Why Are Most Investors Mostly Wrong Most of the Time?

Marc Faber

People crushed by law have no hopes but from power. If laws are their enemies, they will be enemies to laws.
Edmund Burke

They never open their mouths without subtracting from the sum of human knowledge.
Thomas Brackett Reed

It is essential to the triumph of reform that it shall never succeed.
William Hazlitt

I started to work on Wall Street in 1970. What has ever since captivated my mind is how so many investors fail again and again to perform by making repeatedly the same mistakes. They buy at the wrong time the wrong stocks or asset classes and then sell again at the wrong time the wrong stocks and wrong assets. I often think that most investors are always out of step with the market. They buy when everything looks perfect and when a trend has been in place for ten years or so and, therefore, prices are high and then get out at any cost when an asset has been under pressure for a considerable time and when prices are low. I suppose that given the shape of the wealth pyramid (few rich people at the top and many poor people at the bottom), by definition, the majority of investors must lose money to enrich the few who are successful and who buy low and sell high. This is not to say that I am a successful investor. I often think that if I had invested all the money I have earned since I started to work in 1970 at just 5% interest per year, I would today be wealthier than by having dabbled all over the world in all kinds of assets. I also calculated a few years ago that if the equivalent of USD 1000 had been invested at the time of Jesus at just 5% interest per year, today, this original USD 1000 sum would be worth a multiple of the entire world's current assets. Wars and natural disasters were certainly a major contributor to the constant destruction of wealth, but business

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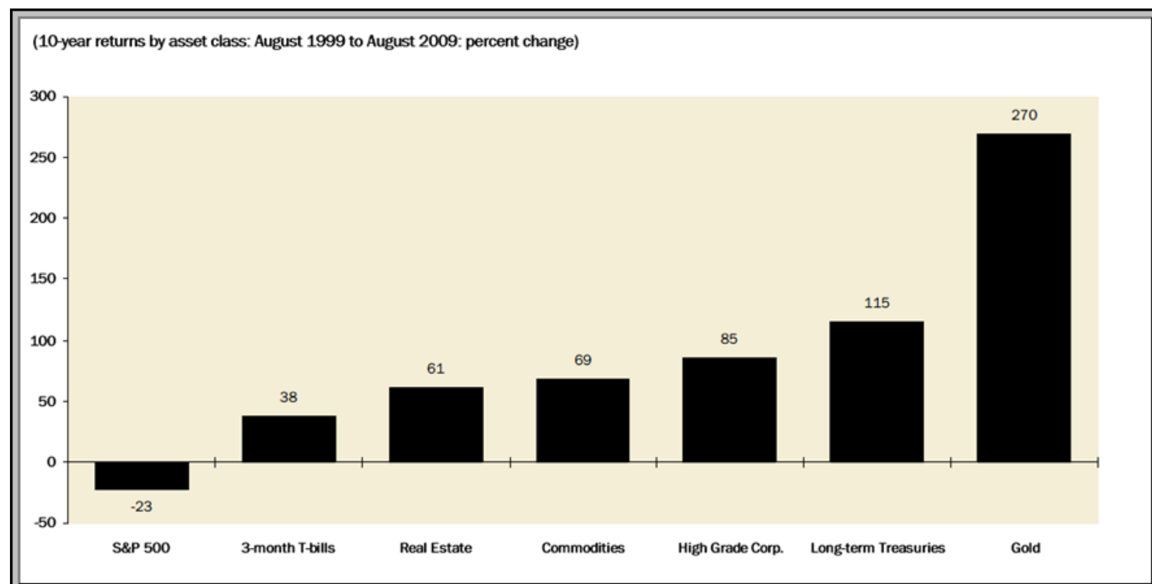
failures and bad investments also played a significant role. Just consider that all the canal companies in the US eventually went out of business and that 95% of US railroads failed at the end of the 19th century. Or remember the end of the 1990s! At that time investors were chasing stocks in the technology, media, and communication (TMT) sectors and completely overlooked the "old economy stocks" such as shipping, steel, mining, and oil companies – not to mention commodities in general. I recall well an investment seminar at which I participated in the US in 1999 where several leading Wall Street strategists demonized me for highlighting how inexpensive gold was compared to equities. For them gold was a "barbaric relict" that had no place in an investor's portfolio (in the early 2000s a well-known institutional research firm compared gold to "washing machines" – a depreciating asset). But, as the following figure shows, post 1999, equities performed poorly and gold and other commodities well (see Figure 1).

Figure 1: Returns of Various Assets, August 1999 – August 2009



Source: David Rosenberg, Gluskin Sheff

I also recall that in the midst of the NASDAQ bubble hardly any investor had any interest in longer-dates US government bonds - the Ten-Years US Treasury Note yield hit an intermediate peak of 6.79% in March 2000! At a Christmas party in St. Moritz in December 1999 the wife of the host – a medical doctor – knowing that I was involved in the investment business asked me about my views. When I told her that I liked gold and that, given the over-valuation of the NASDAQ, bonds might be a place to park some money she exclaimed that "gold only goes

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down" and that a 6% annual return on bonds was totally unattractive when "one could earn 20% or more on equities," which she "traded daily and made so much money" for her husband and brother's portfolios (see Figure 2).

Figure 2: NASDAQ 100 Index, 1997 - 2009

Source: www.decisionpoint.com

Now, I am in no way implying that ordinary people with some common sense and who are not involved in the financial sector cannot beat the performance of professional money managers. In fact, not being under any peer pressure to perform month by month should be advantageous for an investor's long term performance. But, when a housewife without any previous investment experience (and otherwise also clueless) told me full of self confidence at a Christmas party in 1999 that she traded daily high tech stocks from the long side after an 18 years bull market in equities (1982 – 1999) and in a highly priced and hyped sector, it reinforced my view that we were then indeed in the midst of a colossal TMT bubble.

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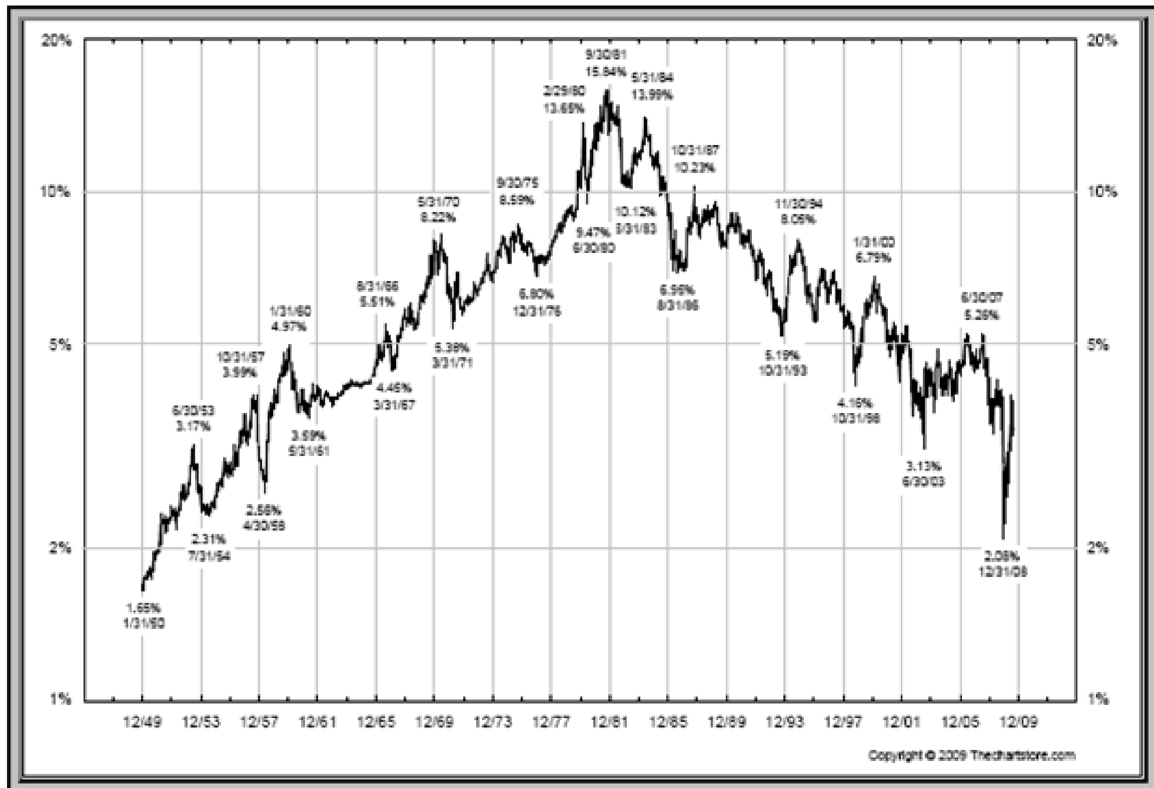
The point I really want to reiterate here is that the longer a trend has been in place, the more cautious an investor should become (see Figure 3).

Figure 3: Ten-Year US Treasury Note Yield, 1950 - 2009



Source: Ron Griess, www.thechartstore.com

But this is precisely what is not happening! Quite on the contrary, **the longer a trend has been in place, the more confident investors become that the trend will last forever**, which then leads to major "blow-offs" and "sell-offs" and "buying" and "selling panics," which then reverse the longer term trend. I am mentioning this phenomenon for several reasons. For one, we had, in my opinion, several major market inflection points over the last nine months. Government bonds made a climatic high in buying panic in late 2008, when the Ten-Year Treasury Note yield dropped to as low as 2.08% (see Figure 3). A day later, on December 19, 2008, oil sold off to $ 32 (low for the CRB Index was on February 27, 2009 when the CRB Index dropped to a tad below 200). Then, on March 4, we had a major turning point in the US Dollar Index (see Figure 4). This was followed on March 6, by a major low for the S&P 500 when the

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S&P 500 sold off to a panic low of 666 (most other stock markets around the worlds also bottomed out then).

Figure 4: US Dollar Index, 2008 - 2009

Source: Ron Griess, www.thechartstore.com

Finally, less than a month ago, we had a panic low for natural gas when it sold down to $2.40 per MMBtu (see Figure 5, and also Figure 2 of the September report).

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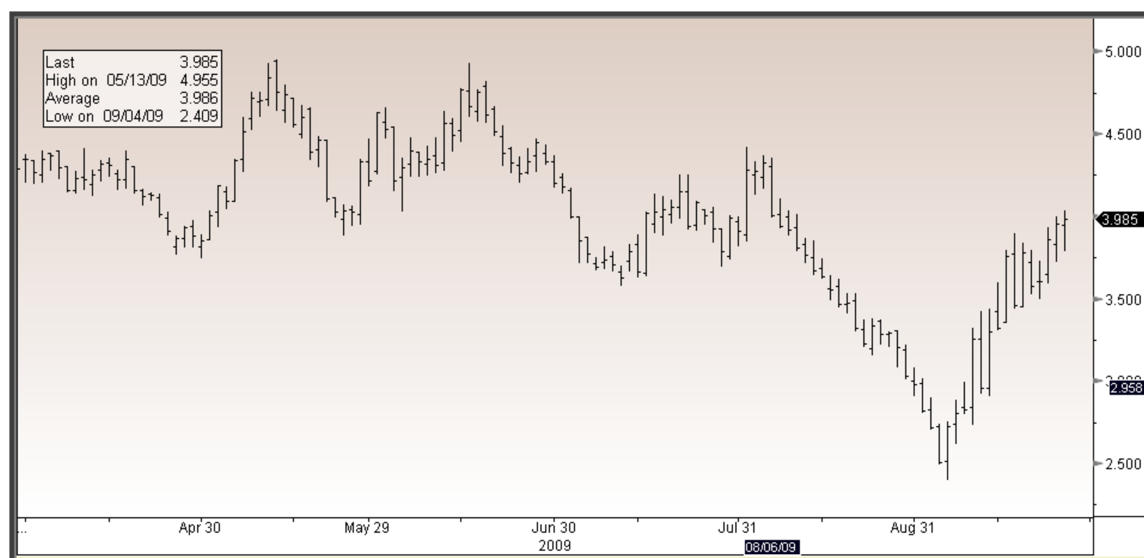
Figure 5: Natural Gas, Up 64% Since The September 4 Low!



Source: Bloomberg

"How do you know that these were major inflection points, especially regarding bonds and equities?" will some inquisitive minds rightly ask. The simple answer is that I do not know for sure. But the point is that when bond yields collapsed at the end of 2008, the risk of buying US government bonds increased as much as the risk had increased when the NASDAQ 100 approached its peak in early 2000 (see Figure 2). Similarly, there was a significant opportunity risk for an investor who sold his stocks earlier this year when stock markets became deeply oversold. Thus, an investor is faced with two risks: the risk of buying at the wrong time, which results in losses (his assets deflate against cash - see Figure 2) and the risk of selling at the wrong time and missing out on substantial capital gains (cash deflates against equities). It should be very clear that if an investor held cash since March 2009 and did not own any stocks his "cash assets" have declined in value by about 50% against a portfolio of equities (the S&P 500 has inflated against cash by 50%).

The future will always remain highly uncertain and we all do not have any clue how the world will look like in 6, 9, or 24 months - let alone in five years. And so, I believe that investors tend to do badly because at times "rational thinking" gives way to "emotions" and "greed and fear" replace the all important objective of capital preservation. Yes, **capital preservation** should be for investors the most important consideration. But capital preservation usually only comes into the mind of investors after they have incurred substantial losses. These losses are substantial because during a boom in an asset class (say the NASDAQ 100 before March 2000), investors grossly overweight the boom sector - convinced

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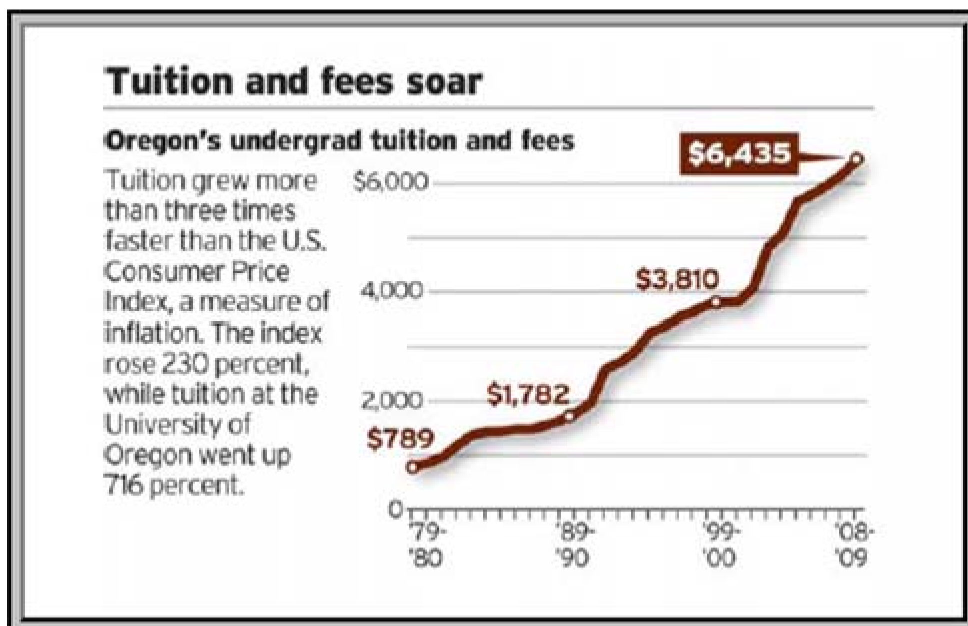
that they will make a fortune. In other words, at such times of "emotional" decisions, investors completely fail to properly diversify, which in my opinion is really the key to capital preservation. As just observed, we never really know anything about the future and so caution should never be abandoned!

Investors then panic when they sit on large losses, sell, and move into cash or another asset class, and this usually again at the wrong time! In my humble experience as an investment advisor, the lack of diversification by investors is a huge impediment to capital preservation and also to sustainable and satisfactory long term wealth accumulation. Just consider the following. Until two years ago investors were convinced that the great asset inflation in stocks and especially real estate would continue forever. So, they put most of their money in equities and homes – the latter with high leverage since they were "convinced" or "knew for sure" that home prices would "never go down." But now, just two years later, I sense from the countless emails I receive that investors fear deflation the most when in fact some symptoms of inflation are very obvious. The costs of insurance premiums, health care, energy, and education seem all to be increasing (see Figure 6).

Figure 6: Educational Costs Have Doubled Since 1998



Source: Michael Berry (mberry@discoveryinvesting.com)

According to Michael Berry, whose notes are always interesting (www.discoveryinvesting.com), "Harvard increased its tuition by 68% and Princeton by 43% over the past ten years. Johns Hopkins now

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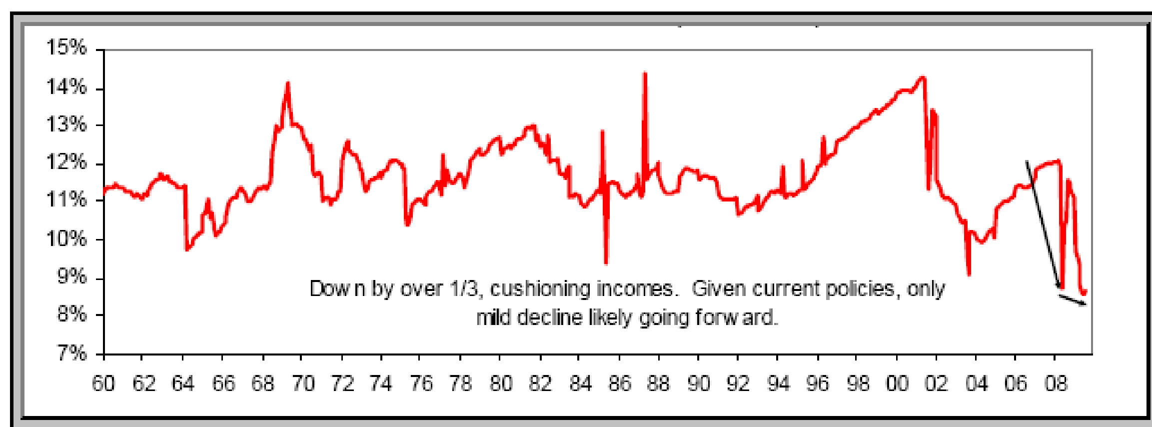
charges $39,150 for an entering freshman – just tuition, not room and board…. In Canada average tuitions have increased from C$2000 in 1990 to over C$5000 in 2008. In addition the percent of Canadian government assistance to tuition fell from 80% to 50%."

This takes me to another issue. Whereas it is true that some consumer good prices are declining, one price that is going to increase is the price people will pay for the government's limitless wisdom and almost unimaginable efficiency (at wasting tax payers money - see Figure 7).

Figure 7: Taxes as Percentage of Personal Income (All Sources), 1960 - 2009



Source: Bridgewater Associates

As can be seen from Figure 7, taxes as a percentage of personal income are at a post war low. But given the huge fiscal deficits, taxes will in time increase! Perhaps the government will not increase taxes "officially," but it is certain that people's "contributions" to the government will go up in the form of all kinds of fees or indirect taxes, which will add to the costs of living. (Doug Noland of PrudentBear fame – www.prudentbear.com – reminded us recently that "in 1909, the US federal government had an annual budget of $ 0.8 Billion. With this it governed a population of just over 90 million people. The cost of government was about $9 per capita. In 2009, the US federal government has an annual budget of $ 3,550 Billion. With this it governs a population of just over 300 million people. That's a cost of about $11,675 per capita.")

Writing about a "Fiscal Train Wreck," Paul Krugman makes for once some sense. According to Krugman, "without the Bush tax cuts, it would have been difficult to cope with the fiscal implications of an aging population. With those tax cuts, the task is simply impossible. The accident, the fiscal train wreck, is already under way. How will the train wreck play itself out? Maybe a future administration will use butterfly

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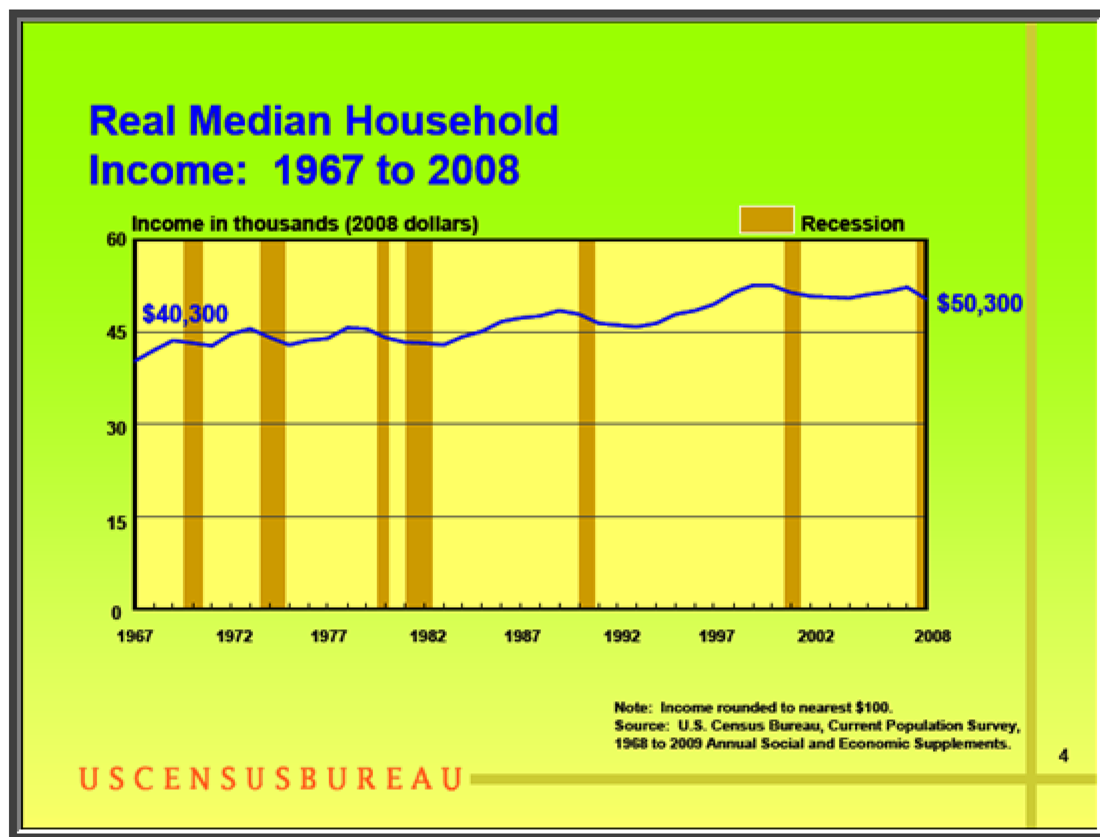
ballots to disenfranchise retirees, making it possible to slash Social Security and Medicare. Or maybe a repentant Rush Limbaugh will lead the drive to raise taxes on the rich. **But my prediction is that politicians will eventually be tempted to resolve the crisis the way irresponsible governments usually do: by printing money, both to pay current bills and to inflate away debt**" (emphasis added).

And since it is a fair assumption that money printing and fiscal deficits do not increase peoples' standards of living, real median household incomes will continue to stagnate or, more likely, they will shrink (see Figure 8).

Figure 8: Real Median Household Income Likely to Decline in Future!



Source: Mike "Mish" Shedlock, http://globaleconomicanalysis.blogspot.com

I should mention that although Mish and I disagree about future inflation trends, I highly recommended his outstanding and refreshing blog!

Now, we know that the BLS under-weights food, educational, and health care costs and massages other goods and service price increases

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through hedonic adjustments when compiling inflation figures. Therefore, real median household income is, in fact, unlikely to be any higher than in the late 1960s (see Figure 8).

Just as a reminder for the deflationists among my readers: According to John Fritze, who writes for USA Today, "an average family health insurance policy now costs more than some compact cars, and four in 10 companies will likely pass more of that expense on to workers," according to a closely watched survey of businesses released recently. "The average cost of a family policy offered by employers was $13,375 this year, up 5% from 2008, the Kaiser Family Foundation and the Health Research & Educational Trust survey found. By comparison, wages rose 3% over that period, the study said…..'The trends are crushing millions of businesses and American families,' Senate Majority Leader Harry Reid of Nevada said."

The annual survey of more than 2,000 companies also found that 40% of small-business employees enrolled in individual health plans pay annual deductibles of $1,000 or more. That's almost twice the number of employees who paid that much in 2007. **"Since 1999, health insurance premiums for families rose 131%, the report found, far more than the general rate of inflation, which increased 28% over the same period. Overall, health care in the United States is expected to cost $2.6 trillion this year, or 17% of the nation's economy,** according to the non-partisan Congressional Budget Office……As insurance costs increase, workers are also picking up a larger share, the survey found. The average employee with family coverage paid 26% of the premium, the study found, but 41% of companies said they are 'very likely' or 'somewhat likely' to increase the amount employees pay for coverage in the next year."

With or without health care reform the cost of health care will continue to increase. It will have to be paid by individuals and companies either directly in the form of higher insurance premiums and medical bills or indirectly in the form of higher taxes. So, here we are unlikely to see any deflation!

Another issue that is usually disregarded in the entire inflation – deflation debate is the following: The explosion of the US current account deficit between 1998 and 2007 (from annually $150 billion to $800 billion) flooded the world with dollars, led to corresponding current account surpluses in emerging economies and to **strong price increases outside the US** (see Figure 9).

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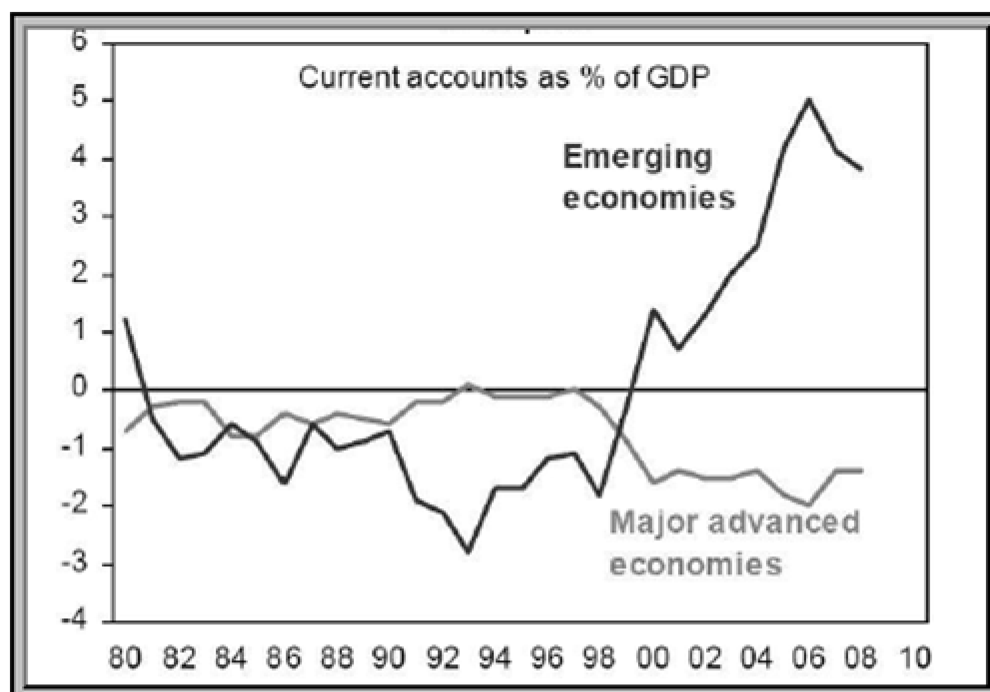
Figure 9: US Current Account Deficit Led to Current Account Surpluses and Inflation in Emerging Economies



Source: IMF

Consider the following: According to Bloomberg, **"Sun Hung Kai Properties Ltd., the world's largest developer by market value, raised the price of two penthouses in Hong Kong by 50 percent to a record HK$75,000 (US$9,700) a square foot as demand surges for luxury apartments. The units will be offered for HK$300 million (US$39 million) each…..** The apartments each have 4,000 square-feet (372 square meters) on three floors, an outdoor garden, and a swimming pool. The number of sales and purchase agreements on Hong Kong homes worth at least HK$10 million (US$1.28 million) more than tripled to 500 in August from a year earlier, according to the Land Registry. Homes at that price in Asia's second-most expensive market after Tokyo have appreciated by 30 percent this year……The properties, the biggest at the Cullinan development in the Kowloon district, were priced at HK$50,000 a square foot when Sun Hung Kai started selling units at the project in February" (emphasis added).

Moreover, according to my friend Mac Overton, "a 7,353 square meter luxury residential site at the Peak in Hong Kong fetched 1.8 billion HK dollars (about 231 million U.S. dollars) during a public land auction here recently, setting a new record price per square foot for land in the

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city. The final price for the 79,148 square foot site is equivalent to an accommodation value of 42,196 HK dollars (about 5,400 U.S. dollars) per square foot."

Lastly, a one-bedroom flat in a luxury development in Tsim Sha Tsui recently fetched a whopping HK$30,025 per sq ft (about USD 3,800 per sq ft), setting a record in Hong Kong for a one-bedroom flat. A local businessman paid HK$24.5 (US$3.1 million) for an 816 sq ft apartment. The useable space is just 590 sq ft (USD 5,200 per sq ft useable space).

The reason I talk about Hong Kong high end property prices is that current prices were completely unimaginable ten or twenty years ago. The deflationists will of course argue that someone who pays US$39 million for a 4,000 square-feet (372 square meters) apartment needs to have his head examined as prices will collapse. That may well be the case, but equally with all the money printing around the world can we be sure that these flats won't sell for US$390 million in ten years! Therefore, I can understand someone who is sitting on US$ one billion in cash and buys such a property not knowing what his cash yielding now zero percent will be worth in ten or twenty years time.

But the point I really wish to make regarding the discussion about inflation and deflation is that some properties can increase in price substantially (luxury accommodation in tax friendly cities in Asia and elsewhere), others can decline due to economic and political reasons. After the recent decline, the average price for a 2,200 square feet four bedroom house in the US is US$363,401 whereby the price for such a house would only be $112,675 in the "Canoe Capital of the World" Grayling (Michigan) and $121,885 in Akron (Ohio). That works out to US$51 and US$55 per square foot respectively!

So, the economist living in Grayling, Michigan, will publish a book about deflation whereas the economist living in Asia will write about inflation and both will be right! All I wish to express is that the world is not black and white and that there can be inflation in some sectors of the economy and in some asset markets while other sectors and asset classes deflate. To illustrate this line of reasoning let us look at the performance or the 30 Dow Jones stocks since September 2001 (see Table 1).

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Table 1: Diverging Performance of Equities, 2001 - 2009

Dow 30 Member Performance Since 9/10/01

Stock	Company	9/10/01	Current	% Chg
HPQ	Hewlett-Packard Co	17.89	45.99	157.07
CAT	Caterpillar Inc	24.05	48.09	99.96
MCD	McDonald's Corp	28.92	54.40	88.11
UTX	United Technologies Corp	33.10	61.47	85.71
XOM	Exxon Mobil Corp	41.24	70.01	69.76
MO	Altria Group Inc	11.14	18.18	63.13
PG	Procter & Gamble Co	36.81	55.46	50.65
MMM	3M Co	51.10	74.05	44.91
IBM	IBM	96.47	118.48	22.82
DIS	Walt Disney Co	23.27	28.15	20.99
BA	Boeing Co	43.46	51.13	17.65
JPM	JPMorgan Chase & Co	37.26	42.77	14.79
AXP	American Express Co	30.65	34.11	11.30
WMT	Wal-Mart Stores Inc	46.23	50.68	9.63
HON	Honeywell International Inc	35.70	38.79	8.66
JNJ	Johnson & Johnson	55.62	60.25	8.32
KO	Coca-Cola Co	49.95	51.45	3.00
MSFT	Microsoft Corp	25.91	24.96	-3.66
DD	EI Du Pont de Nemours & Co	38.39	31.91	-16.88
INTC	Intel Corp	26.07	19.50	-25.20
HD	Home Depot Inc	40.55	27.16	-33.02
IP	International Paper Co	37.84	23.63	-37.55
T	AT&T Inc	42.98	26.42	-38.53
MRK	Merck & Co Inc	62.56	32.28	-48.40
AA	Alcoa Inc	33.80	12.96	-61.66
GE	General Electric Co	39.35	14.83	-62.31
EK	Eastman Kodak Co	43.23	5.95	-86.24
C	Citigroup Inc	39.48	4.66	-88.20
GM	General Motors	51.58	0.77	-98.50

Source: http://bespokeinvest.typepad.com

I find it quite remarkable that in a stock market that essentially moved sideward since 2001, the best performing stock was up 157% while the worst performing stock was down 98%!

So, I hope my readers will stop worrying everyday about deflation or inflation and just accept the fact that some assets will inflate while others will simultaneously deflate. Whether we shall always be able to forecast which assets will inflate and which ones will deflate is another matter. **But I think that the understanding of the concept of diverging price movements within the economic system is as important in the**

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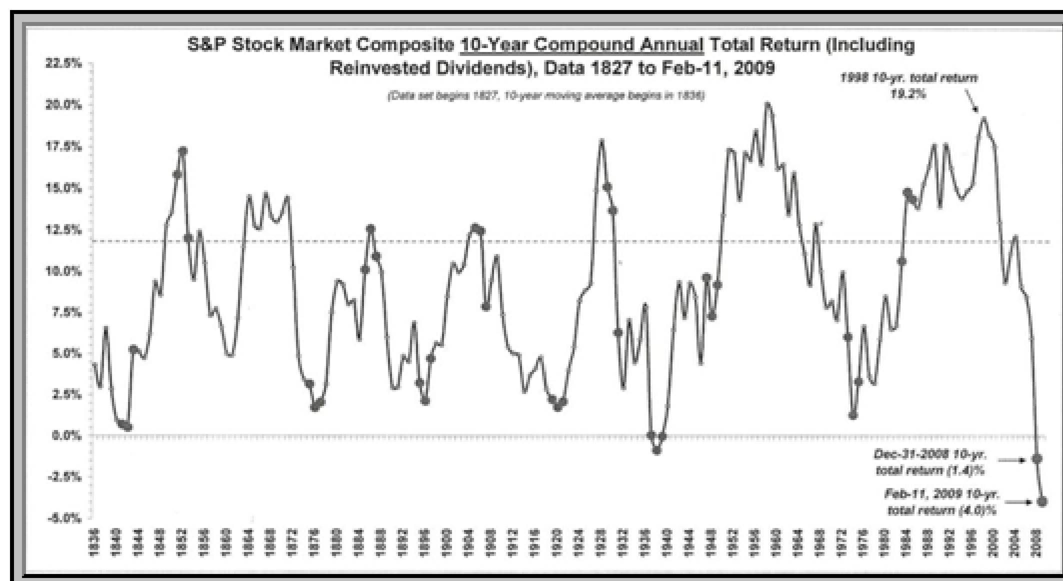
investment process as is diversification and the underlying objective of wealth preservation.

In general I think dollar-related assets are not terribly expensive. Dollar-related assets are properties and equities in the US and in countries which peg their currencies to the US dollar. As an example, property prices in the US seem to be reasonably priced now – certainly compared to Hong Kong high end real estate! This reasonable valuation is due to the poor performance of the US dollar and also of US properties and US equities over the last few years (see Figures 1 and 10).

Figure 10: US Equities 10-Year Compound Annual Total Return 1936 - 2009



Source: Barry Bannister, Stiefel Nicholaus

The relatively low valuation of dollar-related equities and properties is without any doubt partly due to the structural weakness of the US dollar (see Figure 11).

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Figure 11: Dollar Index, 1973 – 2009

Source: Ron Griess, www.thechartstore.com

For Europeans endowed with Euros, US real estate would seem like a bargain! Similarly, Asian properties and equities are for Euro-based investors due to the strength in the Euro against most Asian currencies still attractive. My sense is that either the US dollar will shortly recover or that US assets such as stocks and properties will increase in value (in dollar terms but not necessarily in real or gold terms).

I have continued to add some positions in Thailand where I continue to find good value among equities (see Figure 12). This holds certainly compared to US dollar cash, which will in the long run lose its purchasing power, and now yields just zero percent and will continue to yield ad infinitum - courtesy of irresponsible monetary policies - less than the inflation rate (negative real interest rates). As can be seen from Figure 12, Thai equities seem to have begun to outperform the Emerging Market Benchmark.

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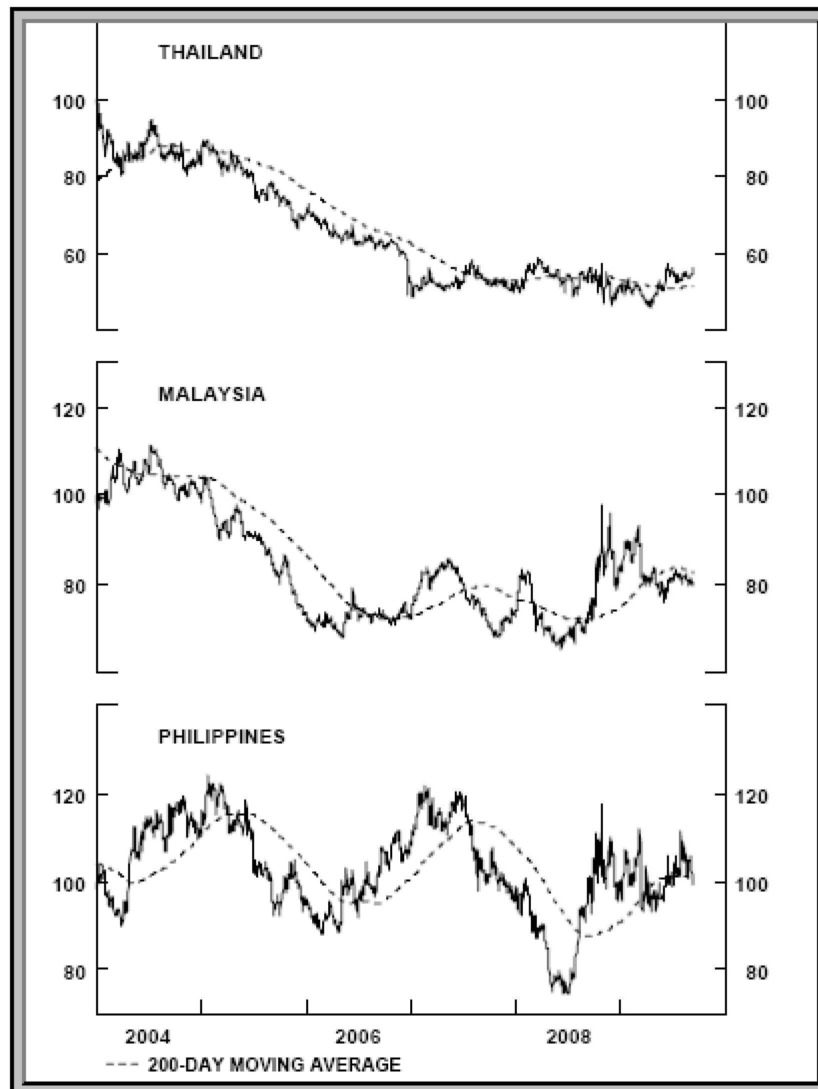
Figure 12: Thai, Malaysia, and Philippines Equity Performance Relative to Emerging Market Benchmark, 2004 - 2009



Source: The Bank Credit Analyst

In Thailand I bought some more Tipco Food (TIPCO TB), Samui Airport Property Fund (SPF TB), Thai Tap Water (TTW TB). In Singapore I initiated a small position in Design Studio Furniture (DSFM SP). Thai Airways (THAI TB) and Airport Authority of Thailand (AOT TB) also look attractive in view of the recent strength in airline shares in the US.

My principal concern remains that asset markets are quite stretched. The Euro is overbought, the US dollar is oversold, and American and other equities are by and large overbought (see Figure 13). As can be seen from Figure 13, each time, the percentage of S&P 500 stocks above their 50-day moving average goes above 70%, a market correction follows,

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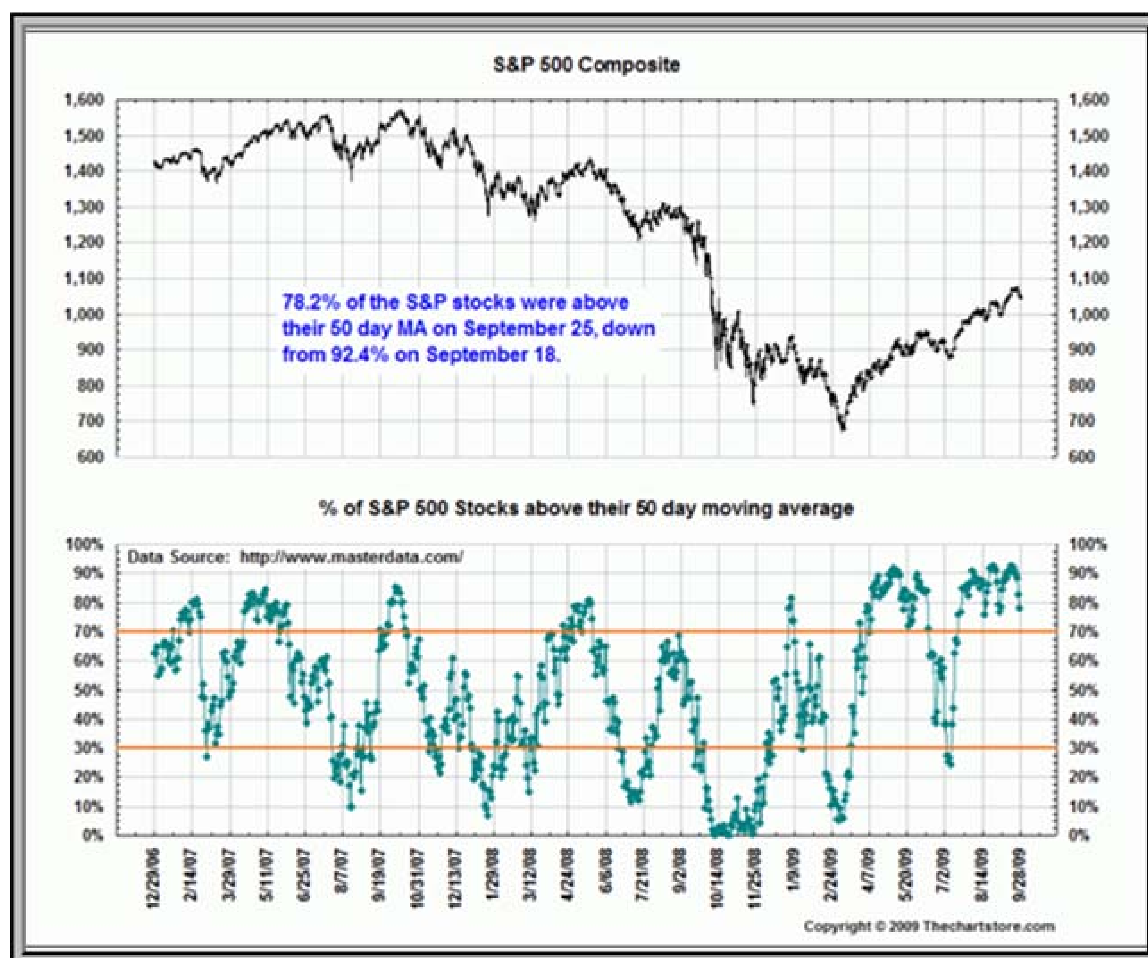
which then brings down the percentage of S&P 500 stocks above their 50-day moving average to around 30%.

Figure 13: Percent of S&P 500 Stocks above Their 50-Day Moving Average, 2006 - 2009



Source: Ron Griess, www.thechartstore.com

However, we should not lose sight of the fact that the current US administration and economic policy makers are desperate to engineer a recovery. And whereas such a recovery will largely bypass the average household in the US, money printing and ever increasing fiscal deficits are likely to further boost some assets such as equities and precious metals. In my mind the US government is determined to make cash unattractive through zero interest rates now and later through negative real interest rates (short term interest rates below consumer price increases). Therefore, following a correction, I still expect equity prices to

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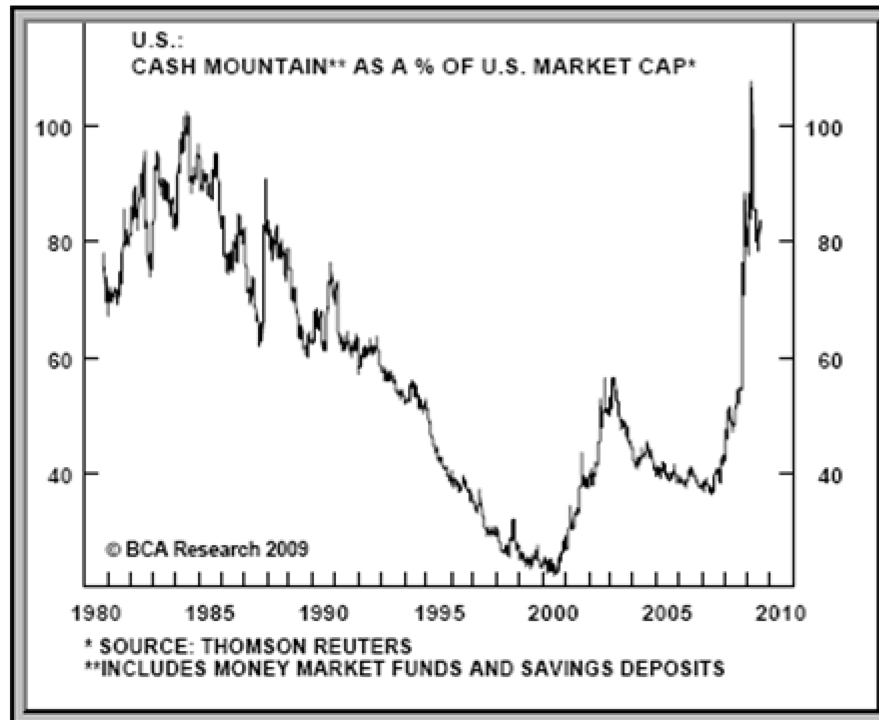
move higher as money flees cash deposits and moves into more risky assets (see Figure 14).

Figure 14: US Economic Policies: Encourage Consumption and Speculation by Making Cash Unattractive!



Source: The Bank Credit Analyst

Consequently, I still like precious metals, oil, and mining and related stocks such as Newmont Mining (NEM), Novagold (NG), and Sprott Resources (SCP CN). But also in this asset class I expect a correction short term. The Baltic Dry Index has recently been very weak and oil and copper prices seem to have rolled over (see Figure 15).

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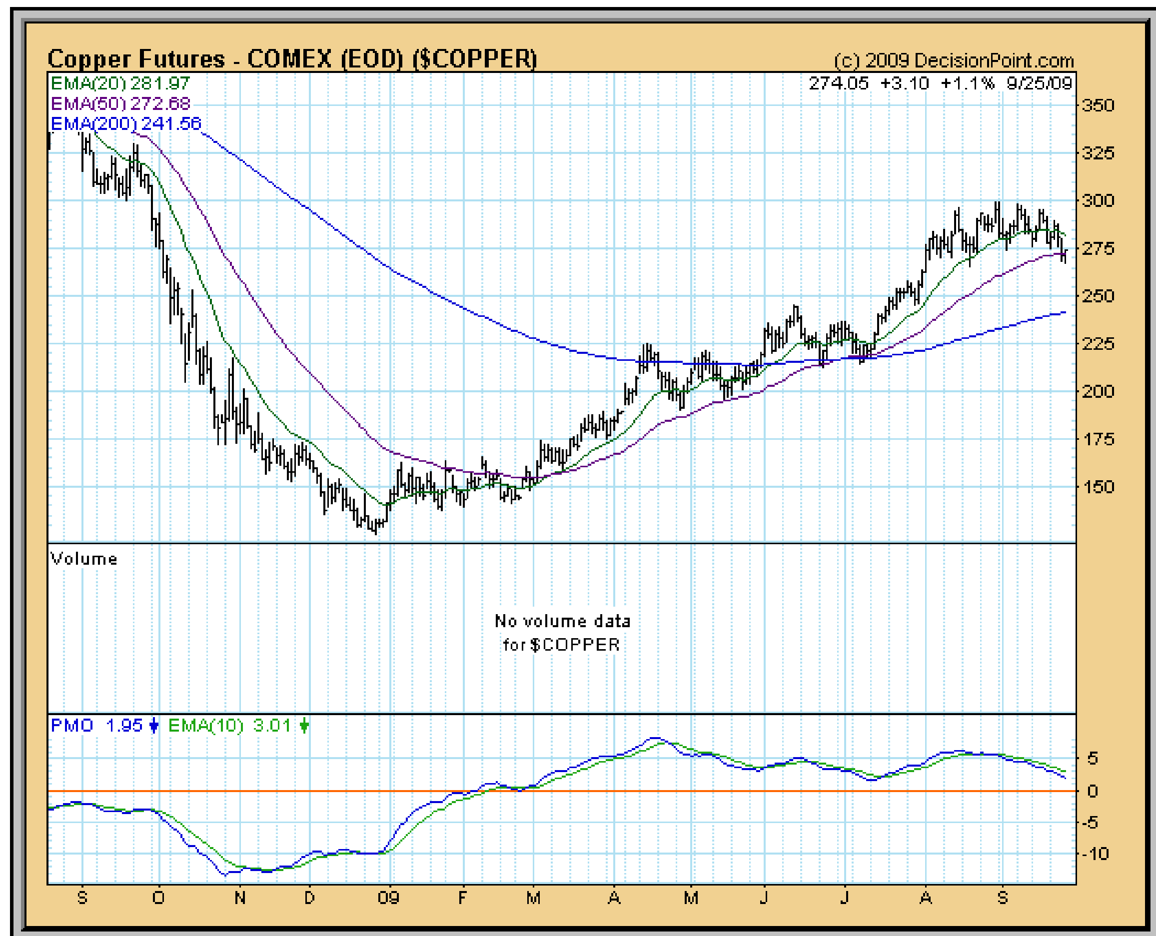
Figure 15: Copper Prices, 2008 - 2009



Source: www.decisionpoint.com

One last comment: I would become more concerned about stocks having made a high for the year if the S&P 500 fell in the period directly ahead below the early September low at 992!

Below, I am attaching some pertinent observations by my friend Faizal Kalla, a businessman living in South Africa. He points out that "in an inflationary environment such as Zimbabwe the stock market kept going up even though the economy kept faltering." That's exactly what I think will happen in the US. After all, Robert Mugabe is the mentor of Mr. Ben Bernanke!

Further below, I am reprinting a book review by my friend Robert Blumen who happens to know something about the Austrian School of Economics.

The review of "Where Keynes Went Wrong: And Why World Governments Keep Creating Inflation, Bubbles, and Busts" by Hunter Lewis" is a great read if you are interested in economics.

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SOUTH AFRICA AND THE FINANCIAL CRISIS IN MOTION

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I am thankful to Dr Marc Faber for allowing me to contribute to the GDB report on South Africa, which is an emerging market and the largest economy in Africa. In the December 08 GBD report I introduced South Africa post apartheid and mentioned that South Africa had experienced a credit bubble unprecedented in its history and the consequences would be undesirable. On October 22,2008 the finance minister Trevor Manuel was upbeat about the growth despite the financial crisis and forecasted 3% GDP growth for 2009.GDP growth for the first quarter came in at minus 6,4% and the second quarter minus 3%.In the first quarter of 2009 almost 250000 jobs were shed and the second quarter 267000 were lost. In the last few years money supply was growing at 25% per annum and GDP around 5%.Currently money supply is growing at a low 4% per annum.

THE HOUSING MARKET

The housing market in South Africa has been declining steadily over the last 18 months. On a month to month basis compared to last year house prices are down some 3,5% for August. Total for the year house prices are down some 17%. Mortgage advances peaked in October 2006 at a growth rate of 30,9% and this year mortgage advances in the first half of 2009 was around 6,4%. From August 2008 to August 2009 the aggregate of house mortgages has been the same implying no movement. After the introduction of the National Credit Act mortgage applications have declined substantially as banks are compelled by law to adhere to strict lending criteria. As a result of this many new home owners do not qualify for home loans because of affordability. In the past home loans were approved instantaneously and now it takes many weeks. There are many home builders going bust and the newspapers are now filled with homes on auctions. A friend who works at one of the largest auction house claims that houses are now being auctioned and bids are placed at fair value less 40%.
The low interest rate environment coupled with credit growth has led to a classic illusion that the appetite for houses was insatiable. As a result many upmarket apartments, penthouses, golf estates, and beach houses were developed. These developments took place on the premise that incomes were increasing rapidly without considering that credit growth was increasing rapidly. In a recent article published an investment bank lent a sum of R1,5 billion to a young 34 year old developer who developed a massive golf estate which is a complete failure with no

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buyers. Also a prominent Nissan Motor Dealer became a developer and has recently gone bust with a development of R200 million. There are numerous signs that home owners engaged in home equity withdrawal. In a street nearby my residence a house went on auction for R590,000 and the outstanding mortgage was R1,500,000. Going forward the big million dollar question is who will the banks lend to? Recently Standard Bank has decided to finance homes up to R600,000 with no deposit. This implies that the banks are finding it difficult to find buyers with substantial 20-30% deposits. Will the banks new clients who do not require deposit qualify for the home loan and have the propensity to save? Rates and taxes on homes have increased last year and this has further increased the cost of holding homes.

COMMERCIAL REAL ESTATE

The commercial real estate market has lagged the housing market and yields around 12% for properties with blue chip leases are attained. However the market is showing rapid signs of deterioration. An article was recently published "how ten shopping malls got it wrong in which a summary of the problems of some shopping malls are now surfacing. With the rapid credit growth the building costs have also risen rapidly and as a result new malls have been built at a very high cost and thus rentals are outrageous. For example a new mall called "BEL AIR MALL" has the following problems with some of its tenants:
DREAM NAILS: owner thought there would be bustling nightlife and planned beauty salon and coffee shop. They promised me "the sun, the moon, the stars." I got nothing, want out, but is tied to a lease.
ZANNY DOLLS (clothing shop): pays R20000 rent per month and makes R300 per week.
BLOCKBUSTERS (DVD shop): pays R37000 rent and cannot cover utility bill.
FLOWER SHOP: tenant left and shop locked.
CAPE TOWN FISH MARKET: tenant left and shop locked.
LIQUOR CITY: no client's one till working only.
BEL AIR JEWELLERS: has had two armed robberies and wants out. Started chain smoking because of stress!
WIMPY FAST FOODS: has no customers and staffs looks bored.
FLOWER SHOP: locked and tenant gone.
ENGEL AND VOLVER: real estate shop locked and tenant gone.
ROYAL RUGS: (carpets) has no customers.
In Soweto a predominantly low income area, a mall was constructed at a cost of R600 million and high end boutiques like Fabiani were brought selling shirts at $300.

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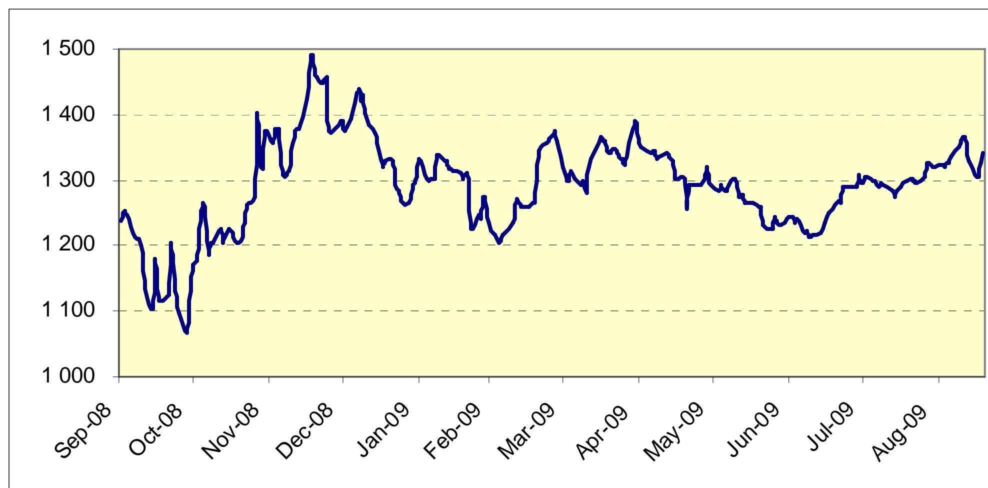
South African malls have been the victims of a massive boom bust cycle in which assumptions have been made that low income consumers have migrated to middle income, when in fact many low income consumers became first time users of credit facility that was expanding over the last eight years or so. The number of real estate brokers has shrunk from around 100000 to 40000 and this will impact the office market severely. Going forward many stores will close and leases will be not renewed or tenants will negotiate big discounts on rentals.

GROWTH POINT PROPERTIES



Source: Bloomberg

THE RETAIL ENVIRONMENT

Car sales in South Africa have declined 26,8% year on year. In the past car deals would be approved within an hour or so and lately the banks are declining border line cases. At the same time new car prices have skyrocketed to the extent that they are unaffordable and this has impacted new car sales drastically. Some car dealers say that they may get 30 loan applications and only 3 to 4 are approved. Over the last five years or so, dealerships have expanded their car franchises with new showrooms ad lifestyle centres catering for the new consumer with unlimited credit facility. These new showrooms were built at a very high cost and were leveraged almost entirely. Furniture and appliance sales are down substantially and store closures are now taking place. Restaurant sales

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have been declining with many closures expected this year. Overall retail sales are down 6,7% year on year.

THE INFLATION DILEMMA

There are some stores now advertising clothing, furniture, and appliances at bargain prices. Some food items have recently come down due to the fact that some multinationals have seen volumes decline by some 20% .There are some off peak specials for holidays but no real improvement in hotel rates. You can buy some clothing items at discounted prices for odd sizes and colours. Fast food prices have been moving up steadily over the years as food inflation skyrocketed over the last few years or so. Electricity, school fees, medical costs have been moving up by at least 10-15% per annum. For example electricity went up 26% last year and now 32% this July. A school teacher recently complained to me that his utility bill is R3000 and his salary is R10000 net. You can go to the mall and buy discounted odd size clothing for 50% less but no discounts for medical care and university fees are available.
The majority of consumers spend almost 35% of their income on food and low income consumers 50% of their income on food.

THE BANKING SECTOR

The banking sector is showing signs of stress and bank lending has been declining steadily. However the stock prices of the banks have rebounded tremendously since the March lows. Overall South African banks are between 15-18 times leveraged. (i.e. assets are 15-18 times net equity excluding preferred stock).This is low compared to the European and American banks that are leveraged 40 times. Prime interest rates have dropped form 15,5% to 10,5% and yet there are no overall signs of improvement in lending. South Africa is late in the economic cycle since commodity prices peaked in August last year .My feeling is that the banking sector will deleverage its balance sheets to 10 times equity in the interim. This may mean much lower future lending or some capital raising exercise or even liquidating unwanted assets of their balance sheets. The rate of defaults may rise even more as job losses mount and the strong rand is impacting mining and manufacturing that account for almost 20% of GDP. At the same time jobs are being lost in real estate and finance.

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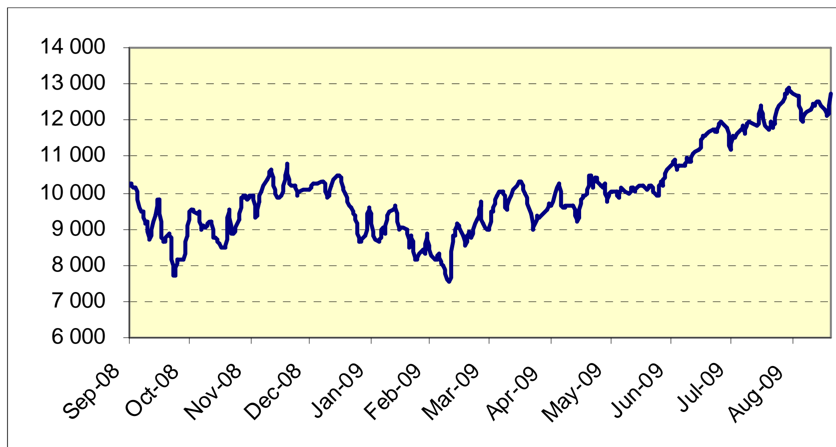
ABSA BANK



Source: Bloomberg

THE WORLD CUP MANIA

The world cup will be hosted by South Africa during 2010 and country is ecstatic as we have many football fans and hopefuls who think that the world cup will generate positive benefits afterwards. The Olympic Games greatly benefited Barcelona in 1992 and tourism and the economy improved tremendously for this city. In the case of Greece the world cup was a disaster as many people were ripped of with expensive hotels and restaurants. South Africans are excited at the prospect of charging massive amounts for accommodation as we do not have enough hotels. Already adverts are being placed for accommodation at up to $5000 per night. The amount spent for stadiums is close on to R48 billion and the question is whether we will benefit from these stadium investments. South Africa has not even invested in new Universities for the last 15 years considering the population has increased.

THE MINING SECTOR

The mining sector has been suffering this year as commodity prices have slipped severely globally. In an article featured last week newspapers cited the possibility "that mining ghost towns" are probable as another 50000 jobs will be shed. Higher mining costs due to higher labor, electricity, and fuel costs plague this sector.

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WHAT WILL POLICY MAKERS DO?

Business report headlines
September 14, 2009 recession forces retail chains to sharpen focus on value for money.
September 15, 2009 Recent moves in rand and oil prices clear path for rate cut
SA unlikely to repeat robust growth
September 16, 2009 Gordhan warns of a higher deficit
Electricity fee hikes given nods
September 17, 2009 nationalise the food sector, unions urge

The Reserve Bank governor has come under harsh criticism for his tight monetary policy approach called "inflation targeting" and will be replaced shortly. The new Governor Gill Marcus will assume her post as the new Zuma led government is under increasing pressure to create jobs. I think that the Reserve bank governor will be under increasing pressure to lower interest rates all the time. They will try to weaken the strong rand which is destroying manufacturing and mining jobs and halt the deflationary spiral of the real estate markets. In a recent productivity survey South Africa came in 43 with Switzerland in the lead. The South African economy's manufacturing base has declined from around 25% of GDP to around 16% currently.
Creating jobs with a population that is increasing locally and given the fact that we have millions of foreigners that have settled here will be a challenge. The budget deficit is likely to reach 8% of GPD this year and private sector debt is 100% of GDP and extremely high considering our high unemployment of 25% .Public sector debt is around 36% of GDP and the government may engage in stimulus packages if the GDP keeps faltering.

INVESTMENT CONSIDERATIONS

The South African stock market has risen tremendously from its low of 18000 in March to around 26000. It seems that global liquidity and the coordinated efforts of central bankers globally to prevent deflation have been a catalyst for all emerging stock markets. However South African consumers have been hard hit by inflation and moving forward the consumer will keep suffering from inflation even if it is moderate. The South African rand has gained strength against the US Dollar over the last few months and it is possible to test R7 to the dollar by year end. In an inflationary environment such as Zimbabwe the stock market kept going up even though the economy kept faltering. Worldwide stock markets

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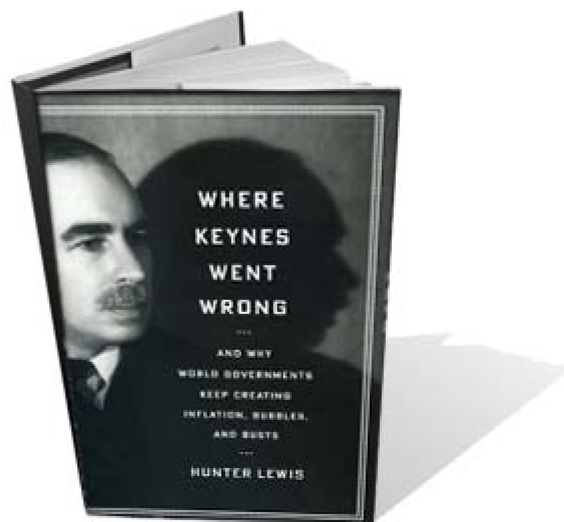
have risen tremendously and a correction is due shortly and thereafter the South African stock market will move higher as global stock markets rally towards the year end.

What Keynes Said, and Meant

Mises Daily by Robert Blumen | Posted on 9/29/2009 12:00:00 AM

[Where Keynes Went Wrong: And Why World Governments Keep Creating Inflation, Bubbles, and Busts • by Hunter Lewis • Axios Press • 390 pages]



"Lewis's book is accessible to anyone who has had a macroeconomics course, and to the general reader of the business media."

This important book fills a gap in the literature. It is an Austrian critique of Keynes that is concise and accessible to the general reader.

Hunter Lewis says that he set out to write the book that Hazlitt had planned when he began composing The Failure of the New Economics (p. 10). Hazlitt started out planning to produce a popular book, but as he delved more deeply into his task, the result was something closer to an academic treatise. Lewis's book is accessible to anyone who has had a macroeconomics course, and to the general reader of the business media.

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Keynes is a famously difficult writer to understand. While his ideas have achieved tremendous influence, most people have been exposed to them only by reading macroeconomics textbooks (which provide a second- or third-generation graphical synthesis of The General Theory), or through media buzzwords such as "stimulus" and "monetary policy."

Lewis writes, "Because few people have read Keynes, it is easy to be confused about what he said" (p. 7). Another source of confusion is that

Keynes himself is often obscure, even at first glance self-contradictory. In some cases, very close examination reveals that Keynes was not actually contradicting himself. Often he was simply being sloppy, although sometimes he seems to be intentionally opaque, rather like former US Federal Reserve Chairman Alan Greenspan.… Opacity has its uses in politics, especially when there is a logical difficulty to obscure or evade.

Where is the logical place to start in order to gain a clear understanding of this difficult original material? Lewis's strategy is to go directly to the source. In part 2 of the book, he presents Keynes's views in a series of short quotes and excerpts from his works (mainly The General Theory). Lewis presents the original words with a minimum of analysis and interpretation.

Reaching chapter 5, in part 2, Lewis summarizes Keynes's macroeconomics as a series of main points (p. 47): (1) people are too future oriented; (2) society tends to underconsume and oversave; (3) interest rates tend to be too high; (4) monetary policy can lower interest rates by money printing; and (5), the core of the theory, "unused savings … interrupt the flow of money through the economy and lead to unemployment. Unemployment reduces society's income."

Keynes believed markets to be fundamentally broken. Markets do not clear, the price system does not allocate resources, and generally, the entire system is unstable and possesses no self-correcting features.

In part 3, "Why Keynes Was Wrong," Lewis presents common-sense arguments and counterfactual evidence that refute the doctrines presented in part 2. He attacks Keynes from several directions: in some cases, showing that what Keynes said makes no sense or contradicts itself; in other cases, citing empirical studies that have produced results contrary to Keynes; and finally, developing alternative theories that make more sense.

"Keynes believed markets to be fundamentally broken."

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The alternative theories are thoroughly Austrian: the author draws upon Mises, Hayek, Rothbard, Reisman, Hutt, Rueff, and Hazlitt for most of his analytical tools. Lewis clearly has a deep understanding of the Austrian teachings on production, money, banking, and the business cycle.

Part 3 parallels the structure of part 2. In fact, in the table of contents, the two parts of the book are lined up in vertical columns, with the heading for each fallacy on the left aligned with the one for the refutation of that fallacy on the right. For example, "Spend More, Save Less, and Grow Wealthy" is lined up across from "Spend More, Save Less, and Grow Poorer."

I will provide a couple of examples of Lewis's analysis. In response to Keynes's view that "interest rates are [too] high because people refuse to lend … on reasonable terms" (p. 91), Lewis writes,

The idea that lenders are obstinately holding out for exorbitant rates is particularly odd. It suggests a one-sided market in which the lenders have all the power and borrowers have little or none.…

Neither lender nor borrower can dictate terms in the market for money any more than in the market for other products or property. (pp. 91–92)

Lewis comes down especially hard on one of the most damaging fallacies of the Keynesian system: the proposition that "new money that has been injected into the banking system is 'just as genuine as any other savings'" (p. 98). Lewis writes,

It is Orwellian to refer to newly printed government money as "savings." Whatever the merits or demerits of "printing press" money, it is not the same as savings. The word savings describes money that has been earned, and having been earned, is not spent but rather set aside for emergency or investment use.…

The government's new money will eventually destroy traditional savings. This is true because the resulting inflation … will ultimately erode the purchasing power of traditional savings and thus ruin the saver, especially the small saver.

Several main themes emerge from Lewis's detailed analysis. One is that most of Keynes's doctrines are paradoxical. The most well-known example is the paradox of thrift: saving is good for the individual but if everyone tries to save, then it drives the economy downwards into a bust.

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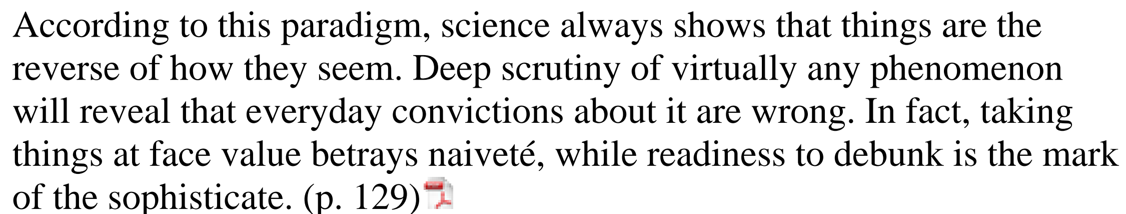
Another example is "unemployment equilibrium" — the proposition that a market with unemployed resources has no tendency toward their employment.

Keynes's method of contrasting paradoxical truth against naïve common sense brings to mind philosopher Michael Levin's discussion of the "skim milk fallacy":



According to this paradigm, science always shows that things are the reverse of how they seem. Deep scrutiny of virtually any phenomenon will reveal that everyday convictions about it are wrong. In fact, taking things at face value betrays naiveté, while readiness to debunk is the mark of the sophisticate. (p. 129)

Lewis tackles Keynes's obscurantism head-on with clear, logical arguments that reveal the nonsense within the paradoxes. He shows how Keynes relied on rhetorical tricks such as shifting definitions, statements that appear plausible but on closer examination make no sense, and hidden self-contradictions.

Contra the "paradox of thrift," Lewis writes,

There is no paradox here; Keynes is wrong. It is prudent for families facing job loss to put something away. It is also prudent for a society that has overspent and overborrowed to start saving. This is true with or without an economic slump.

As we have discussed, the slump came because the government … artificially stimulated the economy by printing new money and injecting it into the economy through the financial system. This lowered interest rates and encouraged a wave of wasteful borrowing and spending by both businesses and consumers. In particular, vast sums were borrowed which would never be paid back.…

The bad investments of the recent past need to be liquidated, or at least marked down in price. Until this happens, savers should build their cash positions and refuse to use them. To invest at the old, unrealistic asset prices would just continue the old pattern of throwing money away. (pp. 129–130)

Another recurring theme in Where Keynes Went Wrong is Keynes's reliance on hunches not supported by facts. For example,

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Keynes offers not a shred of evidence that savings have exceeded investment throughout human history. This is another of his hunches.

He is correct that rich societies, like rich individuals, save more. But it does not follow that they produce more "excess" or "unused" savings.

Lewis demonstrates that Keynes frequently uses a hunch to decide a point in his reasoning that cannot be decided on theoretical grounds. The direction of his hunches was always in the direction that he needed the argument to go in order to get to the result he wanted. As Lewis later argues, Keynes in fact had the answer in advance; he knew what type of policy recommendations he wanted to make and he built his intellectual system to arrive at that destination. In those cases where empirical data existed at the time of his writing, Keynes often dismissed it with no counterevidence.

A running theme of Lewis's critique is Keynes's masterful use of satire and condescension: "satirical burlesques are a Keynesian specialty" (p. 121). Keynes loved to heap scorn and ridicule on the opposing view. Lewis inserts "pauses" in the book where the reader can give "Applause (for the satire)."

Keynes aimed to show, through this satire, that individual behaviors that economists have always thought to be rational and self-interested were in reality irrational and dogmatic. He characterizes saving, for example, as a religion with no practical end (p. 120). Likewise, he claims that policies usually considered sound and prudent, such as balanced budgets, in reality restrain economic growth. Governments, for example, should welcome disasters as an opportunity for deficit spending (p. 131).

Most of part 4, and some digressions in parts 2 and 3, cover what might be called the sociology of Keynes: the way that certain features of his personality and particular talents contributed to the widespread adoption of his views. His success requires explanation because it is entirely undeserved on the merits of the ideas themselves. Lewis identifies several factors, especially Keynes's writing style, his debating skill, his political maneuvering, and his gift for inflicting ridicule and embarrassment on his opponents, as keys in winning the day.

Finally, Lewis arrives at an important juncture:

One could go on, almost indefinitely, citing Keynes's obscurities, convolutions, inconsistencies, factual or logical lapses, and so on, but it is

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time to ask the obvious question: why did he write The General Theory this way? (p. 277)

And he offers the answer:

Keynes was a salesman. He was trying to sell a particular type of economic policy, and he was prepared to utilize any rhetorical device, from crystal clarity and wit all the way to complete unintelligibility, in order to make the sale.

Why would unintelligibility help to make the sale? Not just because it can be used to impress. Equally important, it can be used to intimidate. (p. 277)

Lewis suggests that these qualities, which made Keynes such a formidable debater, did not translate well into written arguments. Debate is fleeting and Keynes's opponents could be disoriented by his quick wit and confusing shifts of meaning. But written words are stable, so his critics have the time to go through them in detail. Hazlitt in particular was able to identify all of the shifting definitions and other tricks that might have passed by too quickly in verbal argument.

This review only skims the surface of Lewis's book. For instance, I have not devoted any space to his excellent coverage of recent events, including the corrupt bailouts. The work contains so many gems that it would be impossible to give due credit to the author without writing a review twice as long as the book itself. The book is highly readable. Lewis is an excellent writer, and I often found myself rereading particular passages.

I came away with an appreciation of the great mystery of Keynes: how did his ideas come to have the profound influence that they do now? The ideas in The General Theory form the foundation of modern macroeconomics, which itself guides the central banking and monetary policy in every country. Keynesianism, if not Keynes, is deeply embedded in academic economics, government, and the public consciousness.

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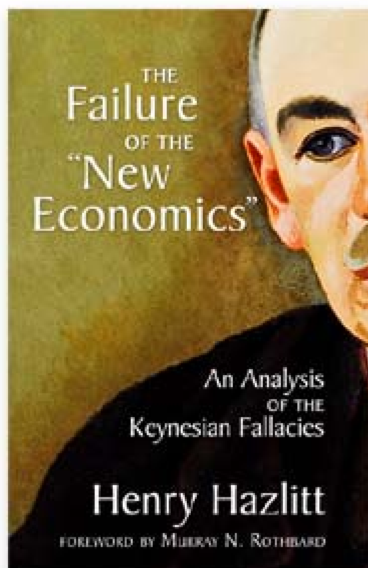

It is difficult not to think that there must be something really deep and profound there (something wrong, perhaps, but surely something deep and profound). Could several generations of professional economists have been so wrong as to adopt an intellectual pile of rubbish as the basis for making decisions having impacts of trillions of dollars?

And this is the book's most important contribution: it demystifies Keynes. Lewis cites a story from one of Keynes's books in which

British Prime Minister Lloyd George "bamboozled" US President Woodrow Wilson … [then] found that "it was harder to de-bamboozle [Wilson] than it had been to bamboozle him." This describes our predicament today. Keynes has bamboozled us and it is very difficult to de-bamboozle ourselves. (p 304)

This book makes a significant contribution to that task.

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