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Sympathy for the devil ?

"The whole world is drinking poison to quench its thirst. It may feel like relief now, but the sickness will strike in 2012."

- Economist Andy Xie, referring to capital injections to stabilize the financial system.

Karl Marx held that capitalism would end through the revolutionary actions of communists. If capitalism does end as a result of a financial crisis that many presume to be over but which we believe is merely in abeyance, it will have come about simply by collapsing in upon its own self-interest. That may actually be a little unfair, not least in semantic terms; the OED defines capitalism as a system which favours the existence of capitalists – a term which it goes on to define as "one who has capital available for employment in financial or industrial enterprises". There is, in turn, a tendency to conflate capitalism with free markets. And the irony, of course, is that we now have neither. Banks are bereft of capital, and the free market has in large part been suspended by government fiat (and governments aren't exactly overflowing with capital either). So the government now controls the price of money (thus impoverishing savers), and despite its ownership of much of the banking system, seems powerless to stop the banks it owns from refusing to lend much of it out – but equally powerless to prevent the banks it owns from lending money to foreigners so that they can take over domestic businesses with the associated threat to domestic jobs. If we outsourced our government to al-Qaeda it could hardly make a bigger mess of things. The alleged unwillingness of capital-light banks to lend may also be missing a broader point: as per Japan's experience during its own balance sheet recession, cutting the price of money to zero has little impact when few really want to borrow and many businesses and individuals are in a greater hurry to pay down their debts than to take on fresh ones.

Either way, if capitalism is dead, or at least gravely ill, it was mauled by a motley combination of bankers – admittedly already in the frame – and politicians – still trying to scuttle away from the public gaze. The bankers overdosed on credit and poured toxic assets into the wider economy; the politicians managed to ensure that any control and regulatory infrastructure was unfit for purpose. While taxpayers watch mystified as this crazy waltz continues to ever more discordant music, bankers display their tin ear to criticism of practices that in less "developed" markets might lead to the death penalty. There is a reason why Bonus Season 2010 may come to be seen by future historians as the last straw for finance as we know it; because every other business on the planet only exists by providing value to its customers. Banking seems to be unique in that its practitioners expect to be well compensated irrespective of the services – if any – provided to its customers, and irrespective, for that matter, of the ultimate source of their own capital. As California Congressman Phil Angelides nicely suggested of Goldman Sachs at last week's Financial

Crisis Inquiry Commission in the US, Wall Street has been selling cars with faulty brakes and then taking out life insurance policies on the drivers.

Anyone wanting front row seats for the critical struggle for the future of free market capitalism need only open their Financial Times to its combined Letters and Comment section. The commentaries are awash with analysis of the latest financial crises – notably the rapid deterioration in the outlook for Greece and the implications for the health of the wider Euro zone project – while the Letters section has for months been carrying extensive but so far inconclusive skirmishing between banks' critics and their fast diminishing band of sympathizers. But it is the readers' letters that stand out for articulating the popular mood, one of what we might call heated disenchantment and growing anger. FT writers and guest commentators are no slouches when it comes to highlighting the travails of the financial system and issuing ameliorative advice, but it is in the nature of journalism that it avoids the middle way, preferring to oscillate between the poles of triumph and (more recently) disaster. Luke Johnson, the chairman of Channel 4 and a noted entrepreneur, took Barbara Ehrenreich to task last week in his FT column for what he took to be the message of her book "Bright-sided: how the relentless promotion of positive thinking has undermined America". He cautioned against despair and denial. Mr. Johnson may be inferring that positive thinking and optimism are the same thing; as the last few years in the US financial system have shown, they are not. It was surely positive thinking (and groupthink to boot) that caused so many financiers to blow their employers up and require government support after incurring catastrophic losses; it was optimists that have made money, to date, by buying the markets at their March 2009 lows. In any event the middle course of realism is surely the preferred route, one that enables us to recognise the gravity of the threats facing the economy, and position our portfolios accordingly, rather than blindly adopt traditional investment approaches (government bonds are riskless !) and hold on and hope for the best. Entrepreneurs may also be something of a special case, a conclusion made by John Gartner in his recent book "The Hypomanic Edge: the link between (a little) craziness and (a lot of) success in America". It may well take just a little craziness to ignore conventional wisdom and take the plunge in launching a new business in the face of nay-sayers and widespread scepticism. Bankers, however, we now know to be simply mad.

A generalised loss of confidence in the capitalist system and a broad distrust of finance may turn out to be a promising secular backdrop for equity markets. Particularly when joined by miserabilist reporting such as Institutional Investor's recent pessimistic corker, "The Equity Culture Loses Its Bloom". This is all investment strategy out of the rear view mirror. The time to be sceptical of equities is after a decade-long boom, not after a lost decade during which stocks went essentially nowhere. But when there is a world-weary distrust of financiers and most things economic, indeed real concern over the longevity and vitality of the capitalist system, there is also a profound contrarian boost for equities being created. Not all stocks will thrive, of course, just as not all government bond markets are worthy of investment. But whereas the bond market has been manipulated to hell and back through the arcane magic of quantitative easing, the stock market remains just that – an open market free of much government constraint where the winners generate rewards for the optimistic realists who can identify them.

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