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Looking for a Steady State

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During the credit crisis of 2008 and the subsequent Euro crisis of 2010, we heard a lot about, “kicking the can down the road.” It was a familiar trope in the financial press at the time; policymakers had no real idea how to solve the problems that had presented themselves, and like the Dutch child with his finger in the dyke, they would simply press on and hope that something would turn up.

The solutions to the financial crises of that time have, unfortunately and perhaps predictably, saddled the present time with equally intractable problems including incalculable debts, low growth, populism, war, and inflation.

In an interesting and reflective op-ed this week, the 76-year-old Robert Reich, an influential economist at Berkeley and former US Secretary for Labor, exhorts Joe Biden not to run for president in 2024. He cites two reasons: one is simply Mr Biden’s age. He would be 86 at the end of a second term and despite one’s 70s being the new 50s, managing the world’s most powerful economy is, to say the least, physically and mentally taxing or so one would assume.

The second reason is more revealing in that he says, “I think my generation – including Bill and Hillary, George W, Newt Gingrinch, Trump, Chuck Shumer, Nancy Pelosi, and Biden – have f*cked it up royally (sic). The world will probably be a better place without us.”

In other words, the generation that kicked that can down the road have indeed, and, at last, run out of road. As a verdict on 40 years of political and economic policymaking it could hardly be more damning.

Of course, there is a contradiction at the heart of the can metaphor; people run out of road, but economies don’t, or at least, not very often. The problems bequeathed to us today by Reich’s generation require people of stature in this generation to solve them or, perhaps, kick them in a different direction.

Enoch Powell once reflected that, “all political careers end in failure,” and in Reich’s words there is a touch of anguished ruefulness at the passing of a political generation and of the opportunities wasted in the pursuit of short-term tactical victory over long-term strategic thought. But there is no doubt his generation have left a legacy of deeply rooted problems.

Growing up in the 1970s and 1980s at the height of the cold war we were very conscious of the existential threat of nuclear Armageddon. Putin’s war in Ukraine and his “new iron curtain” rhetoric have reanimated those primal fears. Nonetheless, nuclear Armageddon did not occur but if, ”the price of freedom is eternal vigilance”, the West has certainly been complacent.

Normal life continued throughout the cold war, business carried on as usual, but today any thought of a “peace dividend” has evaporated. Despite budgetary constraints, military expenditure will rise. Sadly, humanity’s martial instincts seem stronger than the desire for peaceful coexistence but ironically military R&D spurs civil innovation.

Short of a nuclear conflagration which renders all our quotidian problems moot, the biggest challenge for today’s political leaders is on the one hand, inflation, and on the other, the consequent and necessary rise in the cost of money.

Investors will need to adjust back to the period that prevailed before the various financial crises exploded. Money should not be free; QE was always a temporary, emergency policy. The cost of money enables a proper assessment of the economic advantages of competing projects to be made. It instils financial discipline and prevents the unstable and dangerous build-up of uneconomic liabilities and imbalances.

Some of the froth engendered by cheap money is visible in the breakdown and bankruptcy of much of the “crypto-currency” world. Reminiscent of the “dot.com” era, it will be interesting to see what emerges from the wreckage.

You may remember the NICE decade. Mervyn King, governor of the Bank of England, coined the phrase in the 1990s to describe the era of “non-inflationary, constant expansion.” It’s clear that we are now living in the NASTY decade of higher inflation and lower growth.

So, in view of these problems and the legacy described by Robert Reich, why do we retain our faith in equities as our preferred investment?

The first answer is that we do not retain our faith in equity uncritically and not all equities are the same. But companies are the single-most effective entity at dealing with change. In a rising inflation environment, assets that generate a fixed return are not attractive and do not hedge rising prices; companies do.

The second answer, and to return to the can down the road: it is a mistake ever to think that the road ends, there is no “shining city on a hill,” there is no “stable equilibrium.” Companies have the flexibility to respond to price signals and changes in consumer tastes at any time.

Thirdly, companies have agency. The rise in public debt levels across the developed world leaves taxpayers to ultimately foot the bill. Businesses are free to manage their own capital, many of whom have stronger balance sheets than their respective governments.

Robert Reich’s thoughts are a rare admission of failure. Let’s hope the current crop of politicians and policymakers don’t look back in forty years’ time with the same sense of quiet regret.