by bankrupting the Soviet Union. (Note also that the Russian crisis of 1998 occurred following the sharp drop in oil prices between the end of 1996 and 1998 — see Figure 3.) At the same time, the increase in asset values and the peace dividend lifted US standards of living despite poor households' real income growth rates. **In fact, one could argue that the economic and military superiority of the Western alliance, including Japan, under the then uncontested US hegemony reached its peak relative to the rest of the world in the early 1990s.** The Soviet Union was in disarray, China wasn't yet a factor in the global economy, and the commodity-producing nations of Latin America, Africa, Central Asia, and the Middle East were essentially either bankrupt or close to bankruptcy.

BULL MARKETS IN INTERNATIONAL TENSIONS

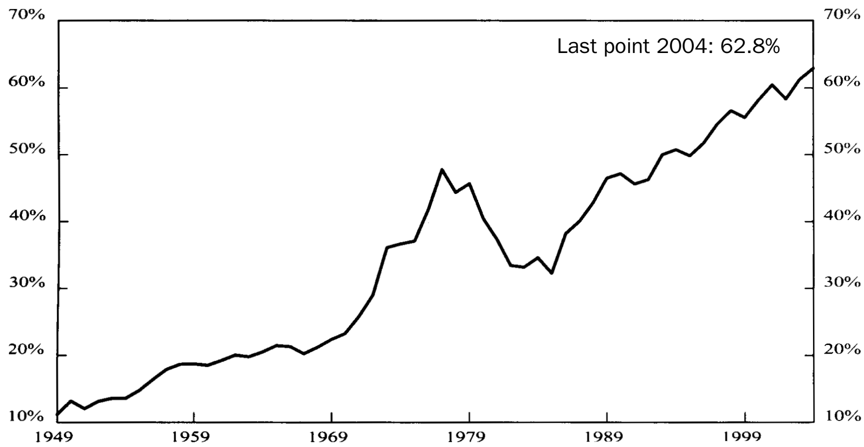
Nikolai Kondratieff established empirically that within the long wave cycle, the periods of the rising wave are characterised by a rise in commodity prices and "are considerably richer in big social upheavals and radical changes in the life of society (revolutions, wars) than are the periods of downward waves".

Figure 7 **US Oil Production (in millions of barrels), 1954–2003**



Sources: Energy Information Administration; www.agaryshilling.com

Figure 8 **Oil Imports as a % of Total Supplied Oil in US, 1949–2004**



Sources: Energy Information Administration; www.agaryshilling.com

But why?! Kondratieff refutes the notion that wars are the cause of rising commodity prices and improved economic conditions (the rising wave of the long cycle). According to him,

> …a much more likely assumption is that wars themselves occur because of an increase in the tempo and tensions of economic life, **and intensification of the economic struggle for markets and raw materials**. And such tension in economic life is especially typical of periods marked by an upswing in business conditions. Likewise more probable is the assumption that **social upheavals are most easily touched off under the strong impact of new economic forces.** Thus both wars and social upheavals are a part of the rhythmic process of the development of the long cycles; and they turn out to be not the forces making for its development but forms of its manifestation. Once they come into being, however, they of course exert, in their turn, a potent and sometimes disruptive influence on the pace and direction of the economic dynamics…. The upward movement in business conditions, and the growth of productive forces, cause a sharpening of the struggle for new markets — **in particular, raw materials markets. On the one hand, this makes for an expansion of the orbit of the world market and the involvement of new countries and regions in the trade network.** On the other hand, it makes for an aggravation of international political relations, an increase in the occasions for military conflicts, and military conflicts themselves. At the same time, the rapid growth of new productive forces, intensifying the activity of the classes and groups within that have an interest in that growth, creates the prerequisite for sharpening the struggle against socioeconomic relations that are obsolescent and hinder development. **It creates the prerequisite for big internal upheavals.** [Emphases added in above paragraph — *ed. note*.] (Nikolai Kondratieff, ibid)

In Chapter XIII of his empirical study on the long wave cycles, Kondratieff shows that major conflicts such as the Napoleonic Wars (1793–1814), the Crimean War (1853–1856), the American Civil War (1861–1865), the Franco-Prussian War (1870–1871), the Sino-Japanese War (1895), the Spanish-American War (1898), the Russo-Japanese War (1905), the First World War (1914–1918), and the February Revolution in Russia (1917) all occurred during the rising wave of the long cycle. I might add that the Second World War and the Vietnam War also occurred in periods of the rising Kondratieff wave.

From the above it is clear that the rising wave, which is accompanied by rising commodity prices, brings about three conditions which intensify tensions: (1) Rising commodity prices intensify the struggle for raw materials. (2) The upward movement in business conditions, the growth of productive forces, and the rise in commodity prices expand the orbit of the world market and lead to the involvement of new countries and regions in the trade network. (3) During the rising wave, rapid growth coming from the application of new technologies and the entry of countries into the global economy intensifies social tensions as the classes and groups of society that have an interest in growth and economic development increasingly "struggle against socioeconomic relations that are obsolescent and hinder development".

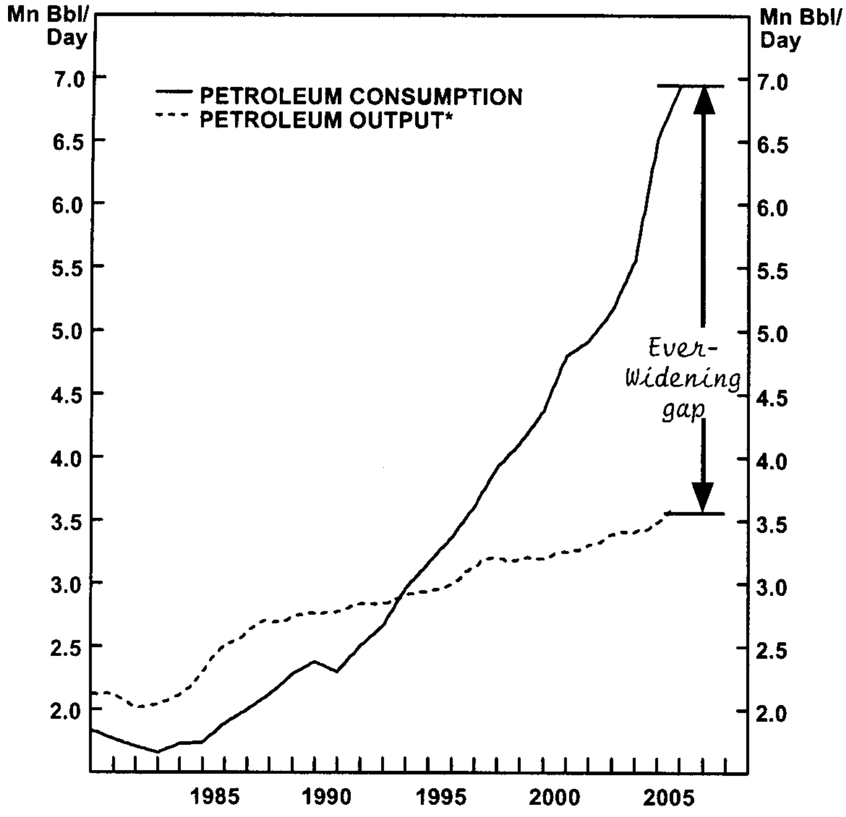
Why do rising commodity prices intensify international tensions?

One of my first experiences of shortages leading to belligerent behaviour was during my childhood. When the Suez Crisis broke out in 1956, everyone in Switzerland, including my mother, stocked up on food and other necessities from grocery shops, fearing that a closure of the Suez Canal would lead to serious shortages. I witnessed housewives fighting like hyenas over whatever they could find on the shelves of stores. Another childhood experience relates to boarding the train that carries skiers from Wengen to the Kleine Scheidegg during the Christmas holidays. (Some trains then go on to the famous Jungfrau Joch through the Eiger — well-known among accomplished climbers for its North Face.) Since between Christmas and New Year the demand by skiers for seats on the Wengen–Kleine Scheidegg train vastly exceeded the available number of seats, as soon as the train pulled into the station the skiers would engage in real fights, using their fists and ski-poles, in an attempt to board the train first and secure a seat.

Simply put, when markets are glutted and over-supplied, no one is going to fight in order to satisfy his demand. Conversely, when markets are characterised by acute shortages, people will fight and go to war in order to secure their required supplies, particularly when the shortages that might arise or that have already arisen threaten the physical and economic survival of the groups or countries involved. This pattern can be observed throughout history. In primitive societies, if there was a shortage of women the members of one tribe would attack another tribe and kill the men, in order to secure the women. And even in more advanced societies (for example, the Easter Islands), shortages of resources — in particular, food — led to cannibalism. (Incidentally, Easter Island — a worthwhile place to visit — is a good example of the fact that natural resources can run out. A more recent example is the island of Nauru.)

Rising commodity prices are a manifestation of shortages. So, when commodity prices rise and shortages threaten to undermine economic development and growth, countries that require a steady or increasing supply of resources from foreign sources do tend to become more belligerent. An interruption of supplies could cause enormous damage to such a nation's economy, society, and military prowess. But it's not only the commodity-importing nations that become more belligerent when shortages drive prices higher. The commodity producers themselves find they are in a sweet spot and become more aggressive in their relationship with their clients — the resource-importing nations. So, whereas we have seen that in the 1980s the balance of power in the world began to shift towards the industrialised nations as commodity prices fell, today it would appear that the balance of power has already shifted back to the resource producers — especially the oil producers. This shift of power to the resource producers is particularly pronounced when new countries and regions become involved in the "trade network", as Kondratieff observed, because the demand from the traditional sources is, as a result of the entry of new countries into the global economy, gradually displaced by the incremental demand of non-traditional and new sources. In this respect, I should mention that 1994 marked a milestone in economic history and geopolitical trends in as far as China became, for the first time in modern times, a net importer of crude oil (see Figure 9).

Figure 9 **China's Oil Consumption and Oil Production, 1980–2005**



Source: The Bank Credit Analyst *Shown as a 12-month moving average

In a situation characterised by shortages and rising commodity prices, the producers of resources tend to play out the established buyers of their resources against their new clients (China, India), who, in order to satisfy their growing domestic demand, bid very aggressively for those resources that are in short supply.

But there is another reason for the shift of power towards the resource producers when shortages emerge. Money! Suddenly, the governments' coffers of the resource producers swell because prior trade deficits caused by falling commodity prices are, in an environment of rising prices, replaced by robust trade and current surpluses, which allow the resource producers to become geopolitically more active and to build their military capabilities (for example, Hugo Chavez, Amadi-Nejad, and Vladimir Putin). In this regard, it is interesting to note that for the first time in recent history, even Latin America has a trade and current account surplus with the United States (see Figure 10)! Remarkably, the US now has a trade deficit with every region of the world.

Why do rising long-term waves expand the orbit of the world market and lead to the involvement of new countries and regions in the trade network?

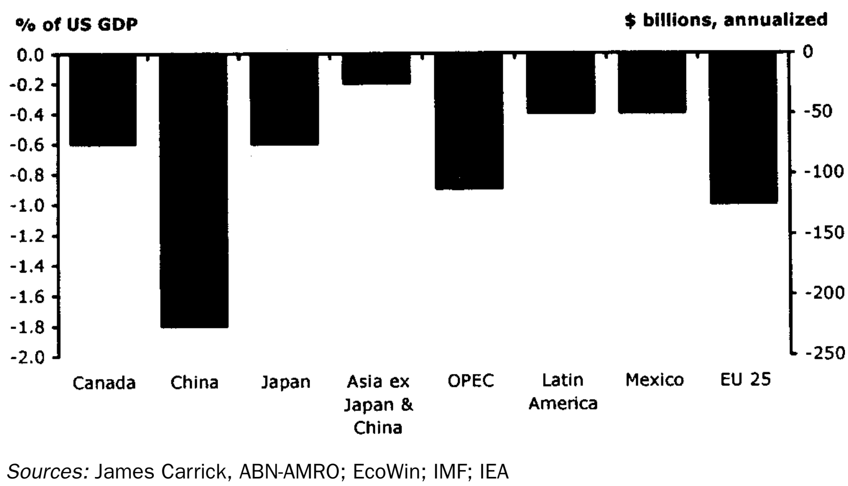
Kondratieff showed that during a downward wave,

> ...the depressed state of economic life stimulates the search for ways of cutting production cost — the search for new technical inventions that will facilitate such cost cutting. And we have already seen that it is precisely during that period — that is, during the long downward wave in economic conditions — that technological discoveries and inventions are especially numerous.

When the new inventions and innovations that occurred during the downward wave are then applied in industries, they lead, according to Joseph Schumpeter, to the upswing and the upward wave of the long cycle. Now, if we look at the displacement (innovation, invention), which led to the rising wave of long cycles, it is interesting to note that most of the inventions related to an improvement in transportation. In the First Kondratieff upswing (1780s to 1814), the innovation was the construction of roads, canals, and bridges. In the Second Kondratieff upswing (1840s to early 1870s), the railroadisation of America was the driving force of the expansion. (The Suez Canal was completed in 1869.) In the Third Kondratieff upswing (early 1890s to 1921), electricity, automobiles, and communication drove the improved business conditions. (The Panama Canal was completed in 1914.) In the Fourth Kondratieff upswing (1940s to late 1970s), electronics and aerospace were key drivers of the expansion. Finally, in the Fifth Kondratieff upswing (2001 to mid-2020s), telecommunications, the Internet, and IT services are driving the expansion. Therefore, we can say that the first two Kondratieff upswings were largely driven by improvements in the physical infrastructure of transportation. (Canals and railroads reduced the cost of transportation enormously.) In the Third Kondratieff upswing, physical transportation was improved through the automobile. Also, for the first time, electricity allowed power to be transported inexpensively, while the telegraph, telephone, and radio brought about instant communication. In the Fourth Kondratieff upswing, transportation speed was vastly improved by the aerospace industry and by the introduction of the container. Lastly, the inventions of the late 1980s and 1990s (a Kondratieff downward wave) in the field of communication (Internet) and high-technology industries are, if not drivers, at least important facilitators of the global expansion, as they greatly improve the capacity for outsourcing of production and knowledge-based industries.

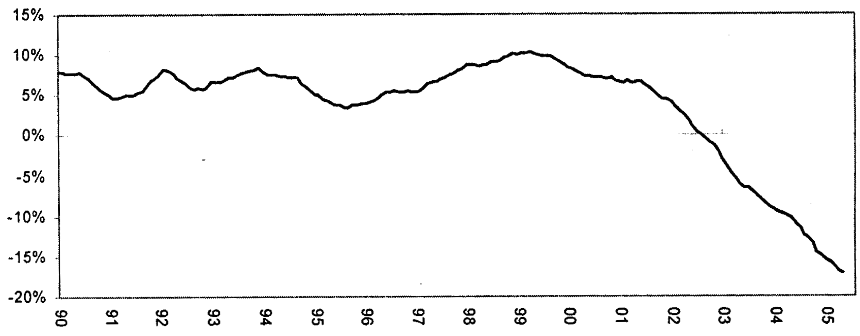
In all the cases of innovations and inventions for the transportation of goods, people, news, knowledge, and data, communities, societies, and regions were brought closer together. Therefore, the application of inventions and innovations in transportation does bring about "an expansion of the orbit of the world market and the involvement of new countries and regions in the trade network", as Kondratieff stipulated. It should be obvious that the application of the Internet and huge advances in the shipment of physical goods (ship and air cargo) allowed a much faster integration of the previous communist or socialist countries into the global economy than would have been possible without these innovations. Moreover, it should also be clear that when new

Figure 10 **US Trade in Goods Balance by Country (2005)**



Sources: James Carrick, ABN-AMRO; EcoWin; IMF; IEA countries become involved in the "trade network", they compete with the established socioeconomic order and frequently displace established industries or countries, which were the previous economic powerhouses. (In the 19th century, the US began to displace Britain as the economic hegemon, and in recent times Asia has began to displace Western economic hegemony.) It should therefore be evident that international tensions arise when new competitors begin to erode the old economic powerhouses' share of world markets and threaten the employment of their labour force. (See Figure 11, which shows the decline of the United States' percentage share of the world's exports.)

Figure 11 **United States' Competitiveness, 1990–2005**



Source: Bridgewater Associates

Why do rising Kondratieff waves intensify social tensions and create the prerequisite for big internal upheavals?

According to Nikolai Kondratieff, during the upswing, "the rapid growth of new productive forces, intensifying the activity of the classes and groups within that have an interest in that growth, creates the prerequisite for sharpening the struggle against socioeconomic relations that are obsolescent and hinder development. It creates the prerequisite for big internal upheavals." The historical evidence seems to support Kondratieff's empirical findings. Most major revolutions took place in the rising wave of the long wave cycle, including (according to Kondratieff) the following: the Declaration of Independence of the United States and the establishment of their Constitution (1783–1789); the French Revolution (1789–1804); the February Revolution in France (1848); revolutionary movements in Italy, Germany, Austria, and Hungary (1848–1849); the Bonapartist coup d'état in France (1851); the national unification movements in Italy (1859–1879) and Germany (1862–1870); the Civil War in the United States (1861–1865); the Herzegovina uprising (1861); the Revolution in Paris (1870–1871); the founding of the German Empire (1870–1871); the Russian Revolution of 1905; the Turkish Revolution of 1908; the Chinese Revolution (beginning in 1911); the February Revolution in Russia (1917); the October Revolution in Russia and the Civil War (1917–1921); the revolution in Germany (1918–1919); and the revolution in Austro-Hungary (1818–1919). I might add that the civil war and seizure of power by the communists in China in the 1940s also occurred right at the beginning of the upswing of the Fourth Kondratieff upswing (1940s–1970s), while the civil war in Vietnam and the revolution by the Red Guards in Iran took place at the end of that upswing.

As indicated, Kondratieff explained the occurrence of so many internal upheavals during the rising wave of the long wave cycle by suggesting that the rapid growth of productive forces led to strife between the groups that have an interest in growth against socioeconomic relations that are obsolete and hinder economic and social development. This observation rang a bell recently while I was on a visit to India. Since the introduction of private budget airlines in India by numerous entrepreneurs, airline traffic has been increasing at a torrid pace. For the full year of 2003, airlines carried a total of just 12 million passengers (compared to 3 million air passengers daily in the US). But since the introduction of budget airlines, the number of air travellers in India has already almost doubled and will increase in the next couple of years to around 50 million passengers. The problem, however, is that airports haven't yet been privatised and are at the mercy of India's archaic bureaucracy, which hasn't found it necessary to upgrade them to meet the increased demand. So, whereas the private sector is rapidly expanding the capacity for air travel by ordering new planes in order to meet the new demand arising from lower fares, the bottlenecks occur at the airports, whose infrastructure has hardly improved, and which involve nightmarish boarding of and de-boarding from planes as well as lengthy transfers to and from airports to downtown centres. So, here we have an example of a group of entrepreneurs who have started budget airlines in India and are keen to see it grow, but who are running up against a socioeconomic system that is obsolete and hinders economic growth.

Likewise, political reforms in China and some Middle Eastern countries have badly lagged behind economic progress and development. Under these circumstances, tensions are likely to increase and lead to social strife in the future. (Terrorism is, at least in part, a symptom of this.) Peculiar to the current environment is the growing social unrest in resource-rich countries. Seeing soaring commodity prices and an enormous profit windfall for mining and oil companies, and the governments that benefit from the rise in prices, opposition groups and voters are becoming increasingly vocal in their demand for a more equitable share in these countries' resource wealth. Recent election results and developments in Venezuela, Bolivia, and Mongolia, rebel attacks against Nigeria's oil facilities, and a civil war in Iraq seem to validate this point.

FURTHER CAUSES FOR INTENSIFYING INTERNATIONAL TENSIONS

The historian A. F. K. Organski developed a theory of "power transition", which regards economic issues as the most important factor in building power, which then leads to wars (A. F. K. Organski and Jack Kugler, *The War Ledger*, Chicago, 1980). According to Organski, "shifts in the international distribution of power … create the conditions likely to lead to at least the most important wars, an power is the most important determinant of whether a war will be won or lost. And power, again, is the resource that leaders hope to preserve or to increase by resorting to armed conflict."

According to Organski, it is more common in history to have one country dominate the international system than to have peace and stability based on roughly equal nations, which prevents the predominance of one nation as the "balance of power" theory assumes. Therefore, when a dominant nation is being challenged by another power, it is the differences in national economic growth rates that will affect the rise and fall of different countries' "relative capabilities" in the international hierarchy and lead to major military confrontation. According to Organski,

> …the manner and the speed of national growth and development change the pools of resources available to nations…. If one nation gains significantly in power [Organski uses GDP as an index of national power or capabilities — *ed. note*], its improved position relative to that of other nations frightens them and induces them to try to reverse this gain by war. Or, vice versa, a nation gaining on an adversary will try to make its advantage permanent by reducing its opponent by force of arms. Either way, changes in power are considered causae belli.

These changes in relative power, which (as mentioned) are measured by Organski by changes in GDP, lead to "challengers" who "are seeking to establish a new place for themselves in international society".

In *World Politics* (New York, 1968), Organski summarised the major mechanics of the power-transition model:

> At the very apex of the pyramid is the most powerful nation in the world, currently the United States, previously England, perhaps tomorrow Russia or China…. Just below the apex of the pyramid are the great powers. The difference between them and the dominant nation is to be found not only in their different abilities to influence the behavior of others, but also in the differential benefits they receive from the international order to which they belong. [In the case of the US, a global dollar standard — *ed. note*.] Great powers are, as their name indicates, very powerful nations, but they are less powerful than the dominant nation…. As we have seen … the powerful and dissatisfied nations are usually those that have grown to full power after the existing international order was fully established and the benefits already allocated [India, China — *ed. note*]. These parvenus had no share in the creation of the international order, and the dominant nation and its supporters are not usually willing to grant the newcomers more than a small part of the advantages they receive…. The challengers, for their part, are seeking to establish a new place for themselves in international society, a place to which they feel their increasing power entitles them. Often these nations have grown rapidly in power and expect to continue to grow. They have reason to believe that they can rival or surpass in power the dominant nation, and they are unwilling to accept a subordinate position in international affairs when dominance would give them much greater benefits and privileges.

In *The War Ledger*, Organski further notes that the "capacity to disturb the equilibrium of the system is largely dependent on the base from which the country begins". Full economic development of small countries will "pass unnoticed", while when large "challengers" begin to modernise in earnest,

> …the effects of such events will inevitably shake up the international power distribution…. The power-transition model postulates that the speed with which modernization occurs in big countries is also quite important in disturbing the equilibrium that existed theretofore. For if development is slow, the problem arising from one nation's catching up with the dominant one may have a greater chance of being resolved. On the other hand, if growth takes place rapidly, both parties will be unprepared for the resulting shift. The challenger may not have had the opportunity to develop a realistic evaluation of its position because its elites will be strangers to power, and the sources of new-found strength are almost entirely the result of internal changes. It seems plausible to think that the chances for miscalculation consequently increase.

In the context of today's world, the relations between the super-power (the US) and its allies (largely the EU, Japan, and Australia) and the challenger — China, with its extremely rapid GDP growth — and, in the context of the Middle East, between Israel as the super-power because of its well-trained army and nuclear weapon capabilities and Iran as a challenger — are extremely complex.

In the case of Iran, as a challenger of Israel and possibly of the Sunni-dominated Arab countries of the Middle East, it isn't faster economic growth rates that have led to the present tensions. However, Organski concedes that the challenger may emerge not only because of faster economic growth rates leading to more desire for power, but also because of "political capacity", which depends on "the level of penetration of government power into the national society, the capacity of the government to extract resources from its national society" [i.e. the motivation and training of terrorists — *ed. note*], and finally, the performance of the government in delivering such resources to the intended ends (i.e. the acquisition of nuclear weapons). In the case of China, it is not likely that it has ambitions to displace the US as the global hegemon, but it certainly would like to establish itself as the dominant power in the Asian region.

Organski has some comforting observations for the US and its allies about the outcome of a war between the "challenger" and the "dominant nation".

> …[A]lliances exert a decisive role in winning such wars once they are started. Even after the challenger has overtaken the leading nation in power, the challenger's coalition remains decidedly weaker than the alliance commanded by the dominant nation. It is precisely this situation that may, indeed, furnish the determining motivation pushing the challenger to resort to war in the first place. It is the stronger country, and it wants immediately what it believes is its due by right of strength, refusing to take time to seduce supporters away from the old leader. This is a strategic error. The outcome of the fight is settled by the greater strength of the coalition supporting the established leader, and the challenger and its friends will suffer defeat on the field of battle.

While I strongly believe in Organski's theory that shifting economic power increases the likelihood of war, because the challengers have reason to believe that they can rival in power the dominant nation and are unwilling to accept a subordinate position in international affairs, it should be noted that China's elites are certainly no "strangers to power" and that the sources of the new-found strength are by no means "entirely the result of internal changes". Moreover, China doesn't want immediately what it believes is its due by right of strength, refusing to take time to seduce supporters away from the old leader (the US). On the contrary, China's leadership has been very smart and patient in building its alliances around the world by virtue of its foreign policy of not interfering in other countries' internal affairs (unlike the US), its ability to assist other countries in the construction of infrastructure projects for the joint exploitation of their resource wealth, and naturally also because of its enormous appetite for natural resources. China has established close relationships with most Latin American governments (Evo Morales, the newly elected indigenous president of Bolivia, has just visited Beijing) and has in recent times increasingly courted African countries. Since 2002, it is estimated that China's trade with Africa has nearly tripled and could exceed $30 billion in 2006. (China imports 28% of its oil and gas from sub-Saharan Africa.) And while US trade with 47 sub-Saharan countries exceeded $50 billion in 2005, at the current growth rate China's trade with Africa could exceed that of the US within three to five years. (In January of this year, China's foreign minister, Li Zhaoxing, led a delegation on a visit to Nigeria, Libya, Cap Verde, Senegal, Mali, and Liberia, underscoring Beijing's accelerating diplomatic and economic presence in Africa.)

In response to the strategic alliance between Japan and the US, China has also carried out joint military exercises with Russia and has significantly improved its relationship with India. (In late February, India's General Arvind Sharma visited China at the invitation of the People's Liberation Army (PLA) in order to find ways to improve relations and cooperative exchanges between the two militaries at different levels. India and China recently also announced that they would team up to bid jointly for selected energy assets abroad.)

In Central Asia, China is actively trying to gain influence through its membership in the Shanghai Cooperation Organization, whose members include China, Russia, Kazakhstan, Kyrgyzstan, Tajikistan (the latter three have a several thousand miles-long common border with China), and Uzbekistan. (China applauded Islam Karimov's bloody crackdown at Andijan, and Russia carried out joint military exercises with Uzbekistan.)

At the same time, China is trying to seal a multibillion-dollar oil and gas deal with Teheran in the coming weeks, which is likely to undermine the US's efforts to isolate Iran. According to Iranian oil ministry officials familiar with the negotiations, both countries are eager to conclude a deal, for which a memorandum of understanding was signed in October 2004 involving the development of Iran's Yadavaran oil field in a transaction worth $100 billion, before potential sanctions are imposed on Iran for its nuclear ambitions. According to Iranian officials, both Iran and China will "follow the agreements and contracts and keep in touch through bilateral-exchange delegations in order to fulfill the agreements on energy section". The Yadavaran oil field is expected to produce about 300,000 barrels of oil per day and would also be partly owned by India's state-owned Oil & Natural Gas Corp with a 20% stake in the project. (Royal Dutch Shell PLC, which is likely to act as a technical adviser, is also interested in participating in the future development of Yadavaran.) And while China, India, and Russia have agreed to refer Iran to the UN Security Council because of its nuclear activities, it is likely that neither of these countries would approve imposing a trade embargo or any other effective economic or political sanctions on Iran, as China and India are interested in Iran's oil and gas supplies while Russia is a major weapons supplier. (Iran has agreed to spend $1 billion on 30 Russian Tor M1 air defence missile systems, capable of protecting a target from up to 48 incoming planes or projectiles to a range of six kilometres.)

Since Iran's President Mahmoud Ahmadi-Nejad is unlikely to back down on his ambitions to acquire the technology to produce nuclear weapons, bombing of Iranian nuclear facilities by either the US or Israel has become increasingly the only option in the eyes of Western powers. (According to Iran's foreign minister, Teheran's resumption of nuclear research was "irreversible".) What China's and Russia's reaction to such bombing would be is hard to forecast. It is, however, unlikely that China would risk any military confrontation at this time in order to protect its economic interests (Iranian oil supplies). More likely would be a desperate act by Iran, which might be tempted to retaliate by disrupting oil shipments through the Persian Gulf. Still, confrontation between the dominant nation (the US) and the challenger (China) would have come a step closer and may result in a significant increase in international tension. In this respect, it is important to understand that Asia is far more dependent on oil supplies from the Middle East than is the US, which imports 60% of its oil requirements but only sources 20% of those from the Gulf region. By comparison, Japan, South Korea, and Taiwan import all their oil, of which 75% is sourced from the Gulf. China imports only 35% of its oil, but 60% of that comes from the Gulf; while India imports 75% of its oil, of which 80% comes from the Gulf. A strike on Iran's nuclear facilities by the Western alliance could, therefore, have far more negative repercussions for Asia than for the US and its European allies. Should, as a result of such bombing, China's interests be threatened, some kind of retaliation would have to be expected. As indicated above, I doubt that it would lead to a military confrontation, but the Chinese might significantly boost the delivery of sophisticated weapons (through their unofficial weapons dealer — North Korea) to terrorist organisations and groups whose interests run contrary to those of the US.

Another point to consider when discussing the potential for an aerial strike on Iran's nuclear facilities is what would follow once the situation normalises again. It is unlikely that the bombing of Iran's nuclear facilities would lead to the demise of the hard-line Mullahs and of President Ahmadi Nejad — unless the country was invaded, which is most unlikely given the military experience in Iraq. If, as a result of such a conflict, the oil flows to China were interrupted, bringing about some meaningful economic disruptions in its economy and in the rest of Asia (including India), it is likely that China might conclude a strategic defence agreement with Iran and assist with the reconstruction of Iranian defence capabilities, in order to secure reliable supplies of oil for the future. Such an Iranian–Chinese alliance, which might also include India, would obviously complicate matters a great deal and further increase tension in the region.

What we can observe is that the stakes are very high and that, unless Iran renounces its nuclear weapons ambitions, some sort of a military intervention seems to be almost inevitable. Furthermore, we can now see why, like Kondratieff postulated, rising commodity prices as a result of shortages lead to intensifying international tensions. If there were currently an oil glut in the world, the bombing of Iran's nuclear facilities would likely already have occurred and have no wider geopolitical consequences. But because the oil market is tight and prices are high, any military intervention could have some serious long-term consequences. Also, it should be clear that the hands of the dominant nation (the US) and its allies are not as free as they were ten years ago, when China hadn't yet emerged as a "challenger" who is now "disturbing the equilibrium that existed theretofore", either intentionally, or unintentionally but simply as a result of its increasing demand for scarce resources.

INVESTMENT IMPLICATIONS

Based on the rise in commodity prices since 2001 and the strong global growth over the last two years, it is very probable that the Kondratieff long wave cycle has already turned up. Moreover, Kondratieff listed another precondition for the upswing phase of his long wave cycle theory:

> …that capital be tied up to a relatively slight degree; that "free" capital be abundant, and consequently, cheap…. once there is a sufficient concentration of relatively free and cheap capital — the time will come, sooner or later, when its extensive investment in big projects provoking radical changes in production conditions will become sufficiently profitable.

There is little doubt that in recent years there was "abundant", "free", and "cheap" capital available, which was an important factor in stimulating massive investments in China (as well as other emerging economies), which in turn had a powerful multiplier effect on employment, production and, hence, economic growth. This, in turn, shifted the demand curve for commodities to the right and contributed to the increase in prices.

So, if we assume that the Kondratieff long wave, which was in a downswing phase from the 1970s to around 2000, has now definitely turned up, what are the implications for investment markets? Note that the decline in commodity prices and interest rates from 1980 to 2001 and the recent upturn, as well as strong global growth, seem to confirm the upswing in the long wave. (In fact, one could argue that commodity prices in real terms turned down in 1974 and bottomed out almost 90% lower in 2002, 28 years later — see Figure 2.)

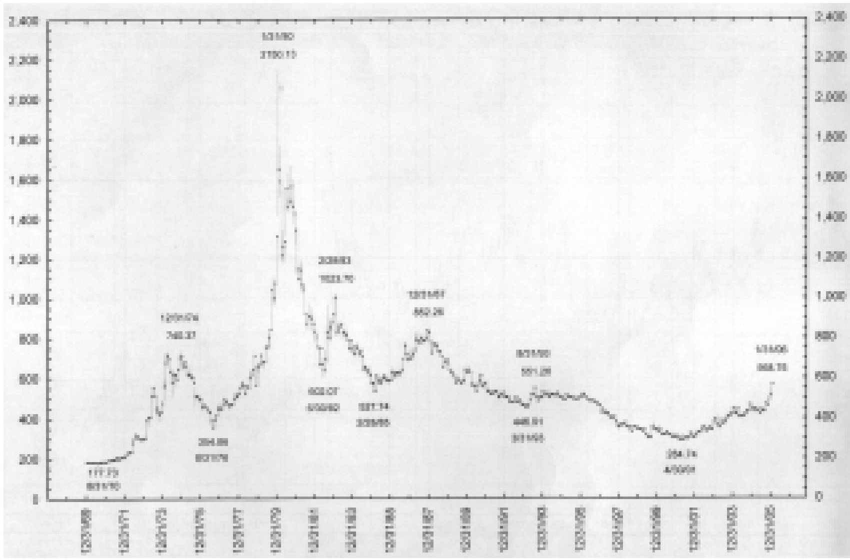
The first implication is that commodity prices will continue to rise for another 15 to 25 years. Remember that the long wave lasts between 45 and 60 years from peak to peak; therefore, both the upward and downward waves last roughly 22–30 years, and we are only in the fifth year of the rising wave. This isn't to say that commodities cannot undergo a vicious correction in the near future, but the long-term trend is very likely to be up. Even the gold bulls shouldn't forget that in the 1970s bull market gold peaked out at \$195.25 on December 30, 1974 and then declined for almost two years into a low at \$103.50 on August 31, 1976 before increasing eight-fold thereafter. (See Figure 12, which shows the gold price adjusted for inflation.)

The second implication is that interest rates will rise, as interest rates have always followed commodity price movements up and down. Again, since we are dealing with very long cycles, the initial rise in rates may be very muted, or may even be delayed, but will likely accelerate in time and lead, towards the end of the upswing, to much higher rates than now seem imaginable. According to Kondratieff, during the rising wave "the investment of capital in big and expensive projects increases the demand for capital…. This engenders a trend toward raising the price of capital and the interest on it. And subsequently that trend will become even stronger. Its cause lies in the development of upheavals: military outside the country, and social within."

The third implication is that while global growth will likely be above the long-term trend, equities are unlikely to perform particularly well in the long term. The best environment for equities occurs in the downward wave, when commodity prices and interest rates decline, as was the case between 1921 and 1929 and between 1982 and 2000. Conversely, the rise in commodity prices and interest rates tends to contain strong stock market advances. Exceptions would include sectors such as resources, sectors that greatly benefit from the application of new inventions and innovations carried out during the downward wave, and sectors that may benefit from a transition economic power (emerging economies — in particular, Asia). It should also be noted that stocks can perform well in the initial stage of the rising wave of the long cycle, as interest rates may not increase much. The Dow Jones Industrial Average more than doubled between 1896 and 1907 and rose almost five-fold between 1949 and 1967. Please note, however, that in both cases, at the onset of the rising wave, stocks were very depressed and were yielding (dividend yield) more than bonds (as was the case at the beginning of and throughout most of the 1921–1929 bull market). Moreover, if we look at the Dow Jones in real terms (adjusted for inflation by the CPI), we note that in 1920 the Dow was no higher than in 1883, and that in 1966 it was only about 50% higher than at its 1929 high — 37 years later (see Figure 13). So, if the performance of equities in real terms wasn't particularly exciting starting from very low valuations, what "great performance" should we expect from today's starting point, which is characterised by relatively high valuations? Most likely, a decline in real terms, as occurred between 1966 and 1982 — down 75% over that period — but hopefully less in future (see Figure 13)!

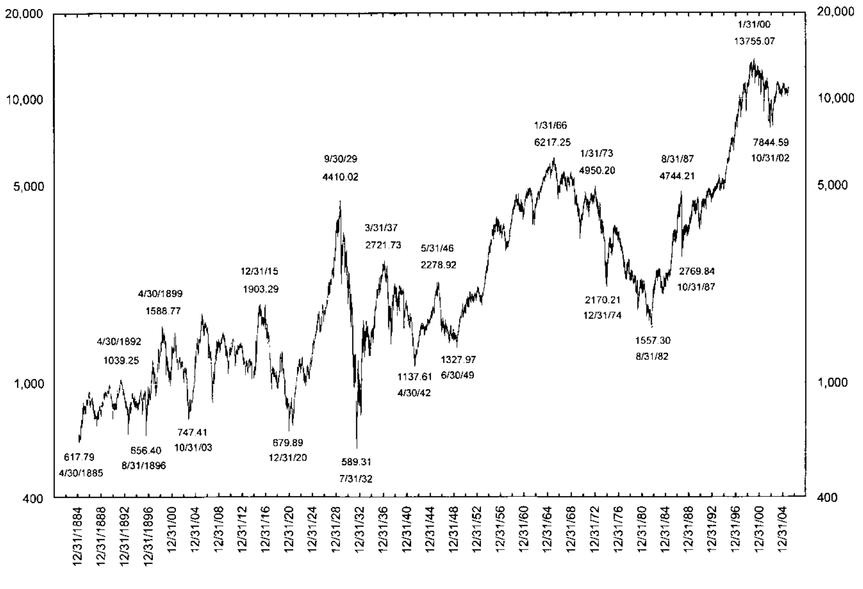
The fourth implication, according to Kondratieff's analysis, is that the current upswing of the long wave cycle will be characterised by the brevity of depressions and the intensity of the upswings. One of the reasons the Kondratieff cycle has been discredited by so many economists is that it is not a business cycle theory but an empirical study of price cycles. I therefore have mixed feelings about Kondratieff's "brevity of recessions" during the rising wave observation. Joseph Schumpeter, who built a business cycle theory around the Kondratieff long wave, breaks the long wave cycle into Juglar cycles lasting from eight to 12 years in

Figure 12 **Gold (adjusted for inflation by the CPI – all items), 1969–2006**



Source: www.thechartstore.com

Figure 13 **Dow Jones Industrial Average (monthly – adjusted for inflation by the CPI – all items), 1885–2004**



Source: www.thechartstore.com

Figure 14 **Mumbai Stock Exchange Sensitive Index in USD, 1994–2006**

Source: Bloomberg

duration. In the Schumpeter model, therefore, serious recessions can also take place during the upswing (as was the case in 1857, 1903, 1907, 1920, and 1974). In fact, some of these crises were accompanied by vicious bear markets. Moreover, according to Schumpeter's theory, there is still one missing element for a sustainable upturn: a liquidation of debts, which precedes the rising wave of Kondratieff's long cycle. (In Asia, a liquidation of debt has, however, taken place following the 1997/1998 crisis, as well as in Latin America and Russia.) In this context, we should be aware that economic growth is very irregular and that different countries, cities, and industries prosper at different times. It is entirely conceivable, therefore, that within the current upswing of the long wave, some regions and industries will do far better than others and in some cases actually displace existing clusters of prosperity and may even make some of them obsolete. The industrialisation of Western Europe and of America in the 19th century didn't lead to prosperity in China. India even suffered from de-industrialisation and from a decline in employment in its industries. Therefore, even if the long wave has turned up around the world, there will be winners and losers — relative and even absolute.

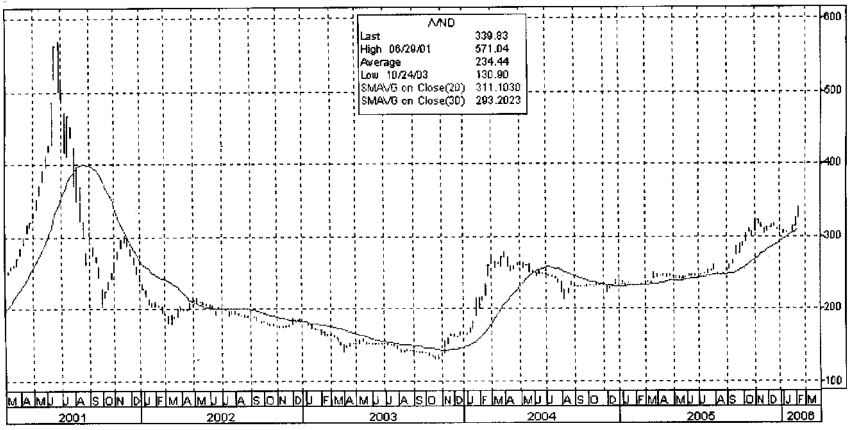
In last month's GBD report, we discussed Russell Napier's analysis of bear markets and noted that, subsequent to a major low, markets usually rally for eight years or more (see GBD report of February 3, 2006). Based on this observation, we made some favourable comments about the long-term potential of Japan, Taiwan, and other Asian markets, which bottomed out at extremely depressed levels between 1998 and 2003. (Please note, however, our near-term caution about both Japan and all asset markets, including especially emerging stock markets.) One stock market about which we have not written recently is India. Since its low in 2003, it has tripled and appears, like so many investment markets, to be near term over-heated. However, if we consider that the Indian stock market at its low in 2003 had been declining since 1994 in US dollars (as a result of the weakness of the Indian Rupee), the recent bull market in stocks in US dollar terms is far more modest than the tripling of prices in Rupee terms would suggest. In fact, in dollar terms, the market is only up by about 40% since 1994 (see Figure 14). So, if we go back to Napier's observation that a bull market lasts around eight years from a major low, the Indian bull market could surprise us on the upside.

Of all the emerging economies I follow, I believe that, aside from Vietnam, India has the greatest potential. The reason is that, with the exception of a few industries such as IT and pharmaceuticals, the country lags far behind other emerging countries in terms of economic development and progress. Now, we cannot be sure whether India will realise this potential, but it certainly does exist. In fact, India today reminds me somewhat of Brazil in the 1980s. At the time, Brazil had managed to disappoint investors for almost two decades. But when its economy began to improve in earnest after 1990, stocks rallied very strongly. (The Brazil Fund rose from $6 in 1991 to $34 in 1994; current price: $60.) This is not to say that a big correction cannot occur in India. In 1987, the Taiwanese stock market was halved during the October crash, but subsequently quadrupled into 1990! Last year, the Pakistan stock market index fell between March and May from 10,300 to 6,400 before soaring to its present high of 11,400. As I indicated above, India aside, I regard Vietnam as having the greatest economic and stock market potential in Asia (see Figure 15).

The fifth implication of the current upswing in the long wave is that international tensions will intensify. According to Kondratieff, the "upheavals, once they take place, increase nonproductive consumption (wars), cause direct destruction, and slow the rate of accumulation, on the one hand. On the other, they increase the demand for capital. It is plain to see that these secondary causes lead to an increasingly acute shortage of capital, and a rise in its valuation [rising interest rates — *ed. note*]." Also, whereas wars are not the cause of the upswing, "once they have come into being", as Kondratieff observed, "they of course exert, in their turn, a potent and sometimes disruptive influence on the pace and direction of the economic dynamics". The "disruptive influence" of the war will then exacerbate the rise in commodity prices and interest rates as the incremental demand arising from a war and shortages manifest themselves. Thus, all major commodity price peaks occurred in war times, such as in 1814 and 1864, or at the end of wars, such as in 1921 and 1980 (see Figure 16). (Please also note the 45- to 60-year cycle in commodity prices.)

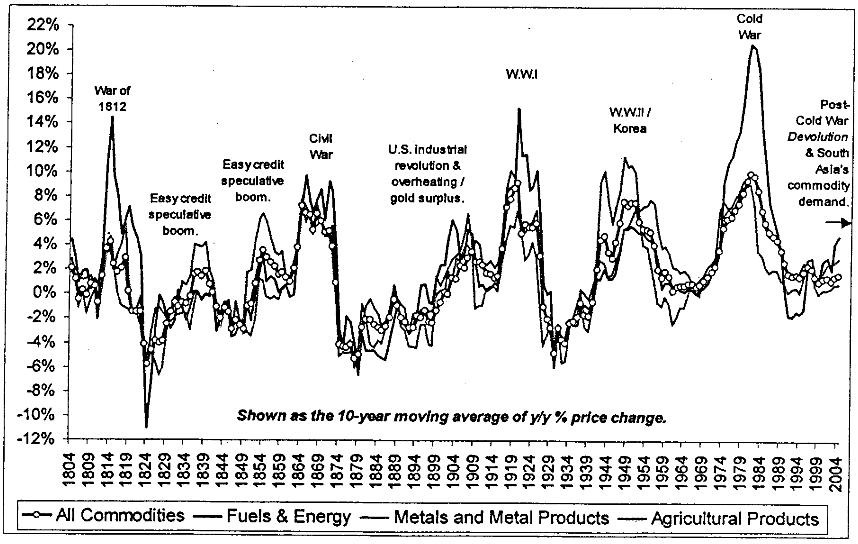
Consequently, it is very probable that the current bull market in commodities will last for another 15 to 25 years and end in an almost vertical rise in prices. Still, as is the case for most other asset markets, sharp corrections will occur from time to time.

Figure 15 **Vietnam Stock Index, 2001–2006**



Source: Bloomberg

Figure 16 **Commodity Prices, 1804–2004**



Sources: US Bureau of the Census; Historical Statistics of the United States; Barry Bannister; Stifel, Nicolaus & Company, Inc.

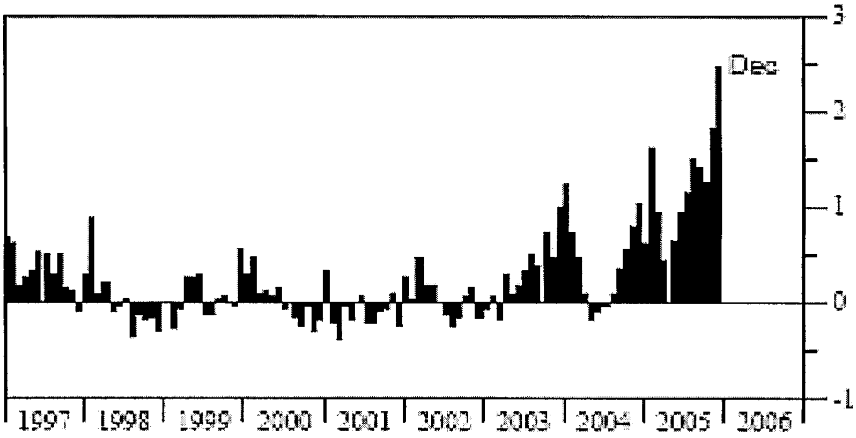
NEAR-TERM INVESTMENT CONSIDERATIONS

With very few exceptions, asset markets have become very frothy. As long as they continue to rise, there is excessive liquidity and the Fed will continue to increase short-term rates. Still, the rise is no longer spread around all asset classes and I maintain that a correction has already begun. The Nikkei Index is now down 4% since the beginning of the year and no higher than it was in mid-December 2005. The CRB Index, at 326 as of this writing, is no higher than in March 2005 and below its September 2005 high. Since the beginning of February, aluminium is down 13%, zinc is down 15%, and lead is down 19%. The Nasdaq 100 Index is marginally down for the year and no higher than in November 2005, while the Nasdaq Composite Index is flat since the beginning of the year. And while some modest further strength in stock and other asset markets shouldn't be ruled out, I believe that investors will be able to buy most assets either at the same price as they sell for today, or significantly lower within the next six months. Below, my friend Kenny Schachter (schachter@mindspring.

com, telephone: 44 (0) 7979 408 914), an art dealer who has not yet lost his sanity, will report on some of the excesses in the contemporary art market — of course, entirely due to excessive savings, as Mr. Bernanke will argue! Kenny Schachter lives in London. He set up *conTEMPorary*, in New York, an experimental exhibition space that was the first interior space designed by Acconci Studio, headed by artist Vito Acconci, and run from June 2002 to the present. His teaching includes a period as thesis adviser in MFA Photography and Related Media, from 1997 to 1999, at New York's School of Visual Arts; running "Exhibition & Interpretation: Theory, Planning & Design", a graduate seminar, which culminated in an exhibition in a temporary location entitled *Next*, at the Fashion Institute of Technology, from 1997 to 1998; "The Ethics of Display", an MFA seminar, Spring 1997, at New York University; and setting up a planned and implemented MFA off-site art exhibition at Columbia University, in Contemporary Art/ Contemporary Society, Spring 1993; also: *Marcel Duchamp and the World of Conceptual Art*, Autumn 1992. His piece follows on pages 15–17.

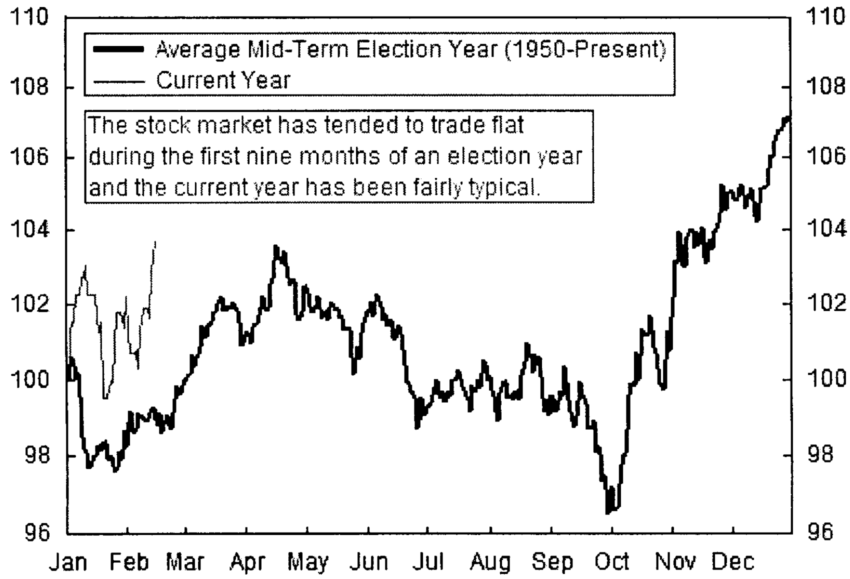
Also, while I am positive about Japan and Asian emerging markets relative to the US in the long term, I am concerned about the near term. There has been a record inflow of money into emerging market funds in December 2005 and January 2006, which, for a contrarian, is a negative indicator (see Figure 17).

Figure 17 **Emerging Market Equity Fund Inflows, 1997–2005**



Source: www.yardeni.com

Figure 18 **Average Mid-term Election Year vs Average Year (Dow)**



Sources: www.chartoftheday.com; Pinnacle Data

Most technical indicators for most investment markets have been deteriorating and have begun to diverge from the rise in prices, suggesting that a near-term peak of markets that are still rising might be approaching shortly.

Lastly, the average mid-term election year saw stock prices rise in the early part of the year and then decline into October — another reason for caution (see Figure 18).

In the meantime, while I am very negative about bonds from a long wave cycle perspective (see above), for the next three to six months US government bonds may be a relatively safe hiding place.

Art becomes Business becomes Art

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Life in the land of the celebrated contemporary artist in the 00s differs markedly from the forlorn, romantic perception of the starving artist of yesteryear. Fifty-seven-year-old US artist-of-the-moment Richard Prince has seized on his newfound white-hot status in the marketplace over the last three years to purchase houses in New York's Hamptons and St. Barts, as well as an interest in a jet chartering business. As Prince flies on his private plane to bask in the sun and hobnob with the elite, the art world frantically buys and sells his work, often the very same pieces over and over, in an effort to shave more profits from each successive transaction.

Forty-year-old Damien Hirst recently established his net worth at about £100 million and stated: "I know I'm richer than any artist has ever been at my age." He has purchased a gothic manor house in the UK closer in scale to the Metropolitan Museum of Art than to the vernacular notion of a home. All told, over £10 million will be spent prior to the time when Hirst installs his £6.5 million contemporary art collection and family into the residence.

Never before in the history of art has the aesthetic of the bottom line taken precedence over composition and content to the extent it has now, dwarfing the glamour and go-go days of New York in the 80s, the decade of greed. Simultaneously (thankfully, to those in the business), we are in an unparalleled time in terms of numbers of art world participants: collectors, galleries, auction houses, and adoring media, all happily aboard the art gravy train. The world is awash with capital, and hard assets such as real estate share many of the same attributes with the current desirability of art. Hopefully, the latest manifestation of the game collectors and speculators (the difference continues to narrow) are frantically playing won't resemble a hot potato — where getting caught with paintings and photos at the top end of the market could spell trouble.

Maybe inflated prices for art and real estate will tank, maybe they won't; everyone is an armchair prognosticator these days, but the forces driving the art market — the commodification of art and insatiability — will remain. Art hedge funds, art market analysis, charts and graphs for Picasso, et al, are already with us (including the version I have devised!). But then again, Michelangelo hoarded gold and Rembrandt bid up his own prints at auction to buttress prices, so maybe things are only more diffuse, transparent, and reflective of new technologies than in the past: the song remains the same.

Prince Prince

Contemporary Art Part I
[Lot 12]
Title: Untitled (Cowboy)
Year: 1999
Medium: Ektacolor Print
Size: 98.4 x 56.7 in. / 250 x 144 cm.
Edition: unique
Sale of Phillips, de Pury & Luxembourg New York: Thursday, November 13, 2003
Estimate: 80,000 – 120,000 US$
Sold for 460,500 US$ PREMIUM

The above was the result of an episode where a mysterious oriental woman held up her paddle without pause until she set a new world record for Richard Prince, which was the watershed moment that foreshadowed the market at the levels of today.

Throughout the 90s and early 00s you could pretty much have had your pick of any Prince, any major Prince, for about $30,000 US. That certainly is no longer the case, but the market is not uniform or totally coherent so one must tread with trepidation. Like the slippery Cindy Sherman market (a premier US mid-career photographer), photos can be had for well under US$100,000 to well over $1 million, but as the Latin saying goes, caveat emptor: buyer beware. Understanding Prince's market over the past five years is a minefield for the uninitiated, though the trend has ultimately been stratospherically up.

We live in a complex new market scheme where one artist's oeuvre scans what would formerly have been five different sale categories: printed matter, paintings, sculptures, photographs, multiples, and yet other hybrid characterisations. Richard Prince's auctioned works vary from printed/painted T-shirts to silkscreen cartoon-joke paintings on canvas to cropped and re-photographed advertising photos. It is not quite as simple anymore as artists painting in the vein of pop or abstract expressionism for the duration of careers.

The jokes in the joke paintings function as corny, nostalgic triggers taking us back to a purer notion of what it was to be an American in the postwar heyday of prosperity, unbridled optimism, and a sexuality innocent, but knowing in its naughtiness. The monochromatic canvases with the one-liners are among the most sought after works, but again one must be careful as the criteria by which these works are judged are wholly different than other artists: they are valued by the nature of the joke (about sex good, violence, less so) coupled with the desirability of the colour.

The appropriated advertising works, fetching even more than some paintings, began when Prince was working in the basement of Time Warner, clipping ads out of magazines, compiling them to be analysed by higher-ups at the company and covertly re-photographing them, which inadvertently spawned a movement known as Picture Artists, or Appropriationists. Besides the iconic and universally admired Marlboro Man series awash in the sentiment of the Western landscape, a la Remington; one of which briefly held the record for the highest price ever paid for a photo, $1.248 million (recently eclipsed by a $2.9 million Edward Steichen photo), there are face shots and product stills that amount to mannerist portraiture. Prince's compositions, though, are not orchestrated by the artist in the traditional sense, but rather his interpretation of an advertisement that contained somewhere within his idea of what the copy could have looked like or should have looked like. In the Marlboro works, he made the notion of branding that is so inbred today as to seem predetermined, his own, seizing on the coded imagery that has been threaded in our DNA to posit a roving, beautiful, ambiguous critique. And a frothing market to back it up.

Nevertheless, as previously mentioned, works can still fetch relatively little or not sell at all at auction. My advice, you can't go wrong buying a quality picture, which in the case of Prince means either a painting or appropriated photograph, for at or under $500, 000.

HIRST HEIST

An arts editor phoned me to meet for dinner, "off the record", with an investigative journalist from a top newspaper, not a tabloid, who was interested in planting a mole in Damien Hirst's studio to prove he didn't have a hand in the creation of his own paintings; that the spots, spins, and butterfly paintings continue to be made by the hundreds, more than ten years on; and, to piece together a picture of how much the artist earns in a given year. Yet, even to a layperson, including every London taxi driver, it is taken for granted that Hirst employs a plethora of assistants, paints lots of dots, and makes lots of dosh (UK slang for cash). The latter reflected by more than a handful of public sales above the seven-figure mark, the $8+ million sale of the dead shark in a vat of formaldehyde (courtesy of Stevie Cohen of SAC), and the $20 million proceeds from Sotheby's sale of the contents of Hirst's failed Pharmacy restaurant.

What is surprising is not that a known journalist from one of the world's foremost papers would stoop to entrapping someone by knowingly placing a spy in their private working environment to surreptitiously glean information (I am not certain of the legality of this), but that he could be so naïve as to not already be aware of such shenanigans in the first place! Even worse, that he thought the public, in this day and age, would be taken aback or outraged by these revelations.

Hirst himself is undaunted by the controversy of the breeding art works, despite his wise and knowing proclamation: "The best way to change is to stop doing the same old shit," which he said in a *Guardian* interview on the subject of his outrageous success. So why stop, he was asked: "I think I've said it now, I've made about 600 (spots, spins and butterflies)." Interpretation: there are many more than that number swimming in the stream of commerce, and trust, they will keep on coming as long as there is demand.

But tomfoolery it is, as I discovered first hand. Despite my awareness of the high volume, manufactured nature of the enterprise, I too bought in, hook line and sinker, to the notion that there is still gold in the hills that is the Hirst market. I purchased a work from a main dealer in the low six figures for resale at which time I asked: how many are there of this particular variety of painting, knowing how Hirst repeats himself ad infinitum. Though it initially went from 2 or 3 to 5 or 6, I was emphatically told the studio was contacted and confirmed that each one was in a different color with a slightly different composition. That's what passes for originality these days and not only with Hirst. OK I thought, if you can't beat them, join them and share in the spoils of the burgeoning public appetite for the brand.

Then one fateful dinner party later I learned the hard way. A guest brought along a friend from a major auction house that spied my Hirst and exclaimed: "I have the very same painting. He said he would give it to me as a gift but he didn't know what colour to paint it in, so I gave him the idea to paint it that very colour!" Great, so not only do I have an "original" painting that I can stomach was painted by *Team Hirst,* but now I find out there are two identical pieces AND it's some form of creative collaboration between the artist and an auction house executive about to eat dinner in my house! I know and appreciate Andy Warhol's art of mechanical reproduction, changing hands at prices that have exceeded $25 million, created by staff in seemingly endless series, but at least his assistants changed the inks around once in a while to distinguish the paintings.

When will the reassessment come — and surely it will, the day of reckoning for a time when demand not only influences art but instigates the making of it and determines its form? Isn't the repetitive nature of some art production in endless series just another name for creating more of the same stuff to sell? When does it stop becoming art as conventionally conceived at this point? Will there be accountability for a time when a Willem de Kooning drawing is worth less than a Hirst spot print in an edition of 1, 000? My guess is sooner rather than later, how long can the sheep keep flocking? Though you wouldn't want to butt heads with a raging bull, a major Hirst sculpture will set you back about as much as a Rembrandt recently sold for at auction. Buyer-beware indeed, a warning I should heed myself.

THE EPONYMOUS GRAPHS

As previously mentioned, artists make work nowadays in a multitude of mediums and sizes so the intent was to create a single graphing methodology that could chart price movement and volume irrespective of the nature of the work — that is, without having to delineate between art forms (for example, paintings, prints, and sculptures) and size (a typically contributing factor to value is magnitude of the piece).

Definition of k-number (selling price normalised for estimate range)

The k-number has been defined with the purpose of describing the relationship between the selling price of an auctioned piece and the piece's presale estimated range, taking into account the size of the range. In other words, it is a measure for the performance of a specific sale relative to its expected selling range. The formula for the k-number is ((selling price — lower limit of the estimate) / (range)).

Possible results fall into the following categories: negative k-number, the result of a piece selling below the lower limit of its estimated range; and, positive k-number, the result of a piece selling at a price that exceeds the upper limit of its estimated range; k-number of .5, the result of a piece selling at the midpoint of its estimated range; k-number of zero, the piece has sold exactly at the lower limit of the estimated range, or at the lowest acceptable price; k-number of one, the piece has sold at exactly the upper limit of the estimated range, or at highest suggested price.

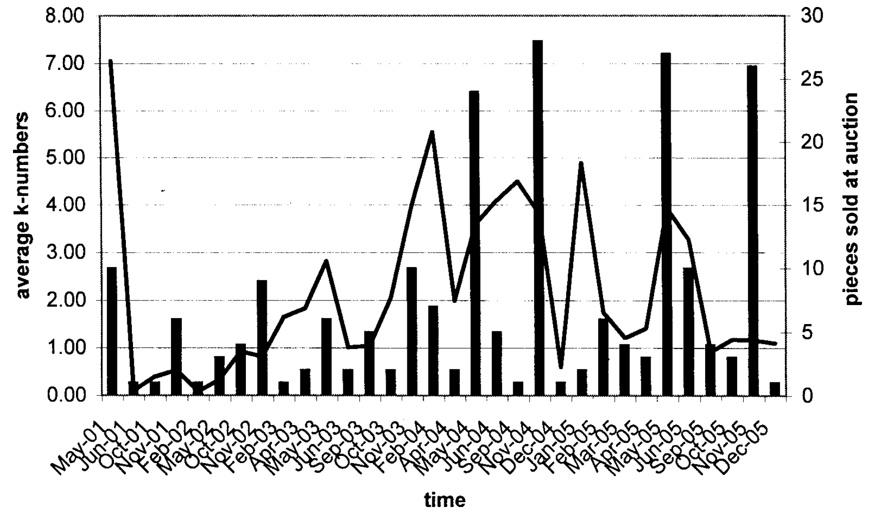
*It is important to note that k-numbers only apply to pieces that have been successfully sold.

Prince/HIrst Graphs

The flatness of the Prince market as of late reflects either an aberration in the momentum due to high estimates instituted by auction houses and overly expectant collectors in the rash of recent record prices achieved, or a cautionary note for the next spate of contemporary auctions (see Figure 19).

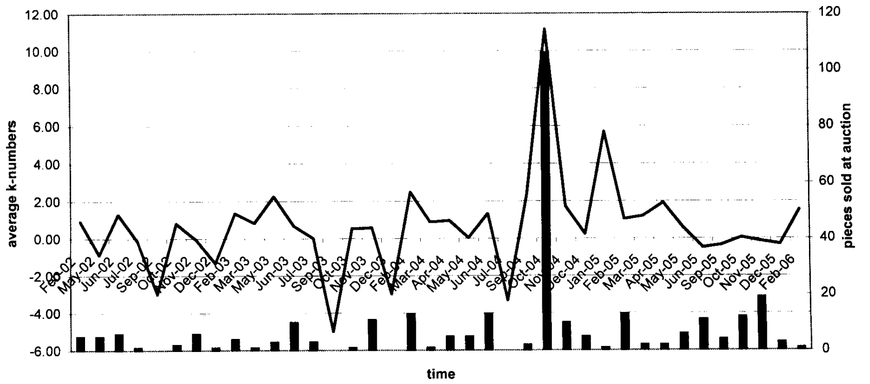
The volatile peaks and troughs of Hirst reflect his explosive performance potential coupled with the inconsistency of his production; early paintings and sculptures are coveted, and later period works less so (see Figure 20). The trend is up, but the public may be souring on his most recent output — more of the same and the newest photorealist paintings unanimously panned by the press.

Figure 19 **Richard Prince Monthly Average K-numbers vs Volume, 2001–2005**



Source: Kenny Schachter

Figure 20 **Damien Hirst, Monthly Average K-numbers vs Volume, 2002–2006**



Source: Kenny Schachter

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