View from the Bridge

an alternative view of the investment world by Clive Hale

Moral hazard and the law of bizarre consequences – February 8th 2012

Posted on **February 8, 2012**

In my formative years, moral hazard was being caught in flagrante delicto by the girlfriend's parents. Today the principal has been abandoned for a code that allows the perpetrator of any financial "crime" the benefit of the doubt, or rather the benefit of remaining solvent at our expense. Any government's income comes in very large part from the imposition of taxes and any form of expenditure be it bail outs, money printing and other financial chicanery gets paid from that income either now or in the future.

In the good old days of accrual accounting balance sheets were signed off as showing "true and fair value" and there was an actual number for contingent liabilities. Today "mark to market" has become "mark to unicorn"… Back in a somewhat more realistic world, if a company (even, heaven forbid, a bank!) was insolvent it went bust thereby giving a salutary reminder to investors, depositors and creditors of the maxim of caveat emptor. By creeping paralysis that principal too has been abandoned by governments and regulators who believe they are better equipped to save us from our own mistakes. The consequence (unintended or otherwise) of which is to compound the error.

Once the basic tenet of capitalism, the efficient allocation of capital, is circumvented, the virus spreads. The current wisdom is that when the patient becomes too big to fail more medicine is administered and, "Guess what?", the patient gets bigger. It then becomes an act of faith to assume that in time the medicine will work. Viruses, like our financial systems, are highly adaptable and become immune to the antidote and ultimately kill their host, as Greece is about to find out.

It seems that economics has become like a religious experience based on superstition and myth and naysayers are tied to the stake and burnt…or worse. Keynesianism may have worked in the past (more by accident than design…) but printing money to infinity no longer does the job because the banks need this medicine – liquidity – to stay alive whilst the host, to whom the money should be flowing – the economy – is dying slowly on its feet.

Maybe Bernanke should set loose his helicopters full of cash. At least this would ensure a fairer distribution of the largesse, although being an avowed student of the Great Depression; he will know that hyperinflation comes next if he does. He will claim to be able to control inflation by employing Volckeresque rates of interest, which reached 20% in the early 80s (to control CPI at a mere 15% – hardly "hyper") but ask yourself how much that would cost the taxpayer in terms of servicing the unfeasibly larger pile of US and other sovereign debt. Once you have worked that out you will need to break out the malt and have a sizeable dram!

But, and it's a big but, the central banks and their acolytes have kept this ponzi scheme going for a very long while, and may well succeed to do so for some time, with the rather bizarre consequence that I may still reach a care free dotage reminiscing about the occasions on which I avoided moral hazard in my youth!

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Investment Biker…with apologies to Jim Rogers – January 28th 2012

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Being a long time motor biker I am very conscious of the ever present threat that comes from being unaware of what is in front of you. Positioning is vital to have a clear view of what is coming your way and to avoid all the pitfalls that too many only learn about with hindsight and a trip to hospital…or worse. It is essential to pay attention to the ever changing conditions and to hone your skills accordingly.

Investing is little different although it is rarely fatal except to your wealth rather than your health; although a shortfall in the former often results in a similar effect on the latter. A high percentage of accidents happen within close proximity to home; familiar territory creates a false sense of security. And so it is in the investment world. We all remember the old adage that property prices never go down, which they didn't for a long time, until of course they