

INSTITUTIONAL ADVISORS

W. ROBERT HOYE
ADDRESS TO THE HALKIN DINNER MEETING
October 11, 2011 – London, England

Massive Struggle

No doubt policymakers still consider themselves as the powers of light in a financial world that would otherwise be dark and chaotic. A random world of unenlightened chaos.

When their intentions of stability are interrupted by adversity macroeconomists claim "*Exogenous!*". If things go really bad – its "*Super-Exogenous!*".

When things go wrong for most policy makers it was due to a "*Policy Overshoot!*", or at the bottom of a recession – it's "*Undershoot!*".

You get the picture.

With great un-expectations, there always something out there to blame.

Silver bugs spend far too much time focused upon supply imbalances and when it inevitably crashes they all shout "*Conspiracy!*".

Of course, the high-end of the gold community is not immune to surprise and then the usual suspects are rounded up. Monsoons and the number of camels in the Arabian Souks provide convincing excuses.

Actually, at exciting times silver acts like a credit spread and as we all know central bankers have little influence upon credit spreads or the yield curve.

A thorough review of history concludes that its great events have similar set ups and there is little justification for "Exogenous", "Overshoot", or "Conspiracy".

This holds for more recent intuitions about market surprises such as "Black Swans" that are rare and unpredictable.

Since the first really big one in 1720 a great financial mania has preceded every great crash and subsequent great depression.

This pattern has been regular, with 2007 being example number six.

Where the evidence is available the same old change in credit markets leads the same old crash by a number of months. We expected credit markets to reverse to the "*Greatest train wreck in the history of credit!*" This was the theme of our presentation to the meeting commemorating Teddy Butler-Henderson in early June 2007.

One would expect that central bankers would know that great manias run some 12 to 16 months against an inverted yield curve. May 2007 was the Fifteenth Month and that fateful change began.

The common feature of the initial post bubble contraction is the stock market crash as short-dated interest rates take a significant decline. During the 1873 Crash the re-discount rate tumbled by 650 basis points.

In 1929, and despite being called the discount rate it plunged by 500 bps.

In 2008, and despite being called Fed Funds it plunged by some 500 beeps.

The rule has been that post-bubble collapses have been accompanied by crashing short rates. Why did the establishment at the sign of troubles in 2007 boast that the Fed would "cut" interest rates and there was no need to worry.

Too many academics still think that the Fed increase in August 1929 from five to six percent "caused" the Great Depression.

No – that was caused by excessive speculation and its demise was signaled when treasury bill rates started to decline in May 1929.

Let's step out of the past for a moment and ask, "*What's next?*".

The business expansion out of the panic that ended in 2009 reached its peak in May 2011. Our conclusion was based upon our Momentum Peak Forecaster that has interesting results when the big action includes commodities.

The Forecaster usually leads the top of speculation and the beginning of the recession by up to three months.

The signal was given in November 1973, commodities peaked a couple of months later and eventually the NBER determined that the recession started in November 1973.

The next such signal registered in November 1979, gold and silver peaked in that fateful January and eventually the NBER determined that the recession started in that fateful January.

This clicked in in January and we expected commodities to surge until around April. Eventually the NBER could decide that the recession started in May.

It could become another "fateful" month.

For us, all the hot action would complete in April and would be followed by a cyclical decline.

More recently, commodities, corporate bonds and a number of global stock exchanges were making new lows.

Senior stock indexes in New York were not, but kept bouncing off the August lows. That, along with the gold/silver ratio not breaking to new highs recommended that October may not be a continuation of the disaster. So far, so good, and the dollar reaching overbought has relieved the investment community.

The rebound is dynamic, but does not represent salvation. Sideways volatility could run for a month or so.

All policymaking has been is a high-falluting scam to transfer wealth and political power from the people to the governing classes – forever.

That's what the Soviet governing classes believed until the Berlin Wall was pulled down in 1989.

Ironically, Obama has been building a massive wall of intrusion into private life and the public is getting fed up with the nonsense.

The financial world is in a fairly typical post-bubble contraction and the next acute liquidity problem will serve again to remind that the Fed can and will be trumped by margin clerks.

And it is timely to review their job descriptions:

The central banker's mandate has been to get the accounts leveraged up and "out of line".

The margin clerks job has always been to get the accounts "in line".

The clash between the forces to "manage" everything have been the most massive in over 400 years. Opposing forces are mounting and gaining political strength. Freer markets will eventually prevail and the next decline will further diminish the nonsense of intervention.

While there is no guarantee that our great contraction will continue, there is no guarantee that it won't. It is prudent to consider the odds.