

■ *Chapter 1*

The Incompetence of Economists

COPYRIGHTED MATERIAL

■ Fight the Fed?

May 17, 2001

“Almost half of the 1,300 employees of the Peruvian Central Bank of Reserve are related to one another,” Bloomberg reports. Central banking is, after all, a government job. It is different from, say, the local Department of Human Resources, only in that its employees are better paid and get better press. Even the Federal Reserve—perhaps the world’s most powerful and prestigious bureaucracy—is still, like every other government agency, a scam, a sinecure, and waste of money.

At least, that is the working hypothesis of today’s letter.

Not much in life is certain. That is why it is such a comfort to have government. One of the few things you can depend on is that government officials will do the wrong thing. Even when they occasionally seem to do the right thing—it turns out later on that it was at best accidental, and at worst, the wrong thing after all.

“The last successful government program,” observed New York mayoral candidate Jimmy Breslin, “was WWII.” Since then, there have been a number of wars declared and undeclared by Washington hawks. But in almost every instance bureaucratic instincts and motives were hopelessly wrongheaded.

In the war on drugs, as we observed here just the other day, the government seeks to put drug dealers out of business by interdicting supplies. This is just the wrong thing to do, since it increases profit margins. The more taxpayer money spent trying to keep illegal drugs off the market, the more profitable the business becomes and the more entrepreneurs rush in to fill the unsatisfied demand.

Yesterday’s *USA Today* brought news that the shooting war has moved to the suburbs as dealers battle it out for control of the Ecstasy market—made especially rich by government decree.

If government really wanted to put dealers out of business it would flood the market with illegal drugs—give it away on street corners for free. But what profit could there be in that? Not only would it put the drug dealers out of business—it would also put the DEA out of business, too.

Likewise, if the bureaucrats really wanted to win the War on Poverty—they would tax poor people at a higher rate . . . not reward them with subsidies and handouts. So, too, would health officials cease to coddle the sick and infirm. If they really wanted a nation of healthy people, they would revoke public health insurance benefits for people who eat too much or watch TV all day, and perhaps shoot a few smokers and fat people in the streets.

Thus do bureaucrats go about their business—making worse whatever problem they're supposed to be fighting, while actually increasing their own power. It is a rare person who will not give up his dignity and his common sense in a bid for riches, fame, or public office.

Even Alan Greenspan, once an Ayn Rand devotee, could not resist the lure of power. In order to get his picture on the cover of *Time*, something he could never do as an “Individualist,” he has become a collectivist central planner.

Unlike other activities in life—from shopping for vegetables to running a Rotary club—government distinguishes itself in a singular way: by its ready use of force. Instead of coming to terms with people in a polite and dignified way, government orders them around like prisoners of war. The results are almost always pathetic and absurd.

Could it be any different with Alan Greenspan and the Federal Reserve? Could the interest rates proclaimed by the Greenspan Fed be superior to those set by buyers and sellers? Could this be one—and perhaps the only one—instance where government is superior to the market, and where the judgment of powerful government bureaucrats is superior to that of millions of investors and lenders?

Raising these questions, I realize that I put myself directly in the path of the rush of popular opinion. “Don't Fight the Fed” blows the common sentiment.

The odds favor the Fed, it is believed. Because easy money has to go somewhere . . . and because stocks rise more often than they fall, anyway. The Fed, clearly committed to cutting rates until the economy turns around, seems to be offering investors a no-lose wager. If at first the Fed's cuts fail to boost stock prices . . . Greenspan will try, try again—and

keep trying until the market finally responds. And yet, anyone betting on government bureaucrats to win the War on Poverty, the War on Drugs, or any of its other wars since 1945 would have found himself on the losing end of the wager.

Even the Fed itself has a reliable record. Charged with protecting the currency, it has done the exact opposite. In the 100 years preceding the creation of the Federal Reserve System, the dollar went up and went down, but it ended the period about where it began, worth as much in 1913 as it was in 1813. Since then, thanks to the Fed's management, it has lost 95 percent of its value.

Having failed so miserably, the Fed has done just what every government agency seeks to do—expand its mandate. Now, the Fed has taken on the job of managing the economy as well as the currency.

Mr. Greenspan believes, at least publicly, that the Fed can manipulate key interest rates and keep the economy expanding almost eternally. And the public believes it, too.

Even people who have not yet begun to shave believe it. Teddy Chestnut, of Montclair (New Jersey) High School, said he was “almost positive” that the Fed would cut another 50 basis points this week. “People are losing confidence,” he explained, “and right now spending is the only thing keeping us out of a recession.”

If the Fed merely cuts rates, Teddy seems to think, consumers will be inspired to do more of what they do naturally . . . and the economy will continue its record expansion. It is, of course, possible that the economy functions in exactly the way Teddy imagines—with the complexity of a grandfather clock. Greenspan has merely to adjust the pendulum to make it run faster or slower as desired. This view helped Teddy's team win \$40,000 from Citibank in a remarkable competition called the “Fed Challenge.” The challenge for the kids is to think like central bankers. That is, to think like central bankers who believe that Alan Greenspan is a bureaucrat like no other . . . one whose decrees actually lead the nation where it wants to go.

How likely is that, dear reader? Should you “fight the Fed” or not?

■ The 17-Year Itch

August 30, 2001

Thus is the universe alive. All things are moral. That soul, which within us is sentiment, outside of us is the law. We feel its inspiration; out there in history we can see its fatal strength. “It is the world, and the world was made by it.” Justice is not postponed. A perfect equity adjusts all parts of life.

Oi chusoi Dios aie enpiptuosi—the dice of God are always loaded.

—Ralph Waldo Emerson

Yesterday’s news brought new evidence, not necessarily of a moral universe, but of a symmetrical one. Nature gives . . . but it takes away too.

Far from Wall Street, the law of regression to the mean . . . of “return to trend” . . . has been invoked. A sentence has been handed down and carried out. “Japanese Stocks Plunge to New Low,” the BBC reported.

Ten years ago, the Dow in Tokyo and the one in New York were 35,000 points apart. Fewer than 1,000 points separate them today.

Yet, there is still a big difference between Tokyo and Manhattan. Wall Street is still on top of the world, the way most people view it. Tokyo is on the other end.

Daily Reckoning masochists will recall the Japan story. It has been recited often in this space, once as a cautionary tale, then as moral lesson, and most recently as a preview of things to come in America.

In 1989, it was hard to find something negative to say about the Japanese economy. Every word was flattery as the Nikkei Dow rose toward 40,000. The triumph of “Japan, Inc.,” as it was called, was thought

to be inevitable. Japanese labor was more disciplined and harder working than labor elsewhere. Japanese management was willing to look further ahead and take bigger risks than its competitors. The Japanese government was thought to be capable of guiding the economy more artfully than Western counterparts.

Japanese terms—such as *kaizen*—sprang from the mouths of investors in January of 1990, as they rolled the dice again, expecting to win as they had in every year since the “Japanese Miracle” began. Little did they know that the dice were loaded.

The head follows the heart, reasons dress up reality, and markets make opinions. In January of 1990, the Nikkei began its descent. Eleven years later, it is hard to find a good word to say about Japan.

Columnists—so recently busily trying to explain why the Japanese would dominate the world economy for a very long time—now explain why Japan will not recover anytime soon. With an alarming lack of imagination, they turn to the familiar reasons, merely giving them a spin in the opposite direction. Japanese government is out of date, managers are incompetent, and Japanese laborers will never learn the secret of a healthy economy—that is, borrowing and spending!

Rarely (perhaps not since the peak of the Nasdaq), has the financial press been so unanimous. Every headline about Japan makes the country sound hopeless. Yesterday, not only did we learn that stocks “Plunge to a New Low” in Japan, we also discovered that “Japan’s Jobless Rate Surges” to its highest level since WWII (*USA Today*) and “Japan’s Industrial Production Falls for 5th Month” (*Financial Times*).

The Nikkei dropped to 10,9779 . . . below 11,000 for the first time since 1984. It has taken more than a decade, but Japan has erased 17 years of stock market gains. Over a period of 11 years, investors have lost 75 percent of their money as the Nikkei Dow has come from a high of nearly 40,000 to within 900 points of Wall Street’s most popular index.

Tokyo’s unemployment rate—once almost a nonexistent number—has risen to 5 percent . . . almost exactly the same as America’s current level.

Even Japan’s GDP growth and that of the United States have converged—both presently at about 0.2 percent . . . an eight-year low for the United States . . . and very nearly an eight-year average for Japan.

My, my . . . might not other things converge, too? How long will it be before American reputations are flattened by a bear market just as those in Japan have been? Will people come to see that U.S. stocks, U.S. central

bankers, U.S. corporate managers, and U.S. politicians are big losers . . . just like their Japanese counterparts?

“There is a crack in every thing God has made,” explains Emerson. “It would seem there is always this vindictive circumstance stealing in at unawares, even into the wild poesy in which the human fancy attempted to make bold holiday, and to shake itself free of the old laws—this back-stroke, this kick of the gun, certifying that the law is fatal; that in nature nothing can be given, all things are sold.”

“Great bear markets take their time,” says Jeremy Grantham. “In 1929, we started a 17-year bear market, succeeded by a 20-year bull market, followed in 1965 by a 17-year bear market, then an 18-year bull. Now we are going to have a one-year bear market? It doesn’t sound very symmetrical. It is going to take years.”

“Every one [bubble market],” adds Grantham, “went back to trend, no exceptions, no new eras, not a single one that we can find in history.”

Japanese stocks have returned to their 1984 trend line—17 years later. The U.S. bubble market began in 1995. If the United States repeats the Japanese experience, stocks may be expected to return to their 1995 trend line . . . with the Dow below 4,000 in the year 2012 . . . almost the very moment at which America’s baby boomers will most need the money.

Nature in her wisdom . . . and God in his grace . . . always make sure people get what they’ve got coming, not what they expect.

■ From Funeral to Funeral

November 21, 2003

In a world where science and reason do not suffice—and where the future can be anticipated, but not predicted—lives and dies a funny little creature called man. . . .

Come now, you who say, “Today or tomorrow we will go to such and such a city, and spend a year there and engage in business and make a profit.” Yet you do not know what your life will be like tomorrow. You are just a vapor that appears for a little while and then vanishes away.

—James, Chapter 4

The *New York Times*, as reported in France’s *Le Monde*, marks the 25th year of its science coverage with a worry. It notes that while 90 percent of Americans say they are interested in science, barely 50 out of 100 are aware that it takes a year for the earth to make a full circle around the sun.

In an election year, of course, people will believe anything. A politician might go all the way to the White House, in our opinion, by proposing to add a month to the calendar in order to give everyone an extra four weeks vacation. He might also suggest rounding off the number Pi in order to make it easier to remember . . . or reducing the boiling temperature of water, in Fahrenheit, to a round number, say, 200 degrees.

But how the chattering classes would screech! They have come to adore science the way jackals adore road kill; they would be nothing without it. “Better living through chemistry” was their motto back in the 1960s, when mood-altering drugs were popular. We mustn’t lose “the primacy of reason,” says French president Jacques Chirac, 40 years later.

The burden of the following little reflection is that Jacques Chirac is a dreamer and much of what pretends to be scientific is a fraud.

Reason never was primal. Not even secondary. Whoever made an important decision based on reason alone? What fool ever decided what he would eat . . . what he would drink . . . with whom he would sleep and work . . . and what he would do with his life . . . on the basis of unadulterated reason? No one we have ever met.

Instead, reason is so heavily diluted with greed, fear, envy, love, hope, and other emotions, you can barely taste it. It is rarely more than a rationalization for what people want to do anyway. “The head is merely the heart’s dupe,” noted La Rochefoucauld famously. Reason is really only used for things that don’t really matter, such as choosing stocks and cooking eggs.

Still, when the Federal Reserve tells us that the economy is likely to improve in the coming quarters, most people believe that there is something more in this pronouncement than just wishful thinking. They imagine there is some science backing it up. A man reads such a forecast like a favorable report from his latest physical examination. “All clear,” he thinks the doctor wrote. He cannot hear the quacking noises in the background. Nor does he realize that there is no real science behind the Fed forecast at all. Just statistics . . . and many of them phony.

Science is marvelous; who are we to argue with it? But *Daily Reckoning* readers are cautioned: Don’t take it too seriously. We recall that Harry Markowitz won a Nobel Memorial Prize in Economics for proposing a model to predict future risk in markets. Two of his disciples and fellow Nobel winners, Myron Scholes and Robert Merton, used his work to help them run a hedge fund, Long-Term Capital Management. Within four years, Long-Term had come and gone—blown up by a science that any decent trader would have laughed at.

Science evolves from funeral to funeral, it is said. Each corpse is another lesson . . . another scientist gone mad and another theory gone bad. Each exquisite cadaver is another reminder that there are only two kinds of scientific theories—those that have been disproved, and those that have not been disproved yet.

Science is all very well for predicting when a soft-boiled egg will be done. But it is little help in predicting when people will get spooked by the market. At sea level, water will begin to boil at 212 degrees Fahrenheit. Investors could boil over any time.

Scientific market forecasts . . . and detailed economic models . . . pretend that man is something he definitely is not—reasonable and rational. He is neither. If he were, the whole jig would be over. Since he could be expected to act in a rational way, scientists could model his behavior and figure out what he would do next. Would he buy stocks . . . or sell them? Having the answer, the rational investor would position himself immediately to benefit from whatever future the model showed. But in a matter of minutes, the model would blow up . . . for our rational investor's positioning would have changed the model's inputs.

People believe that things improve. They think Darwin's Theory of Evolution describes a world constantly mutating toward perfection. Every day, we add more and more information . . . and every day, our formulas become more accurate and more reliable.

If only it were true!

"The more data you have, the more ignorant you are," explains our friend Michel. "If, for example, you get quarterly reports of corporate earnings, rather than annual ones, do you know more? No, because it's easier to manipulate quarterly returns. Imagine that you got returns every month . . . or every week . . . or every hour. You'd have much more data, but actually much less knowledge of what was going on. You'd suffocate under all the data."

But in the world of finance and economics, confidence increases with data. If stocks go up one year, people are happy, but not confident. If they continue to go up . . . year after year . . . confidence increases with every passing year. Thinking scientifically, they reason: If stocks have gone up for so long, odds are that they will continue to go up.

As confidence grows, the odds become exaggerated, skewed by emotional inertia. Unpredictable by real science . . . risk is under-priced. Eventually, a collapse comes, as it always does.

It has been a long time since the world's money system—or its reserve currency—has fallen apart. The event happens so rarely, it is practically unimaginable to most investors. They believe the current system will live forever. Consequently, insurance against its demise is extremely cheap. We don't know, but it may turn out to be one of the best investments ever made . . . when the funeral is finally held.

■ The Whacky World of Modern Economists

October 8, 2004

Economist: One who is exiled from dinner parties; a recluse, trapped in his own deluded sense of wishful thinking, unconcerned with debt . . . the people who manage the entire world's finances . . .

Most economic theories have little practical use in the real world.

—Walter Williams

Pity the poor economist.

He is a pariah at dinner parties. His conversation is dull. His face has no expression. His opinions are commonplace. He might as well be on reality TV. And so what if the world's economies need to be “rebalanced?” Not only do we not know what it means, we can do nothing about it anyway.

If you spend 15 minutes a year trying to figure out the world economy, Peter Lynch used to say, you've wasted 10 of them. Peter believes in buying stocks. Keeping it simple, he believes in buying the stocks of companies he knows. That way, he figures, what he doesn't know can't hurt him.

Lynch ran a major equity fund in a bull market. He was lucky enough to get out before the bull market was over and smart enough to write books for people who were dumb enough to believe that stocks always go up in the long run. You didn't need to convince them this was so. Their gains were proof enough. You didn't need macroeconomics, either; you just needed a bull market.

The poor macroeconomist gets no respect. Which is the way it should be; typically, he deserves none.

Generally, his employer determines the economist's opinions. And typically, he is bullish. Neither the City of London nor Wall Street make money by helping people get rich. They make money by selling them financial assets. Economists are put to work persuading clients that assets will go up in price. Abby Joseph Cohen, for example, is paid millions of dollars each year because she is reliable, not because she is accurate. Her forecasts are always the same—shares will go up! Even government economists usually have a bullish bias; neither presidents nor prime ministers are re-elected on bad economic news.

What's more, honest economists have few insights that aren't obvious: You can't spend more than you make forever, the old-timers would tell you. The dollar will go down in price if you print too many of them, they figured. If something gets too far out of whack, they predicted, it is likely to come back into whack sooner or later.

These insights are hardly enough to command much respect, let alone a high salary. So early in the last century, ambitious economists set to work creating a set of propositions that were not based on ordinary common sense—but on wishful thinking. Economists do not manage their own finances noticeably better than anyone else. But if given the authority to manipulate short-term lending rates, bank regulations and money supplies, they offer to manage an entire nation's economy. And if central bankers of major nations are able to collude on policy, they believe they can manage the entire world!

These vaulting pretensions required undergirders at least as absurd as they were. Hurricanes blew across Florida in record numbers this autumn. Yet the prevailing wind among U.S. economists and ordinary citizens was delightful. Rebuilding would be good for the economy, they told us.

The price tag for America's "war on terror" and the war against Iraq rises almost daily. Estimates over \$200 billion are current. Those, too, are thought to be good things for the world's largest economy. More defense contracts will be let. More people would be hired. More money would be spent on tanks, equipment, and all the other paraphernalia needed to kill or avoid being killed.

The oil price hit more than \$50 per barrel for the first time ever at the end of September. Yesterday, it broke \$53. But even that is considered good news, at least according to the economists at the *New York Times*.

Every cloud now has two silver linings. Every disaster brings relief even before it happens. Every attack is met by an overwhelming counterattack of growth and prosperity. Drought, pestilence, famine, and war—nothing is so awful that it doesn't bring on a new burst of something wonderful.

Of course, if destruction really were so beneficial, it is surprising that economists do not encourage it. We still wait for a pair of them, armed with the courage of their convictions and a jerrican, to burn down each other's houses.

"Stimulus," they will say.

"Arson," we will reply.

Nor have we yet heard an economist propose the elegant solution put forward by a *Daily Reckoning* reader: Instead of waiting for a natural disaster or an attack by foreigners, bring our troops home from Iraq and put them to work blowing up our own cities!

But *stimulus* is just one of the twisted beams that hold up modern economics to ridicule. The "disappearance of whack" is another.

If Peter Lynch had tried his approach in the bear market of the 1970s, for example, today he might be just another poor schmuck, rather than an investment icon. Bear markets take down the stocks you know along with those you don't; they maul the geniuses as well as the morons.

The mean, an economist will tell you, is something to which things tend to regress. Prices progress in a bull market. They regress in a bear market. If something is far from the mean—the ordinary state of things—the economist guesses it will have to come back. "This can't go on forever," he will say. And yet perverse and inexplicable trends have been known to go on for decades after the economist who spotted them reached room temperature. Still, the earnest economist of the past looked for things that were out of whack—either with the way they have always been . . . or with the way he thinks they ought to be.

But the new economists of the twentieth and twenty-first centuries began to lose interest in whack. Things were no longer in it or out of it. They were merely what other economists had made them! Economies might be well managed or mismanaged, they thought, but they couldn't be unmanaged. For they had no natural condition, but only a state of being engineered for them by other economists. If they wanted faster growth, they had merely to yank a little harder on the lever marked *growth*. If they wanted less inflation, they might want to ease off. It was all a matter of how you ran the great machine! And if something went wrong—well, some economist must have made a mistake. Whack disappeared altogether.

This is a convenient way to look at things now. Because if there still were a whack to measure against, the whole world economy would be further out of it than ever before.

The world's two most important economies sit at opposite ends of a shipping channel. In one direction, ships head east loaded to the gunwales

with geegaws and gadgets. As they make their way across the Pacific, they pass other ships coming back—empty. On one end of the trade are a billion Chinese making things at a furious pace. At the other, Americans enjoy the extraordinary lightness of being that comes with acquiring things without having to pay for them.

Asians work and save. Americans borrow and spend. The U.S. current account deficit—a measure of how out of whack the world economy has become—approaches 6 percent of GDP. The home of Anglo-Saxon consumerism isn't much better. In the United Kingdom, the current account gap is moving toward 3 percent of GDP.

If you asked a dead economist, "Something's got to give," would probably be his judgment. "No nation can spend more than it makes forever," he might go on. "There must be a give for every take."

But we have been taking record amounts of goods from Asia—more than we can afford—and giving paper money IOUs in return. Asians have been giving all they can . . . hoping to recycle their IOUs into something valuable before the paper money sinks.

Living economists are not worried. It is just another thing to be managed, they believe. It does not seem to bother them that the Americans and the British are getting poorer. They do not concern themselves with the huge pile of debt built up by consumers and government; these too can surely be managed.

Here again, economists replaced the old, obvious insights of an earlier age with absurd new ones. Every previous economist who ever thought about it had come to the same conclusion: The way to wealth was to make sure outgoings did not exceed income. The self-evident corollary was that you needed to focus your attention on creating wealth, not spending it. It was production, not consumption, that made people rich.

Yet the new economists are not paid to worry . . . they are paid to flatter.

"America has the most dynamic, flexible economy in history," the lumps believed. "They sweat, we think," they said approvingly. "We are creating wealth at the fastest pace in decades," said their president.

What we are really creating is a world economy that is dangerously out of whack.

But who cares? When it blows itself up . . . imagine how stimulating that will be!

■ Disappearing on the Pampas

October 31, 2008

The average cab driver in Buenos Aires knows more about financial crises than Trichet, Brown, and Paulson put together. His training comes neither from Keynes nor Smith. . . . And what the typical Argentine has learned, the English and the Americans are about to discover for themselves. Bill Bonner explains . . .

Last week, at the annual convention of the nation's mortgage bankers in San Francisco, protestors used bullhorns to heckle attendees; they demanded a moratorium on foreclosures.

Meanwhile, south of the Rio Plata, a mob formed in Buenos Aires, too. Their gripe was that the government of Christina Fernandez de Kirschner was grabbing their pension money. "No way," replied the queen of the pampas. We are just going to "rescue" it from the wicked capitalists. Like a Doberman rescuing a hot dog, the Argentine government will swallow \$26 billion worth of private pension funds. The federales say they are taking the money into protective custody. It will just "disappear," say protesters.

The signal on the flag here unfurling is that, compared to the Argentines, the American mob is a bunch of naïve chisellers. At least the gauchos can tell the difference between self-delusion and grand larceny. But the average cab driver in Buenos Aires knows more about financial crises than Trichet, Brown, and Paulson put together. His training comes neither from Keynes nor Smith. The great Anglo-Saxon economists may have laid out their theories of political economy. But they left some important holes. Argentina's presidents have filled in the blanks. And what the typical Argentine has learned, the English and the Americans are about to discover for themselves.

Leaving Argentina, our cab driver tried a familiar flimflam. Hearing a foreign accent, he said: "My meter is broken . . . but the fare to the airport is

always a flat 200 pesos.” On the pampas, no self-respecting taxi driver gives a sucker an even break. But then, rarely do markets or governments, either.

“What is the message that the government is giving to the people today?” asks Argentine economist Roberto Cachanosky. “That it is ready to take their revenues and their savings with no limit . . . and also, that they will continue to give out information and make announcements that, to say it gently, have no connection to reality.”

“The only secure retirement is one backed by the state,” said a member of the Peronist party, proving Cachanosky’s point. As the country approached bankruptcy in 2001, its leaders followed the traditions of all Peronists, Democrats, Republicans, and National Socialists when they get themselves in a jam. First, they lie. Then they steal.

Argentina has a parallel system of state-owned and privately owned pension accounts. Its state system pension payments were cut by 14 percent in 2001, and then cut an additional 66 percent when the peso was devalued the following year. Now, the Kirchner government is nationalizing the private accounts. Set up in 1993, these funds must invest 60 percent of their money in Argentine bonds. Naturally, bonds backed by the Argentine government are not necessarily the strongest credits in the world. Argentine peso bonds—like pensions—are adjusted for inflation. But the government lies, with a measure of inflation that is less than half the real 30 percent rate. As to the dollar bonds, it steals. In 2001, it defaulted on \$95 billion worth of loans made by overseas lenders. It didn’t settle up until four years later—stiffing the foreigners for 70 percent. And now the government is in trouble again; it must make a big payment to overseas lenders in 2009. Its main exports—soybeans, gas, and oil—are down about 50 percent this year. And the country has more public debt than it did when it defaulted seven years ago. That’s why the private pension accounts are being seized; the government needs the money.

Things have a way of disappearing in Argentina. After WWII, hundreds, maybe thousands, of Nazis arrived in Buenos Aires from Europe, never to be seen again. Whether people are wanted by the law, or not wanted by the lawmakers, they have a way of vanishing. In the 1970s, when the generals running Argentina wanted to get rid of their opponents, they called on the old Nazis to help “disappear” thousands of them.

Money disappears, too. More than a half century ago, Evita Peron posed as an angel. She set up charitable organizations to help the poor and handed out Christmas presents, personally. After the holidays, she went

back to her tricks—making the money disappear from the charitable funds and reappear in her Swiss bank account. And then, after her spirit gave the world the slip, Evita's own corpse disappeared. People wondered what had happened to the husk of her, until it was retrieved by Juan Peron 16 years later.

Senora Fernandez is a practiced magician too. Her recent acts of larceny have included disappearing Aerolineas Argentina from its Spanish owners . . . and then disappearing the profits of the nation's farmers, first by preventing them from selling on the open market and then by imposing a confiscatory tax (later withdrawn) on exports.

"Nationalizing private pensions is theft," said Juan Domingo Peron himself. The Peronists say they are only acting in the public interest—like the U.S. Treasury and the Bank of England. We would never have done this had there not been a worldwide financial crisis, they explain.

"The question that many people ask themselves," continues Robert Cachanosky is: "What rate of interest do you need to compensate for the risk of keeping assets within the reach of a government desperate for more funds?"

Answering Cachanosky's question, today you can buy 8.28 percent Argentine bonds at 22 cents on the dollar—giving you a yield of 31 percent. By comparison, a U.S. 10-year Treasury note, at less than 4 percent yield, looks like a broken taxi meter to us.

■ Inevitable and Disgraceful, But Still Unpredictable

November 28, 2008

Here at the *Daily Reckoning*, we take the part of the underdog . . . the downtrodden and the despised. Who fits that description now? Who is held in lower esteem than child molesters? Who gets less respect than smokers? Who is in a lower caste than hewers of wood and drawers of water? We're talking, of course about the toilers on Wall Street. So today, we take their part, because no one else will.

Who's to blame for the worldwide financial meltdown, a crisis that has so far wiped out a notional \$30 trillion dollars . . . give or take a trillion or so?

"Lax central bankers . . . reckless investment bankers . . . the hubristic quants," says Niall Ferguson, writing in *Vanity Fair*. "Regulate them," is the universal cry. "Tax them," say the politicians. "Hang them," say investors.

First, let us look at the charges:

They skinned millions of investors—with their outrageous bonuses, spreads, fees, incentive shares, performance charges, salaries, and profits—leaving the financial industry severely undercapitalized . . . and unprotected.

Guilty as charged.

They ginned up securities that no one really understood and sold them to unsuspecting investors, including widows, orphans, colleges, pension funds, and municipal governments.

Uh . . . guilty again.

They put the whole financial world in a spin—churning positions back and forth between each other in order to collect commissions . . . leveraging . . . flipping . . . stripping assets . . . securitizing . . . derivatizing . . . making wild bets based on flimflam mathematics. . . .

No point in going on about it . . . guilty.

Yes, the financial hotshots did all these things. And more. They sold the world on finance, rather than making and selling things. Then, it was off to the races. Everybody wanted to bet. Perfecta, place bets, odds-on . . . double or nothing. Of course, investors would have been better off at the racetrack. The track takes about 20 percent. In the financial races, Wall Street took 50 percent to 80 percent of all the profits.

Before 1987, only about one of every 10 dollars of corporate profits made its way to the financial industry—in payment for arranging financing, banking, and other services. By the end of the bubble years, the cost of finance had grown to more than 3 out of every 10 dollars. Total profits in the United States reached about \$6 trillion last year; about \$2 trillion was Wall Street's share. What happened to this money? Other industries use profits to build factories and create jobs. But the financial industry paid it out in salaries and bonuses—as much as \$10 trillion during the whole Bubble Period. And now that the sector finds itself a few trillion short, it waits for the government to open its purse.

But Wall Street's critics have missed the point. Yes, the financial industry exaggerates. But so does the whole financial world. Both coming and going. It's madness on the way up; madness on the way down. Investors pay too much for finance when the going is good. And then, when the going isn't so good, they regret it. This regret doesn't mean the system is in need of repair; instead, it means it is working.

The financial industry was just doing what it always does—separating fools from their money. What was extraordinary about the Bubble Years was that there were so many of them. There is always smart money in a marketplace . . . and dumb money. But in 2007, there were trillions of dollars so retarded they practically cried out for court-ordered sterilization. What other kind of money would pay Alan Fishman \$19 million for three weeks' work helping Washington Mutual go bust?

Whence cometh this dumb money? And here we find more worthy villains. For here we find the theoreticians, the ideologues . . . and the regulators, themselves, who now offer to save capitalism from itself. Here is where we find the bogus statistics, the claptrap theories, and the swindle science. Here is where we find the former head of the Princeton economics department, too, Ben Bernanke . . . and both Hank Paulson and his replacement, Tim Geithner. Here, we find the intellectuals and the regulators—notably, the SEC—who told the world that the playing

field was level . . . when everyone could see that it was an uphill slog for the private investor.

“Six Nobel prizes were handed out to people whose work was nothing but BS,” says Nassim Taleb, author of *The Black Swan*. “They convinced the financial world that it had nothing to fear.”

All the BS followed from two frauds. First, that economic man had a brain but not a heart. He was supposed to always act logically and never emotionally. But there’s the rub, right there; they had the wrong guy. The second was that you could predict the future simply by looking at the recent past. If the geniuses had looked back to the fall of Rome, they would have seen property prices in decline for the next 1,000 years. If they had looked back 700 or even 100 years . . . they would have seen wars, plagues, famines, bankruptcies, hyperinflation, crashes, and depressions galore. Instead, they looked back only a few years and found nothing not to like.

If they had just looked back 10 years, says Taleb, they would have seen that their “value at risk” models didn’t work. The math was put to the test in the Long-Term Capital Management crisis . . . and failed. Their models went sour faster than milk. Things they said wouldn’t happen in a trillion years actually happened while Bill Clinton was in still in office.

In the real world, Taleb explains, things are stable for a long time. Then, they blow up. Then, all the theories and regulators prove worthless. These blowups are inevitable, but unpredictable . . . and too rare to be modeled or predicted statistically. “And they are almost always much worse than you expect.”

■ Gonoism!

December 5, 2008

The *Daily Reckoning* typically takes the part of the underdog, the despised and the downtrodden. Sometimes we do so because the calumnies are misplaced . . . and sometimes we just pick up the poor schmuck for the fun of knocking him down and treading on him some more. Gideon Gono is no exception.

The *Financial Times* tells us that sales of government debt will reach \$2 trillion next year—led by the United States and Britain, each borrowing about 10 percent of GDP. For France, the borrowing will reach 8.6 percent of GDP. Yet, this week, the brightest star in the investment firmament burned brighter still: U.S. Treasury bond prices rose to levels never before seen. The 10-year T-Note, for example, yielded all of 2.67 percent (yields fall as prices rise).

It was as if the laws of nature had been suspended. The cost of the world's bailout efforts are said to be beyond \$10 trillion already. Yet, the more bonds governments sell to finance the rescue, the more the demand for them grows. Remarkably, the further in debt government goes, the more people want to lend it money. Maybe, if the feds get away with this, gravity will be the next to go.

Central bankers, as everyone now knows, are rascals and scalawags. Gideon Gono is no exception. But there is something heroically imbecilic about the man. While most economists hedge and weasel, Mr. Gono goes boldly, recklessly forward—where no central banker has dared to go, at least not since the worst days of the Weimar Republic. Mr. Gono stands tall . . . a colossus of error . . . an Olympus of bunglement.

It is easy to criticize the chief of Zimbabwe's national bank. In fact, it is hard not to criticize him. Keynes warned that "there is a lot of ruin" in a nation. Mr. Gono's contribution to economics is to show how much

ruin there is. That . . . and proving that the laws of supply and demand still apply to money.

The latest news tells us what he hath wrought and it sounds like Hell: The trash piles up in Harare and the water system no longer works. Vendors are selling bottles of water for \$25 U.S. Cholera has broken out . . . and anthrax too. Shops are empty. People are hungry. Nothing works. This week, even the forces of law and order are on the rampage, breaking windows . . . looting what little remains in the shops. The soldiers and police haven't been paid, at least, not with real money.

Between August 2007 and June 2008, the Zimbabwean money supply increased 20 million times. Naturally, this led to the kind of spectacular increases in consumer prices that modern economists had only seen on newsreels. Consumer price inflation was clocked at 2 million percent six months ago. Now, it is said to have sped up to 230 million percent.

Of course, Mr. Gono rolled out all the usual inflation-fighting measures—all that is, except for the one that works. Prices have been controlled. Mr. Gono personally went around, found shop owners who have illegally raised prices, and had them arrested. Bank withdrawals have been limited to 500,000 Zimbabwe dollars per day. If you wanted to buy 2 kg of sugar, for example, you'd have to stand in line for four days at an automated teller. But at present rates, you could stand in line at the automatic tellers every day for eternity and never get enough money to buy a drink of water.

Last weekend was Gideon Gono's 49th birthday. We salute him. He may be a moron; but at least he's a useful one. Better than another bad theory, he has provided a bad example. In an age when central bankers all over the world are trying to avoid a decline in the cost of living, Mr. Gono has proven that there are worse things.

But despite Gono himself, Gonoism seems to be gaining admirers in the rest of the world because the alternatives don't seem to work. Keynesianism, for example. The Keynesians say that when people stop squandering their money, the feds have to step in and squander it for them. Right now, practically every government in the world is promising huge new spending programs. Deficits be damned! In the heat of the emergency, Europe waves aside the Maastricht limits and America prepares its first trillion-dollar deficit in 2009. By 2010, America's deficit could easily reach \$2 trillion.

But will "Keynes on steroids," as one journalist put it, work? There's no evidence of it in the record. America tried it in the 1930s. Japan tried it in the 1990s. In neither case were the results favorable.

Milton Friedman saw the problem with Keynesianism—it led to rising prices . . . and then stagflation. He pointed to the lever marked *monetary policy*. Give that a pull, he said; just make sure the economy has enough money, everything else will take care of itself. Maggie Thatcher and Ronald Reagan both pulled on the monetary policy lever. And in the recession of 2001–2002, Alan Greenspan yanked it so hard the handle practically broke off. Milton Friedman was still alive at the time and actually approved of Greenspan’s handiwork, saying that he had “spared the economy a worse recession,” or words to that effect.

But now we face an even worse recession. And central bankers are running out of ammunition to fight it. The U.S. Fed’s key rate is only 100 basis points from zero. His resources are “obviously limited,” said Bernanke, in a speech in Austin, Texas. But then, while the Fed can’t push interest rates below zero, “the second arrow in the Federal Reserve’s quiver—the provision of liquidity—remains effective,” he said. One option is for the Fed to buy “longer-term Treasury or agency securities on the open market in substantial quantities,” Bernanke said.

Gonoism, in other words.

■ 100 Years of Mismanagement

January 8, 2010—Baltimore, Maryland

There must be some dark corner of Hell warming up for modern, mainstream economists. They helped bring on the worst bubble ever . . . with their theories of efficient markets and modern portfolio management. They failed to see it for what it was. Then, when trouble came, they made it worse.

But instead of atoning in a dank cell, these same economists strut onto the stage to congratulate themselves.

“The Greatest Depression that could so easily have happened in 2009 but did not is the tribute that the world owes to economics,” wrote Arvind Subramanian in the *Financial Times*.

We were lost from the get-go, trying to interpret the sentence. It is as tangled and puerile as the staggering conceit behind it. Then, Mr. Subramanian sets up the stage props:

“In 2008, as the global financial crisis unfolded, the reputation of economics as a discipline and economists as useful policy practitioners seemed to be irredeemably sunk. Queen Elizabeth captured the mood when she asked pointedly why no one (in particular, economists) had spotted the crisis coming. And there is no doubt that, notwithstanding the few Cassandras who had correctly prophesied gloom and doom, the profession had failed colossally. . . .”

He then brushes off the Queen’s very sensible question:

But crises will always happen, and even if there is a depressing periodicity to them as Professors Reinhart and Rogoff have catalogued, their timing, form and provenance will elude prognostication.

Of course, the record doesn't show that the crisis eluded prognostication; any dope could have seen it coming. But the prognosticators who had contributed so mightily to the crisis had blinded themselves with their own claptrap. Still, Mr. Subramanian figures that they "vindicated" the profession in the way they responded to the crisis.

On monetary policy, Bernanke was true to the word he gave to Milton Friedman on the occasion of his [Friedman's] 90th birthday: "Regarding the Great Depression, you're right, we did it. We're very sorry. But thanks to you, we won't do it again." Bernanke, the pre-eminent student of the Great Depression, found conventional and some very unconventional ways of not doing "it" again. At the peak of his interventions, the U.S. Fed came to resemble the Soviet Gosbank, more a micro-allocator of credit than a steward of macroeconomic policy.

It probably wasn't the point he intended to make, but the Fed does resemble the Soviet-era Gosbank—manipulating, meddling and micromanaging the economy toward destruction. Meanwhile, Congress is doing some Soviet-style management, too; it is now owner of the nation's largest automobile company and its largest insurance business: "They took their cue from the writings of the academic scribbler of yore—Lord Keynes—and provided massive public demand for goods and services where private demand had collapsed. . . ."

We were still gasping for air when, on the 30th of December, columnist Martin Wolf called upon Keynes's ghost again. He, too, shuddered to think how horrible things would have been if the financial authorities had not taken resolute action:

We could not in such times, even take the survival of civilization itself for granted. Never before had I felt more strongly the force of John Maynard Keynes's toast "to the economists—who are the trustees, not of civilization, but of the possibility of civilization."

Is there any doubt that Keynes was a scalawag? Civilization flourished for thousands of years before anyone made a living as an economist. Crises came and went. In the nineteenth century, for example, there were panics

followed by depressions in 1819, 1837, 1857, 1873, and 1893. Not one of the depressions seemed worthy of the *great* modifier. Hundreds of banks failed. Civilization didn't seem to care. The rich and powerful took their lumps along with everyone else; most people enjoyed watching them go down. Business went on.

In 1913, on Christmas Eve, Congress passed the Federal Reserve Act, setting up America's central bank. Only then did economists get their hands on the economy's throat. The dollar was worth about the same thing it had been worth 100 years before. Now, almost a hundred years later, it is worth only 3 cents. And only 16 years after economists took their positions at the Federal Reserve came a depression worse than anything the nation had ever seen—at least, it was worst after government economists finished with it.

The Great Depression may have been an accident, but the debasement of the dollar certainly was not. It was a matter of policy. Economists, led by Keynes, had the idea that they could spur the economy forward by creating phantom demand—in the form of additional units of purchasing power. The gold standard stood in the way; it was abandoned like a bad neighborhood. First, temporarily, then partially, then, in 1971, completely. The first consumer credit boom came in the 1920s . . . leading to the Great Depression. By the 1980s, 50 years later, Americans had lost their residual fear of debt. Consumer credit boomed again. Then it bubbled. Economists didn't understand what was going on. They rarely do. But they had created a hundred-year flood of consumer debt. Now they congratulate themselves; households sink . . . but civilization floats.

■ Three Out of Four Economists Are Wrong

July 30, 2010—Paris, France

What does an economist think . . . when he adjourns to the local bar . . . or is hauled away to the asylum? In the dead of night or the quiet of a confessional, does he laugh sourly at having fooled most of the people most of the time? Or does he curse his trade and feel like hanging himself?

The thing economists said was nearly impossible actually happened last week. Yields on 2-year U.S. debt hit a record low just as the Treasury prepares for another record-setting deficit. The supply of Treasury debt and the demand for it hit new highs—together. Stranger things have happened. But the strangeness of this event has caused a furor loquendi amongst economists. Usually, there are only two major ways of misunderstanding current events. Now there are at least four of them.

Party economists take the party line; whenever the party flags, get out more gin. Now, they say the recovery is proceeding, thanks to adroit demand management. Unsurprisingly, since they are the authorities, they claim that record low Treasury yields mean investors have confidence in the authorities. Deficits don't matter, they add.

Another group—the Paul Krugman, Martin Wolf, Joseph Stiglitz wing of the neo-Keynesian faction—fear the recovery may stall, as it did in America in the 1930s and Japan in the 1990s. They say deficits do matter; they wish there were more of them. Low bond yields are cheap gin to them.

In opposition is a large group of *inflationistas*. (Marc Faber, Jim Rogers . . .). They believe the authorities have already added too much monetary juice. And now they're afraid the feds will run bigger deficits and add even more monetary inflation. Along with tightened supplies and demand

pressure from the emerging markets, this will cause consumer prices to rise more than expected. The dollar and bonds will be crushed.

A small group of hardcore deflationists, meanwhile, believes falling yields prove the economy is sinking into a deep hole of debt destruction and depression (Robert Prechter, Gary Shilling). These Jeremiahs expect the main U.S. stock index—the Dow—to lose 95 percent of its value and the bond market to continue to rise.

Yet another school of thought confines itself to this *Daily Reckoning*. It acknowledges that nobody knows anything, but it doesn't mind taking a guess. Herewith is its view, beginning with a critique of its opponents. Fair-minded reader, you be the judge.

Mainstream opinion is contradicted by the facts. Fewer people are employed today in the United States than when the stimulus program began. Sales are down. Growth is falling. Credit is contracting. Even hairstylists and cab drivers know something is wrong.

As for the inflationistas view, it makes sense. The feds add money. Prices should rise. But in Europe and America, the rate of consumer price inflation is generally ebbing. That's what low bond yields are really telling us; they signal deflation, not inflation. Maybe the inflationistas will be proven right, eventually. But for the moment, prices in the developed world are going down; they should remain weak until this phase of debt reduction is largely complete.

Meanwhile, hard-core deflationists could be right, too. A big credit expansion typically gives way to a big credit contraction. The past is not prologue; it is an account payable. Now it's due. But there's room for negotiation. If the hard-core deflationists are right, credit will contract back to 1970s levels, and asset prices will correct as much. But a lot has happened since the Carter era. There's much more demand, for example, coming from all over the world. China is now a bigger energy consumer than the United States, and a bigger auto buyer, too. Demand for just about everything is growing. This new demand is bound to boost prices.

The supply side, too, puts a brake on deflation. The easy, cheap oil has already been pumped. Other resources—including food and water—require huge new capital investments before supplies will increase. Domestic inflation rates in China and India are already increasing. It's just a matter of time before the exporters put inflation in a shipping container and send it west.

But we don't need to rely purely on guesswork. We have an example right in front of us—Japan. The island has been deleveraging its private

sector since 1990—complete with ultra-low bond yields. Consumer prices fell. Between real estate and stocks, investors lost an amount equal to three years' total output.

Economists misunderstood it completely and gave consistently bad advice. And the authorities took the advice and squandered a whole generation's savings. But the world did not come to an end. Japan deleveraged while the rest of the world went on a buying spree. Now, the entire developed world deleverages, while the emerging world continues to shop.

Nobody knows anything. But readers should expect a long, soft correction just the same.

■ The Patsy Revolt of 2010

March 12, 2010—Mumbai, India

“**M**asked youths . . . attacked the head of Greece’s largest trade union, who was addressing the crowd, and hurled stones at the police. GSEE union boss Yiannis Panagopoulos traded blows with the rioters before being whisked away, bloodied and with torn clothes.”

The *Daily Mail* account put the blame for these disturbances on Germany’s finance minister, who warned the Greeks that “the German government does not intend to give a cent.” At least *Bild*, a popular German newspaper, was trying to be helpful. It suggested that Greece sell Corfu . . . and that Greeks get up earlier and work harder.

Meanwhile, from Iceland comes news that every voter with an IQ above air temperature has cast his ballot against a bailout plan. The Icelanders were slated to make good \$5.3 billion in bank losses. But why shackle common voters to the banks’ losses? The plan was so outrageous and so unpopular that Iceland’s normally compliant prime minister called for a referendum. Given a chance to vote on it, 93 percent said no. The other 7 percent probably read it wrong.

Insurrection is in the air. In England, government employees are preparing the biggest strike since the 1980s. In America, dissatisfaction with Congress is at record highs; four out of five of those polled say, “Nothing can be accomplished in Washington.”

Herewith, an attempt to deconstruct the rebel yell. By way of preview, it’s not the principle of the thing, we conclude; it’s the money.

There are more clowns in economics than in the circus. They invented an economic model that has been very popular for more than 50 years—particularly in the United States and Britain. It began with a bogus insight; John Maynard Keynes thought consumer spending was the key to prosperity; he saw savings as a threat. He had it backward. Consumer spending is

made possible by savings, investment, and hard work—not the other way around. Then, William Phillips thought he saw a cause-and-effect relationship between inflation and employment; increase prices and you increase employment too, he said.

Jacques Rueff had already explained that the Phillips Curve was just a flimflam. Inflation surreptitiously reduced wages. It was lower wages that made it easier to hire people, not enlightened central bank management. But the scam proved attractive. The economy has been biased toward inflation ever since.

Economists enjoyed the illusion of competence; they could hold their heads up at cocktail parties and pretend to know what they were talking about. Now they were movers and shakers, not just observers. The new theories seemed to give everyone what they most wanted. Politicians could spend even more money that didn't belong to them. Consumers could enjoy a standard of living they couldn't afford. And the financial industry could earn huge fees by selling debt to people who couldn't pay it back.

Never before had so many people been so happily engaged in acts of reckless larceny and legerdemain. But as the system aged, its promises increased. Beginning in the 1930s, the government took it upon itself to guarantee the essentials in life—retirement, employment, and to some extent, health care. These were expanded over the years to include minimum salary levels, unemployment compensation, disability payments, free drugs, food stamps, and so forth. Households no longer needed to save.

As time wore on, more and more people lived at someone else's expense. Lobbying and lawyering became lucrative professions. Bucket shops and banks neared respectability. Every imperfection was a call for legislation. Every traffic accident was an opportunity for wealth redistribution. And every trend was fully leveraged.

If there was anyone still solvent in America or Britain in the twenty-first century, it was not the fault of the banks. They invented subprime loans and securitizations to profit from segments of the market that had theretofore been spared. By 2005, even jobless people could get themselves into debt. Then, the bankers found ways to hide debt . . . and ways to allow the public sector to borrow more heavily. Goldman Sachs did for Greece essentially what it had done for the subprime borrowers in the private sector—it helped them to go broke.

As long as people thought they were getting something for nothing, this economic model enjoyed wide support. But now that they are getting

nothing for something, the masses are unhappy. Half the U.S. states are insolvent. Nearly all of them are preparing to increase taxes. In Europe too, taxes are going up. Services are going down. And taxpayers are being asked to pay for the banks' losses . . . and pay interest on money spent years ago. Until now, they were borrowing money that would have to be repaid sometime in the future. But today is the tomorrow they didn't worry about yesterday. So, the patsies are in revolt.

Several countries are already past the point of no return. Even if America taxed 100 percent of all household wealth, it would not be enough to put its balance sheet in the black. And Professors Rogoff and Reinhart show that when external debt passes 73 percent of GDP or 239 percent of exports, the result is default, hyperinflation, or both. IMF data show the United States already too far gone on both scores, with external debt at 96 percent of GDP and 748 percent of exports.

The rioters can go home, in other words. The system will collapse on its own.

Junk Science

November 15, 2010

“**W**hen I started my economics studies at 16,” wrote Paul A. Samuelson not long before he died last year at aged 93, “Carlyle was right to call economics a ‘dismal science.’ Thanks to modern science and better economic knowledge, this Malthusian curse has been vanquished. Good modern economics make economics the Hopeful Science. At last!”

Lucky professor Samuelson! Like an apparatchik who joined the shades before 1989, he went to his reward with his delusions intact.

This week, the scientists began to have doubts. Like the Pope wondering about the resurrection, or the Mormons questioning the veracity of the angel Moroni, the head of the World Bank, Robert Zoellick, shocked the learned world. It’s time to start discussing a gold-backed currency, he said. Maybe the crown of creation of modern economics—its centrally managed money—was not such a good idea after all.

Like Christianity, the dollar only has value as long as people have faith in it. But that is true of almost every trick up the modern economist’s sleeve. If people stop believing, the spell is broken and they’re worthless.

Two years ago, when the financial world was melting down, we were told that the volcano needed to be appeased. Without immediate injection of funds, the whole system would blow up, they said. Where was the science behind that? The financial system melted down countless times in the past. No central bank came to its aid before the 1930s.

Or how about the corollary article of faith: that the public had to rescue the big banks, a *tout prix*? It was practically a universal constant—like the Golden mean or Brownian motion. When bankers make profits, it is theirs to keep. When they lose money, the losses are moved on to the public. The United States bailed out its banks. Britain, Ireland, and Iceland did

the same. But where was the evidence that bank failures were so horrible? During America's Great Depression, 9,000 banks failed. And history is full of the wrecks of banks that were "too big to fail."

A hick Congressman from one of the corn states once proposed to round off pi to 3 to make it easier for schoolchildren to remember. He must have been joking. In the world of science, water boils at 212 degrees Fahrenheit, at sea level, whether you believe or not. Pi is always a long string of digits. The mathematicians can sweat and shake all they want; it doesn't change. But modern economists take the joke seriously. They think they can command water to run uphill and reset the Periodic Table with fancier china. That's why they hate gold: They can't control it. And it reminds them that they are imposters, no more effective than witch doctors or marriage counselors.

As of this writing, it takes more than \$1,400 to buy a single ounce of gold—a new record. Why? Isn't it obvious? People are losing faith. Last week, the U.S. Federal Reserve said it was creating another \$600 billion to buy U.S. Treasury debt. That will mean a total of \$2.3 trillion added to America's monetary footings since the Fed began its QE program almost two years ago. This will also mean that Ben Bernanke has added three times as many dollars to America's core money supply as *all the Treasury secretaries and Fed chairmen who came before him put together*.

"Easier financial conditions will promote economic growth," wrote Mr. Bernanke, in the *Washington Post*, ". . . higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion."

Where is the proof? Where is the controlled test? Where is the peer review? Such an extravagant assertion ought to be accompanied by extravagant evidence. But there is none at all. Throwing virgins into a volcano would be no less scientific. The virgins appeased the gods; that was the theory. Mr. Bernanke has a voodoo theory, too. He says all that new money will make people feel richer . . . and then they will act richer . . . and then they will be richer!

John Hussman, also an economist with a loyal following of his own, read Mr. Bernanke's explanation and pronounced judgment: "The most ignorant remarks ever made by a central banker." The latest \$600 billion gamble may or may not increase stock market prices, he says. Even if it does, it is unlikely to produce the "wealth effect" that Ben Bernanke is counting on.

People spend and borrow when they think they have permanent wealth. World stock markets have suffered two major shocks in the last 10 years . . . with no net gains for investors. An increase in stock prices now—driven by the Fed's printing press—is unlikely to create the kind of expectations that lead people to spend money. Especially when they don't have any.

Which makes us wonder, too. If modern economists are scientists, it makes us suspicious of the rest of them. What about the physicists? The molecular biologists? The archeologists? Are they all quacks too?