MBMG Outlook
31st December 2021
Rock and Roll Winter?

Winter scene taken at Shipka Pass in Bulgaria[1]

[1] By Psyguy, 3.0, https://commons.wikimedia.org/w/index.php?curid=533690

Executive Summary

2021 was another year, arguably the 3rd in succession, where risk-taking was once again rewarded. The highest risk assets generated strongly positive returns, zero risk assets generated nothing (or at most a rounding error) and low risk assets lost money during the course of the year.

The long-term runes continue to indicate weak economic activity, transitory inflation, and anaemic interest rates. In 'Technicalities,' we explain the significance of money creation in a post-QE world, why the Fed's and Treasury's stated policy course of tightening both fiscal and monetary policy would be disastrous (eventually) for risk assets. Finally, we also show that fortunately their words are currently at variance from their actions. This leads us to conclude that "2022 looks as though it could be a 'game of two halves'" in which "the first half could benefit from the continuation of positive momentum, whereas the second half could see that derailed by the withdrawal of liquidity from capital markets. However, both of these assumptions are very much subject to changing conditions and 2022 is the year when strategy will need to evolve and adapt alongside those changes."

We don't know when Covid will pass but we do believe that at some point, possibly very soon, possibly not, it will. However, the problem of extreme debt, inequitably distributed, is persistent and, within the current policy framework, unremitting. This creates contradictory forces but at a time when the prices of risk assets allow very little margin of error.

2022 is a year when we recommend paying constant attention to economic indicators and asset prices and adopting an active, adaptive, and pragmatic approach to asset allocation, even more so than in the year just passed, when such an approach proved essential to achieving acceptable returns without taking on extreme risk.

2021 YTD Total Returns for Asset Classes (as of Dec 31st)

Long term treasuries (TLT) -5.9%	**Medium Term Treasuries (CBU7) -2.4%**	**Gold (GLD) -6.2%**	**WTI Oil (CRUD) 68.6%**	
GBPUSD -0.3%	**USDAUD 5.6%**	**USDTHB 11.0%**	**USDCAD -1.1%**	**USDEUR 7.7%**
SP500 28.8%	**NASDAQ Comp 23.2%**	**FTSE 100 12.4%**	**MSCI India 13.7%**	**Dow Jones Industrial Average 20.2%**

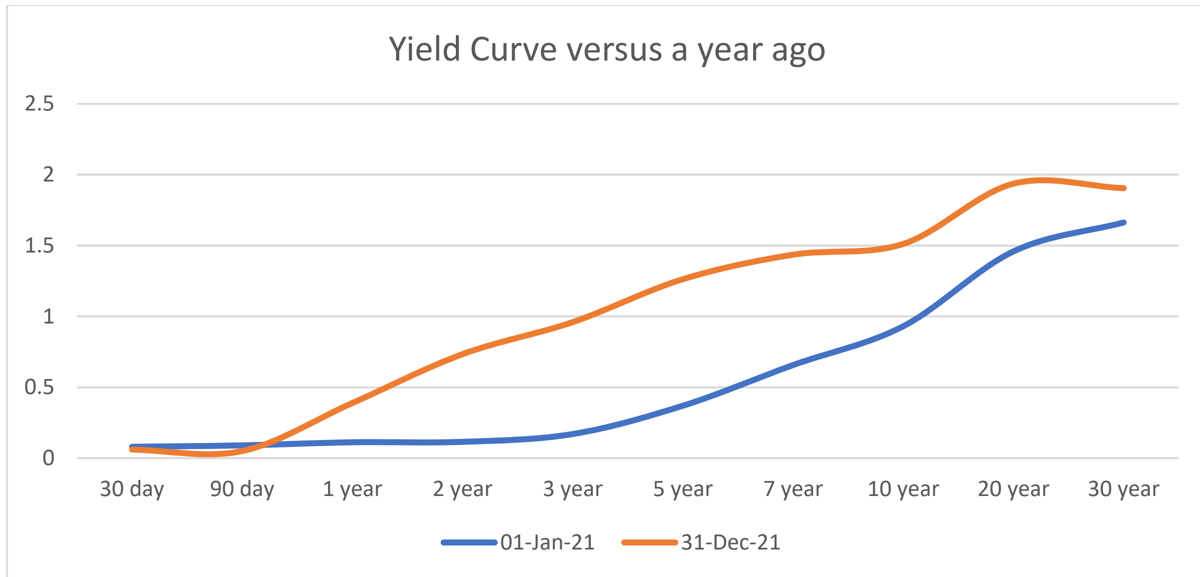
Asset Class Observations

The year proved challenging for defensive assets and therefore for genuinely cautious or low risk portfolios. In many ways, the last 3 years have seen risk taking rewarded.

The most risk free of all investable asset classes (90-day treasury ETFs) returned 0.01% for the year, with little, if any, premium paid on good quality deposit accounts. Duration was penalised with intermediate treasuries losing 2.4% whereas long term treasuries lost 5.9% for the year. Even in fixed interest, risk was again rewarded as investment grade corporate bonds (LQD) lost 1.8% for the year whereas high yield and junk returned profits (HYG 3.75%, JNK 3.99%).

The yield curve flattened appreciably as the year has progressed. The anchoring of long-term treasuries, where the move up has been greater than any other major treasury bond duration.[2]

[2] Treasury bonds are typically government debt with a duration of one year or longer (with durations of 20 years or more regarded as long-term bonds) whereas government debt due to be repaid within one year are regarded as treasury bills, or -T-Bills.



When we also consider the implied break-even inflation,[3] which in the post-COVID rebound has failed to break above 2.4%, which, if it continues to do so, implies that structural disinflation, along with constrained inflation and growth expectations remains in place, as it has since 2013:

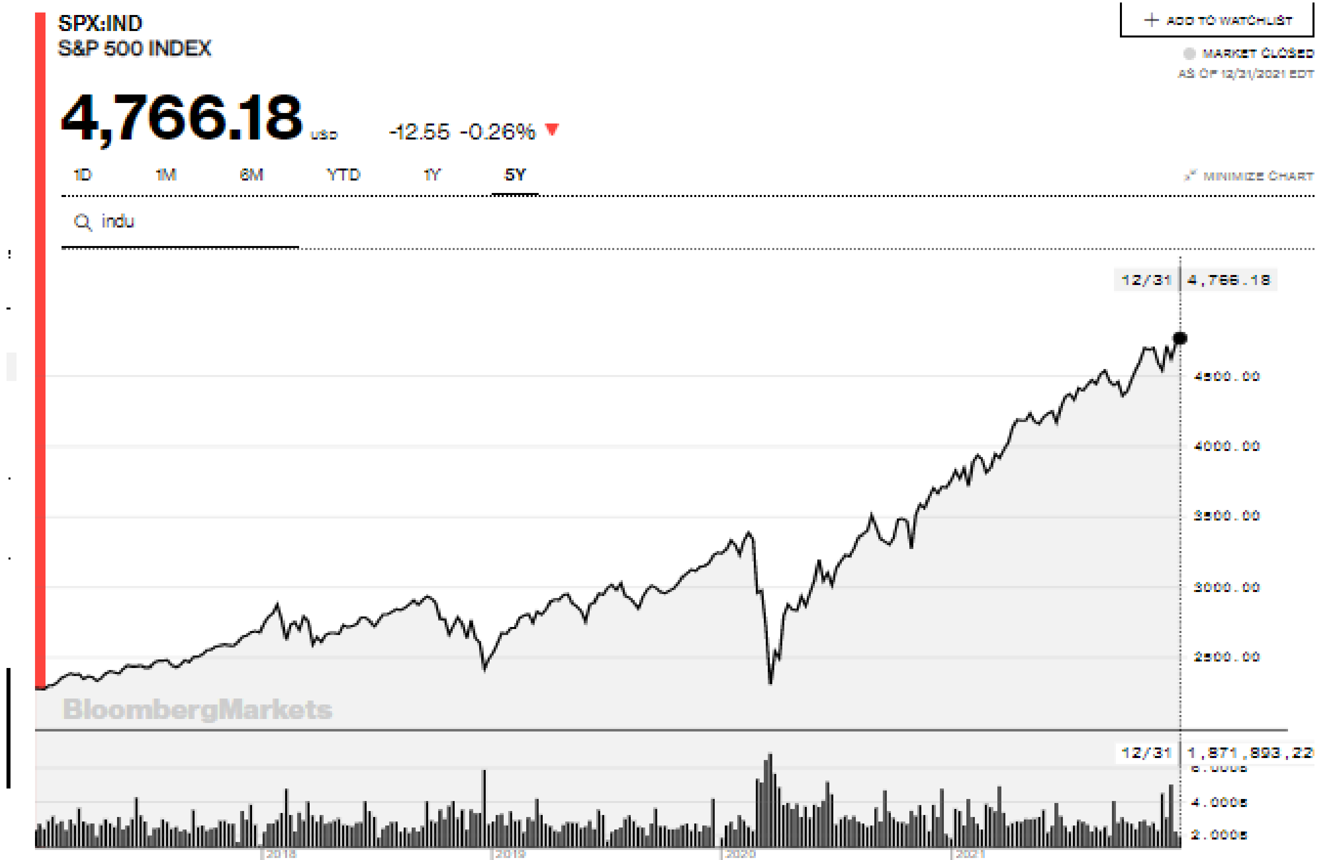
[3] "The differential between a long-term nominal bond yield and the real yield available on an index-linked bond of the same maturity is generally known as the "break-even inflation rate." This is because, under this rate of inflation, the expected nominal return to an investor will be the same regardless of whether the investment is made in a fixed nominal income or an index-linked bond. However, the break-even inflation rate is not a direct measure of inflation expectations. First of all, it also contains an inflation risk premium to allow for the additional uncertainty faced by an investor in a fixed income bond due, in particular, to the volatility of inflation, [which] implies that the break-even inflation rate overestimates true market expectations of inflation."- https://www.ecb.europa.eu/pub/pdf/other/mb199902_focus02.en.pdf

This indicates that inflation fears may be overdone, growth expectations may be too great and would validate the view that we have held throughout 2021; namely that policy interest rate increases are not justified by economic conditions. If this view continues to be supported by bond market expectations and ultimately to be validated, then long-term treasuries should offer reasonable returns and strong diversification to growth assets from here (iShares 20+ Year Treasury Bond ETF would need to increase in price by over 15% from here to regain its peak of last year, whereas PIMCO 25+ Year Zero Coupon U.S. Treasury Index Exchange-Traded Fund would need to increase by over 22.5%). We recommend a highly adaptive allocation to these assets – if bond markets' expectations are wrong and long-term growth and inflation expectations are insufficiently robust, then rates will move sustainably higher, and our thesis will have to be abandoned. Conversely, if our thesis is ultimately validated, it seems unlikely, in view of the prevailing volatility, that this would happen in a straight line from here. The PIMCO ETF has fallen by over 7% from its peak of 4 weeks ago – this is extreme volatility in terms of treasury pricing. This creates opportunities that can be exploited by buying into relative dips and decreasing at higher levels. At some point, long treasuries might break out and lightening up might leave some opportunity on the table but for this year, such active position management has enabled our clients to generate profits from an asset that has actually fallen in value by over 5% compared to a year ago.

Similarly, gold has endured a difficult year with gold falling by 15% in the first quarter of the year and gold miners down by over 20% in the first 2 months. Since then, both have rallied back into positive territory before falling again (the gold mining ETF, GDX, showing a year-to-date loss of over 25% just prior to the end of quarter 3, with gold re-testing the March lows). The subsequent rally has been volatile and unconvincing (GDX had barely recovered just a couple of weeks ago before ending the year 16.8% lower than it started, while gold is down by 6.2%. Again, assuming that market expectations of low growth, disinflation and low interest rates are validated, then this is a positive backdrop for gold and gold miners. In addition, they also provide strong diversification benefits to growth assets. Analogously long-term treasuries, if expectations are wrong and interest rates move sustainably higher, our thesis will have to be abandoned, whereas if our thesis ultimately validated, it is unlikely to happen in a straight line from here and therefore the adaptive approach to dip-buying and profit-taking on gold and gold miners could continue at least through the first half of 2022.

Currencies have generally behaved as we expected – although USD strength substantially materialized only from mid-June onwards. Again, if the market expectations and our contingent thesis about weak growth and weak inflation is ultimately validated, then we'd expect USD to significantly strengthen from here, especially against Euro and also deficit currencies such as AUD. However, if not, then we should expect to see EM currencies in particular outperform and also possibly AUD if H1 22 data such as deficits are better than estimated. Even in the event of ultimately continuing USD strength, the recent surge in USD has set up the high risk of a counter trend pullback during the first half of 2022. Short term FX exposure may be too difficult to call – any weakness in USD, without indicia of higher growth emerging, could be a buying opportunity.

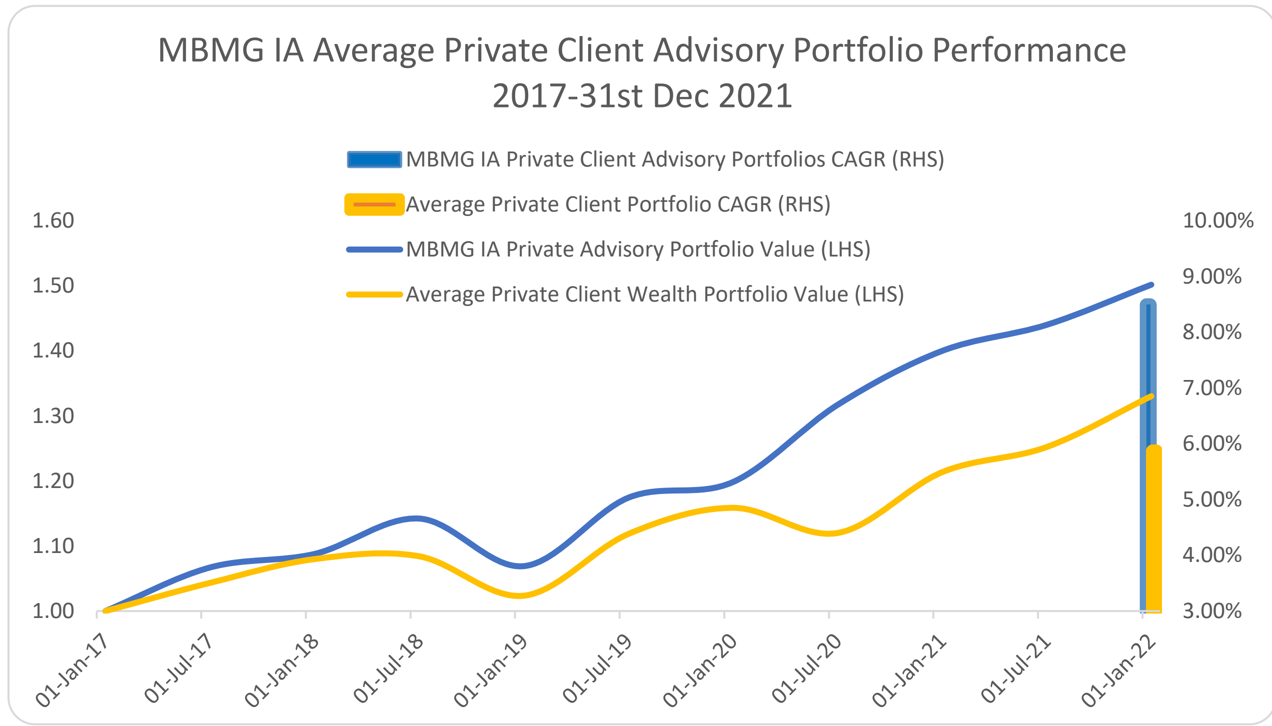
Risk assets – such as equities, corporate bonds, and property, look extremely richly valued. The S&P 500 has more than doubled from the low point in March last year and has done so in a straight line (see chart below). While the NASDAQ Composite has strongly outperformed the broader index during this period, it's notable that since Valentine's Day, the broader index has reclaimed leadership, increasing roughly double the 10% that NASDAQ has increased, with the industrial stocks that dominate the Dow Jones, falling in between.



If bond market expectations come to pass, then these extreme valuations look ultimately unsustainable. While our base case (but with very low conviction) is that good news on COVID will support earnings momentum into the first half of 2022, unless we see a shift in long term expectations, then at some point earnings will fail to grow sufficiently to support risk asset valuations. This is particularly worrying in the current policy environment, which should see liquidity gradually dry up. However, as we discuss in this report, liquidity conditions remained extremely supportive into the year end. If we listened to what the Fed & Treasury were saying, we'd be worried about a major risk asset correction in the coming months. If we look at what they're actually doing, it seems as though they haven't yet started that particular alarm clock, or maybe time bomb, actually ticking.
We can only watch for when they do and hope that earnings sustain until then and that the rally built on foundations of sand continues. But hope is not a strategy and therefore, we're happy to continue to sacrifice potential return in the name of risk management by resorting to significant degrees of hedging in our portfolio advice.

For some time, it has looked as though something must give. Policymakers are saying that they have blinked because of inflation but so far this is more head fake than reality. If it does become reality and if we don't see any improvement in structural economic weakness, then the risk-taking that has been encouraged and rewarded could be very seriously punished in months or, more likely, years to come.

MBMG's Private Bank Advisory Portfolios versus the average portfolio YTD (As of 31st December)



1. MBMG Portfolios based on the average performance of MBMG IA's private client portfolios of USD 1 million or more, from 1st January 2017 to 31st Dec 2021 (actual & estimated data to 31st Dec 2021)..
2. Average US$ portfolios based on estimated ARC Research Private Client Indices from 1st January 2017 to 30th November 2021, extrapolated to 31st Dec 2021) - https://www.suggestus.com/pci.

If you can survive the virus, will the hope kill you?

No winter lasts forever; no spring skips its turn. – *Hal Borland*

In our Autumn Outlook, at the beginning of September, we wrote "*There's a sense that markets right now are throwing up a dilemma - that perhaps we might be on the cusp of a major change or that maybe we might not. To borrow cricketing terminology, we find ourselves very much in a corridor of uncertainty. This may be an opportune time to go between the horns of the bull (or bear) rather than risking being spiked by either.*"

Since then, stocks fell by around 5%, rallied back to new highs, shed over 3% in a week and again rebounded, via a pattern like an alarming oscilloscope chart, to even higher new highs in the last week. For both equity and treasury bond investors, the last 4 months has been the rollercoaster ride that we'd feared-

Good morning weathercock, make this day bright
Put us in touch with your fair winds
Sing to us softly, hum evening's song
Point the way to better days, we can share with you – Jethro Tull

Equity investors have at least managed to relieve the motion sickness by racking up gains of over 5%, whereas treasury investors can only peer through the nystagmus at a loss of almost 1%, which is a remarkable turnaround from the start of this month, when bond investors held the bragging rights.

What this volatility and reflexivity tells us is that not for the first time, the edifice of asset prices are largely built on the highly volatile foundations of liquidity flows. Assets may be appropriately priced with regard to fundamentals (although we'd very much doubt that) but if so, it would be much more down to luck than judgement – a case of navigating blindly without a map, but taking just the right number of fortuitous wrong turns to actually end up at the right destination.

In our autumn commentary, we also spoke of preparing for barren winter. Winter officially began at the hibernal solstice on December 21st, the shortest, darkest day of the year in the Northern hemisphere, with the pole at its farthest tilt from the sun.

According to Greek mythology, Demeter brought about winter, in a depression during the period that her daughter, Persephone had to spend each year with Hades.

However, this time of year is very much a period for both looking ahead at what next year might have in store and reflecting back on the year passed.

We have adopted that approach which has resulted in an even lengthier than usual commentary, as we enter into the month that is named after Janus, the Roman God of beginnings and endings.

Bust of Janus, Vatican Museum

Rock n Roll Winter –*Roy Wood (Wizzard)*

Through the icy rain the northern winds may blow
But now your friendly music keeps me warm each night
It's the perfect pleasure you might never know
Come on, come on, come on, you'll be all right

Oh, we're gonna make some rock n' roll this winter
Now my teenage heart has said hello to you
Oh there's gonna be some rock n' roll this winter
It's a wonderful rock n' roll winter, baby

The backdrop – Reasons to be cheerful, pt 3?

Good times, These are the good times.
Leave your cares behind. These are the good times
Good times, These are the good times.
Our new state of mind. These are the good times *– Chic*

The theme dominating investment headlines is, once again, the pandemic. The surge of the Omicron variant has generated news columns that markets have done their best to ignore during December. They may well be right to do so.

There's a very good chance that reactions to the Omicron variant are in fact an overreaction- there are good historical precedents to suggest that we might now be much closer to the end of the pandemic than the beginning - risk assets have focused on the pandemic and the variants and typically have got it very wrong - in January last year, we were the first investment advisory firm that I'm aware of to have warned that Corona Virus as it was then known, might be a bigger problem than people were admitting[4] and then when the markets woke up to this, they overreacted to the downside in March, which again we highlighted.

We think that since then markets, especially developed major markets like USA, have generally been too complacent, especially the way that they rebounded in October, climbing about 10% from trough to peak in just a few weeks - this was a selling opportunity, that again we highlighted.

For traders we'd say that the odds that Omicron blows over and we see a short-term rally, a blow off top are good, but for most investors, we'd like to see cheaper entry levels and we'd also say that even when that happens, there will be opportunity in risk assets, but it will be highly speculative.[5]

We note that there are strong precedents for viruses becoming much more widely transmissible but also weaker in a way that has ultimately led to the extinction of that separate viral identity, in the way that, for instance, Spanish flu was subsumed into ordinary seasonal flu.

[4] https://www.youtube.com/watch?v=QrtveCk_cBc Interview with CNBC, 27th January 2020
[5] Composite of Paul Gambles' recent interviews with TAM-EIG Facebook, Channel News Asia https://mbmg-group.com/article/new-variant-good-or-bad-negative-liquidity-to-impact-asset-values and CNA 938

No lethal pandemic lasts forever. The 1918 flu crisscrossed the globe and claimed tens of millions of lives, yet by 1920, the virus that caused it had become significantly less deadly, causing only ordinary seasonal flu. Some pandemics have lasted longer, like the Black Death, which swept out of Central Asia in 1346, spread across Europe, and ultimately may have killed as many as 1/3 of the inhabitants of Europe, the Middle East, and parts of Asia. That pandemic came to an end, roughly 7 years after it started, probably because so many had perished or developed immunity. As far as scientists and historians can tell, the bacterium that caused the Black Death never lost its virulence, or deadliness but the pathogen responsible for the 1918 influenza pandemic, which still wanders the planet as a strain of seasonal flu, evolved to become less deadly, and it's possible that the pathogen for the 2009 H1N1 pandemic did the same. Will Covid-19, follow a similar trajectory? Some scientists say the virus has already evolved in a way that makes it easier to transmit but it's too soon to tell [for a possible decline in virulence].

The idea that circulating pathogens gradually become less deadly over time…seems to have originated in the writings of a 19th-century physician, Theobald Smith, who first suggested that there is a "delicate equilibrium" between parasite and host, and argued that, over time, the deadliness of a pathogen should decline since it is really not in the interest of a germ to kill its host. This notion became conventional wisdom for many years, but by the 1980s…mathematical biologists Roy Anderson and Robert May, proposed that germs transmit best when hosts shed a lot of the pathogen, which may often mean when they are quite sick…which makes it easier for the next host to pick it up. So, virulence and transmissibility go hand in hand, until the germ gets so deadly it winds up killing its host too soon, and therefore can't spread at all. ***This is known as the transmission-virulence trade-off.*** The most familiar example is that of the myxoma virus pathogen introduced to Australia in 1950 to rid the country of rabbits. Initially, the virus killed more than 90 percent of Australian rabbits it infected. But over time, rabbits evolved resistance, the myxoma germ declined in virulence, and both rabbits and germ remained in precarious balance for some time.

A second theory, developed by evolutionary epidemiologist Paul Ewald…suggests that, as a rule, the deadlier the germ, the less likely it is to spread: If victims are quickly immobilized (think of Ebola, for example), then they can't readily spread the infection. By this thinking, if a germ requires a mobile host to spread, its virulence will, of necessity, decline.[6]

[6] https://www.smithsonianmag.com/science-nature/will-coronavirus-evolve-be-less-deadly-180976288/

It may be that this weakening and resultant disappearance of COVID-19 is already well under way and that the studies that suggest that Omicron variant is in fact much closer to dissipating:

"They say it is not as harmful as it seems, some experts even call it 'live vaccination'." - Russian President, Vladimir Putin

However, we will not know for certain whether this is the case until afterwards. Possibly some time afterwards. Even then, we might not fully understand the secondary effects – such as calibrating the effects of the interruptions to the labour force that a mild but ubiquitous virus variant can bring. Until then, this remains simply one of the possibilities. This is why even European and to a lesser extent Chinese equity markets which would be the most affected by Draconian control measures, have shrugged off the impact of Omicron. Any signs of an end to the Pandemic, or even that policy responses to Omicron have been excessive and can be eased, will likely result in a boost for risk assets such as corporate bonds, stocks, and property, especially if this occurs during the first half of 2022.[7]

So, if markets haven't been unduly vexed by Omicron, what has caused the pullbacks that have taken place intermittently since September?

The main issue that fund managers were concerned about, until a couple of weeks ago when it fell to second place, was inflation,[8] with asset bubbles in 3rd ahead of COVID-19 resurgence in 4th.

[7] It should be noted however that sporadically direct descendants of the 1918 flu combine with bird flu or swine flu to create powerful new pandemic strains, as happened in 1957, 1968 and 2009, claimed millions more lives.

[8] Bank of America, Global Research, Fund Manager Surveys, December 2020 to December 2021

Sentiment can change over time, often very quickly but, despite having taken the view that the supply shock effects are probably transitory, we too are concerned about inflation. Just not necessarily in the same way that everyone else seems to be, especially in the UK, where the Bank of England seems to be 'spooked' by inflation fears, having already raised interest rates-

I'm not sure that the inflation rate is high. Although official data show a year-on-year increase of 5.1%, we have to remember that

All economies are still suffering supply shock inflation - price increases due to global inability to deliver pre-pandemic levels, or in many cases lower, of goods & services (basically the world shut down for much of last year and re-opening has proved to be a challenge due to mainly logistical and organizational challenges) - UK inflation is for instance much lower than US. In the UK, the challenges of developing new supply lines in the aftermath of Brexit during a pandemic and with one of the worst governments in UK history (and there have been plenty of bad ones before) has made this worse - and shortages have affected consumer behaviour with a surge in pre-Xmas sales because of fears about empty shelves in the shops.

One of the clearest instances of this is commodity markets - where pricing tends to be marginal - i.e. big changes in demand or supply can have big outsize impacts we've seen this in various commodities but most recently in energy and food, which have been big components of the latest UK inflation 'surge'.

The Pound has been weakening - while it's only around 1.5% weaker over the last 12 months, it actually strengthened in the first half of the year (which hid some of the impact of supply shock inflation) but has fallen almost 5% over the last 6 months - much of the inflation that we're seeing is simply the weaker Pound - for instance, the price of oil is up over 40% in Dollar terms and almost 50% in GBP terms over the last 12 months (even though the UK is a major oil produce it is a slight net importer and what's more, the oil price is set in Dollars - so UK oil companies have been doing well but the broader UK economy has been paying the price for that).

So, the numbers sound bad and there's no doubt that households are hurting, especially at Xmas because wages are lagging (in real terms wages have fallen by 2.6% in the last 3 months), so sadly we don't expect the pre-Xmas retail to continue much longer. With personal debt increasing, 2022 looks a very difficult year for the UK in the absence of competent economic leadership.[9]

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[9] Composite of Paul Gambles' recent interviews with TAM-EIG https://www.facebook.com/watch/live/?ref=watch_permalink&v=652448656194359 Channel News Asia https://mbmg-group.com/article/new-variant-good-or-bad-negative-liquidity-to-impact-asset-values and CNA 938

In other words, there isn't yet any reason to suspect that the reported inflation numbers are anything other than 'supply shock inflation, which is covering over some very disturbing underlying economic fundamentals.

What is supply shock inflation?

The exact nature and causes of supply shocks are imperfectly understood. The most common explanation is that an unexpected event causes a dramatic change in future output. According to contemporary economic theory, a supply shock creates a material shift in the aggregate supply curve and forces prices to scramble towards a new equilibrium level.

The impact of a supply shock is unique to each specific event, although consumers are typically the most affected. Not all supply shocks are negative; shocks that lead to a boom in supply cause prices to drop and raise the overall standard of living. A positive supply shock may be created by a new manufacturing technique, such as when the assembly line was introduced to car manufacturing by Henry Ford. They can also result from a technological advancement or the discovery of new resource input. One positive supply shock that can have negative consequences for production is monetary inflation. A large increase in the supply of money creates immediate, real benefits for the individuals or institutions who receive the additional liquidity first; prices have not had time to adjust in the short run. Their benefit, however, comes at the expense of all other members of the economy, whose money loses purchasing power at the same time that fewer goods are available to them. As time moves forward, production becomes less efficient. Real wealth generators are left with fewer resources at their disposal than they otherwise would have had. Real demand drops, causing economic stagnation.

Negative supply shocks have many potential causes. Any increase in input cost expenses can cause the aggregate supply curve to shift to the left, which tends to raise prices and reduce output. A natural disaster, such as a hurricane or earthquake, can temporarily create negative supply shocks.

- https://www.investopedia.com/ask/answers/041015/why-do-supply-shocks-occur-and-who-do-they-negatively-affect-most.asp

This has led to parallels being drawn with 1970s stagflation. We believe that there are significant fundamental distinctions between today and the oil price shock although it's worth reminding ourselves of the crisis of nearly 40 years ago-

> The most famous supply shock in modern American history occurred in the oil markets during the 1970s, when the country experienced a period of strong stagflation. The Organization of Arab Petroleum Exporting Countries (OAPEC) placed an oil embargo on several Western nations, including the United States. The nominal supply of oil did not actually change; production processes were unaffected, but the effective supply of oil in the U.S. dropped significantly and prices rose.
>
> In response to the price increase, the federal government placed price controls on oil and gas products. This effort backfired, making it unprofitable for the remaining suppliers to produce oil. The Federal Reserve attempted to stimulate the economy through monetary easing, but real production could not increase while government constraints remained in place.
>
> Here, several negative supply shocks occurred in a short period of time: reduced supply from an embargo, reduced the incentive to produce from price controls and reduced demand for goods resulting from a positive shock in the supply of money.
>
> - https://www.investopedia.com/ask/answers/041015/why-do-supply-shocks-occur-and-who-do-they-negatively-affect-most.asp

The main echoes that we see of the 1970s today are twofold- geopolitical tensions and policy effects.

In fact, economic policy concerns have now overtaken inflation as the number one concern of investment managers.[10] 42% of fund managers cite this as their biggest concern. This is the first time for over 3 ½ years that this has been the most widely stated concern of professional investors.

In fact, the last time that managers stated inflation as their main worry a run up in equities ensued for several months, followed by a sharp fall, accompanied by weak months for treasuries, before a reasonable rebound:

[10] Bank of America, Global Research, Fund Manager Survey, December 2021

Policymakers have done nothing to justify the public confidence and it seems that they are still operating with a faulty playbook. This has been a concern to us for some time - https://www.cnbc.com/video/2021/02/19/theres-bad-economics-and-mathematics-at-play-in-the-markets-mbmg.html

In particular, The Bank of England have already raised interest rates and indicated that further rate increases will follow, and the Federal Reserve has already started to reduce its programme of asset purchases and also indicated that it will raise interest rates next year. This seems extremely imprudent leaves the following possibilities

1. Policymakers have forecasted next year's economic conditions with perfect calibration and their prescriptions will lead to sustainable growth, acceptable levels of inflation and the level of support required to sustain capital markets.
2. Policymakers have underestimated the strength and persistence of inflation and will have to take additional measures in order to limit what they perceive to be harmful consequences
3. Policymakers have got it hopelessly wrong and tightened into a weak economy.

The first would be ideal but also unprecedented. The second would likely precipitate a recession and an equity market crash. The third might fleetingly look like 1970s stagflation but with much more embedded underlying

challenges, primarily the high levels of private debt, could be the worst outcome of all for risk assets. Policymakers seem determined to re-enact Keynes' famous quote about their predecessors of the 1930s.

This is something that we cover in great, probably too great, detail in the final section of this report, *Technicalities*.

"O, wind, if winter comes, can spring be far behind?" - Percy Bysshe Shelley

Technicalities – fauxflation but real policy mistakes?

The world has been slow to realize that we are living this year in the shadow of one of the greatest economic catastrophes of modern history. But now that the man in the street has become aware of what is happening, he, not knowing the why and wherefore, is as full to-day of what may prove excessive fears as, previously, when the trouble was first coming on, he was lacking in what would have been a reasonable anxiety. He begins to doubt the future. Is he now awakening from a pleasant dream to face the darkness of facts? Or dropping off into a nightmare which will pass away?

He need not be doubtful. The other was not a dream. This is a nightmare, which will pass away with the morning. For the resources of nature and men's devices are just as fertile and productive as they were. The rate of our progress towards solving the material problems of life is not less rapid. We are as capable as before of affording for everyone a high standard of life—high, I mean, compared with, say, twenty years ago—and will soon learn to afford a standard higher still. We were not previously deceived. But to-day we have involved ourselves in a colossal muddle, having blundered in the control of a delicate machine, the working of which we do not understand. The result is that our possibilities of wealth may run to waste for a time—perhaps for a long time.[11]

We have long expressed concerns that western policymakers, especially in USA, have pursued policies that have driven up asset prices but with flow through to the real economy that at times has been limited or negligible, and at other times may even have been negative in its impact.

The pandemic slightly changed this in that while the flow through to the real economy was much less than the support given for asset markets, it has been a significant benefit. The following Op-ed penned for CNBC in 2014, lays out our concerns about policymakers-

[11] THE GREAT SLUMP OF 1930, JM Keynes

How QE may be doing more harm than good

I've spent the last few weeks talking almost entirely about the Bank of England's (BoE) latest research findings. The findings in question are contained in the BoE's Quarterly Bulletin. The paper's introduction states that a "common misconception is that the central bank determines the quantity of loans and deposits in the economy by controlling the quantity of central bank money — the so-called 'money multiplier' approach."

This "misconception" is obviously shared by the world's policymakers, including the U.S. Federal Reserve, the Bank of Japan, and the People's Bank of China, not to mention the Bank of England itself, who have persisted with a policy of quantitative easing (QE).

QE is seen by its adherents, such as former U.S. Federal Reserve Chairman Ben Bernanke, as both the panacea to heal the post-global financial crisis world and also the factor whose absence was the main cause of the Great Depression. This is in line with their view that central banks create currency for commercial banks to then lend on to borrowers and that this stimulates both asset values and also consumption, which then underpin and fuel the various stages of the expected recovery, encouraging banks to create even more money by lending to both businesses and individuals as a virtuous cycle of expansion unfolds.

The theory sounds great.

However, it has one tiny flaw. It's nonsense.

Back in June 2011, (https://www.cnbc.com/video/2011/06/05/qe2-and-the-us-economy.html) asked me why I was so critical of Ben Bernanke, an acknowledged academic expert on The Great Depression, I explained that I couldn't justify the leap of blind faith demanded by Bernanke's neo-classical monetarist theories.

Professor Hyman Minsky was one of the first to recognize the flaw in those theories. He realized that in practise, in a credit-driven economy, the process is the other way round. The credit which underpins economic activity isn't created by a supply of large deposits which then enables banks to lend. Instead, it is the demand for credit by borrowers that creates loans from banks which are then paid to recipients who then deposit them into banks. Loans create deposits, not the other way round.

In the BoE's latest quarterly bulletin, they conceded this point, recognizing that QE is indeed tantamount to pushing on a piece of string. The article tries to salvage some central banker dignity by claiming somewhat hopefully that the artificially lower interest rates caused by QE might have stimulated some loan demand.

However, the elasticity or price sensitivity of demand for credit has long been understood to vary at different points in the economic cycle or, as Minsky recognized, people and businesses are not inclined to borrow money during a downturn purely because it is made cheaper to do so. Consumers also need a feeling of job security and confidence in the economy before taking on additional borrowing commitments.

It may even be that QE has actually had a negative effect on employment, recovery, and economic activity.

This is because the only notable effect QE is having is to raise asset prices. If the so-called wealth effect -- of higher stock indices and property markets combined with lower interest rates -- has failed to generate a sustained rebound in demand for private borrowing, then the higher asset values can start to depress economic activity. Just think of a property market where unclear job or income prospects make consumers nervous about borrowing but house prices keep going up. The higher prices may act as either a deterrent or a bar to market entry, such as when first time buyers are unable to afford to step onto the property ladder.

Dr Andrea Terzi, Professor of Economics at Franklin University Switzerland, also suggests that many in the banking and finance industry, who often have trouble with the way academics teach and discuss monetary policy, will find the new view much closer to their operational experience. "The few economists who have long rejected the 'state-of-the-art' in their models, and refused to teach it in their classrooms, will feel vindicated," he adds.

Foremost among those economists is Prof Steve Keen: a long-time proponent of the alternative view, endogenous money. Having co-presented with Prof. Keen, I've been taken with the way that his endogenous money beliefs stand up to 'the common-sense test.' The proverbial 'man on the Clapham omnibus' knows that borrowing your way out of debt while your returns are dwindling makes no sense. Friedman and Bernanke couldn't see that.

Ben Bernanke positioned himself as a student of history who had learned from the mistakes of the past. Dr. Terzi questions this, "This view that interest rates trigger an effective 'transmission mechanism' is one of the Great Faults in monetary management committed during the Great Recession."

"The reality is that the level of interest rates affects the economy mildly and in an ambiguous way. To state that monetary policy is powerful is an unsubstantiated claim."

For a central bank to recognize that its economic understanding is flawed is a major admission. However, unless it takes the opportunity to correct its policy in line with this new understanding then it will repeat the same old mistakes.

The world's central banks are steering a course unwittingly directly towards a repeat of the 1930s but on a far greater scale. It's not yet clear that there is any commitment to change this course or indeed whether there is still time to do so. Either way, it will be very interesting to see what future economic historians make of Ben Bernanke's contribution to economic policy.

- https://www.cnbc.com/2014/05/07/how-qe-may-be-doing-more-harm-than-good.html

Recently, our criticism has become more strident-

Central Banks are a cross between a private members' club, a lunatic asylum, and a religious cult. The Fed take encouragement from the crazy behaviour of other lunatics - they all feel safe and warm swimming together in the same stream.

We know from our discussions with Central Bankers that they all speak to their counterparts regularly, so I'm sure that Jerome Powell speaks to Andrew Bailey regularly to encourage and support each other. I think that it's more than likely that Powell encouraged Bailey to hike rates rather than vice versa. My sense is that Powell is quite dovish but wants to limit the effect of Dollar strength at the time that the FOMC is determined to both taper and hike (which would normally be expected to underpin Dollar strength). I think Powell would like other Central Banks to act before the Fed so that the Fed can try to learn from this - it's almost like an experiment where other Central Banks are used by the Fed as lab rats or Guinea pigs.

It seems highly likely that Central Banks are misunderstanding goods and services inflation - this is a supply shock, and it will blow itself out but equally, they're misinterpreting the asset price curve that they have driven into bubble territory. Fed policy since 2008 has been all about supporting capital markets and asset prices and, until last year, not about supporting the economy, creating a huge and still growing gap between the economy and asset prices.

However, the consequences are asymmetrical. Both tapering and proposed rate hikes could hurt both the economy and the capital markets. It's not so much that the Fed is behind the curve but rather they've lost sight of where the curve even is.

Long term implied break-even inflation projections (the inflation rates that bond markets expect, which they imply through the difference between fixed rate government bonds and inflation rate linked bonds) tell us that inflation, interest rates and growth rates will be very low for the next 50 years, without even factoring in unknowns such as geopolitical risks or climate change. The Fed is years if not decades behind the economic curve. For 40 years now, they've clung to economic models that don't exist in the real world, neglecting the real economy while focusing primarily on driving asset prices into the biggest bubble in history. It's hard to imagine

that they can catch up now - in fact, they just seem to be falling further behind. [12]

Although this criticism might sound extreme, it reflects our extreme concern. Tightening monetary policy (increasing interest rates) at the same time as tightening fiscal policy (reducing currency creation) into an economy demand-constrained by unsustainably high levels of private debt, during a policy-driven asset bubble has much closer echoes to the late 1920s than the oil crisis of the 1970s.

However, even if our concerns are valid, the translation of these policy mistakes into market consequences is still, to some extent nebulous, because the mistakes don't happen in isolation – other market factors will disguise the consequences which will also be deferred and initially diluted during the time taken for the current pools of surplus liquidity to be absorbed. Only when that has happened will the impact be fully felt.

In short, capital markets have become an embodiment of Game Theory, dependent upon the whims of policymakers, nowhere more so than in America's stock and bond markets. It has been a long journey to this point, at least 250 years in the making. The Founding Fathers of the American nation clearly included exceptional military and political leaders, authors, and thinkers.

Many of their achievements are rightly celebrated to this day. However, their most audacious and enduring success necessarily had to be hidden at the time and has largely remained so in the intervening centuries.

According to Noam Chomsky, James Madison was well aware of the dilemma first identified by Aristotle over 2,000 years earlier - that great and unequally distributed wealth can't co-exist with genuine democracy and consequently created a framework for the new country that emphasized property rights over democratic principles.

Madison's genius was to do so in a way that in a revolutionary era that prized liberty, equality, and democracy, he created an enduring myth that his solution was both democratic and egalitarian.

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[12] Composite of Paul Gambles' recent interviews with TAM-EIG https://www.facebook.com/watch/live/?ref=watch_permalink&v=652448656194359 Channel News Asia https://mbmg-group.com/article/new-variant-good-or-bad-negative-liquidity-to-impact-asset-values and CNA 938

“Aristotle took it for granted that a democracy should be fully participatory and that it should aim for the common good. In order to achieve that, it has to ensure relative equality, "moderate and sufficient property" and "lasting prosperity" for everyone. In other words, Aristotle felt that if you have extremes of poor and rich, you can’t talk seriously about democracy…that if you have, in a perfect democracy, a small number of very rich people and a large number of very poor people, the poor will use their democratic rights to take property away from the rich. Aristotle regarded that as unjust, and proposed two possible solutions: reducing poverty (which is what he recommended) or reducing democracy.

James Madison, who was no fool, noted the same problem, but unlike Aristotle, he aimed to reduce democracy rather than poverty. He believed that the primary goal of government is "to protect the minority of the opulent against the majority." As his colleague John Jay was fond of putting it, "The people who own the country ought to govern it." Madison discussed this quite explicitly at the Constitutional Convention, expressing his concern that the poor majority would use its power to bring about what we would now call land reform so he designed a system that made sure democracy couldn’t function. He placed power in the hands of the "more capable set of men," those who hold "the wealth of the nation." Other citizens were to be marginalized and factionalized in various ways.

To be fair, Madison was precapitalist and his "more capable set of men" were supposed to be "enlightened statesmen" and "benevolent philosophers," not investors and corporate executives trying to maximize their own wealth regardless of the effect that has on other people. When Alexander Hamilton and his followers began to turn the US into a capitalist state, Madison was pretty appalled. In my opinion, he’d be an anti-capitalist if he were alive today — as would Jefferson and Adam Smith.”

Excerpted from The Common Good - Noam Chomsky

What does that have to do with US’ capital markets’ addiction to policies such as Quantitative Easing or QE, often referred to as ‘money printing’? Probably a great deal more than is immediately obvious.

The development of the 13 rebellious east coast colonies into the most powerful superpower yet seen, owes a great deal to the acceptance by Americans of this largely unquestioned reverence for property rights, enabling the creation of a highly financialized economy (i.e. where financial activity dwarves commercial or industrial activity - or on other words where Wall St. towers over Main St.) in which capital, which increasingly has come to mean borrowed capital, has been able to exploit human, natural and all other resources to an unprecedented extent.

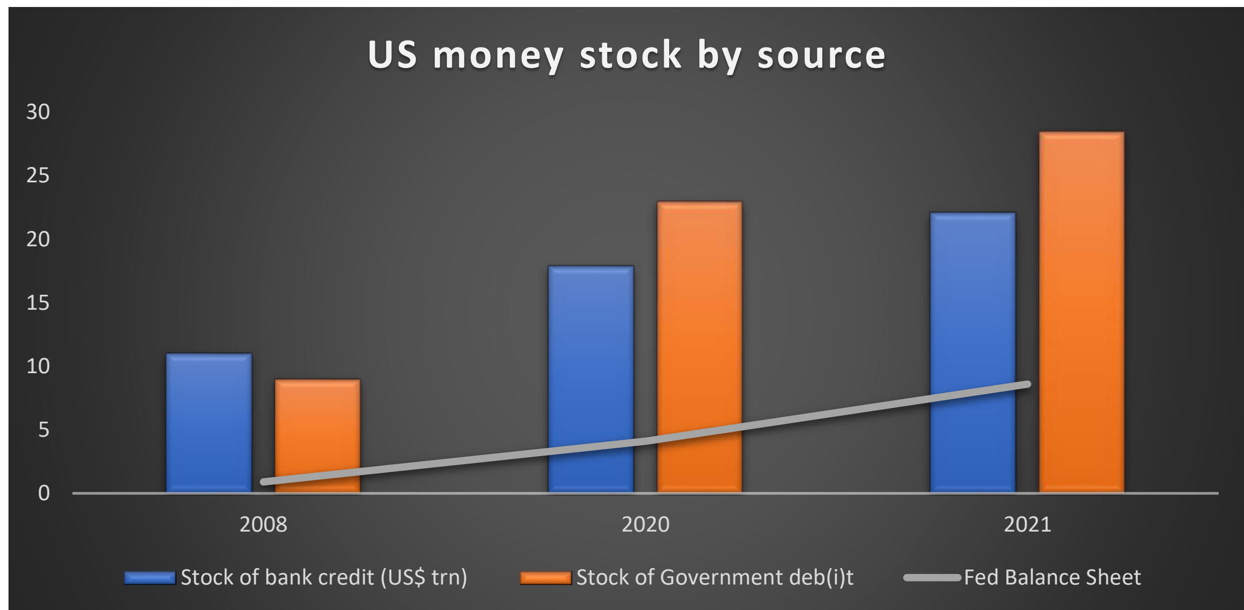
The has led to the precedence of the role of the creation of US capital - ultimately to the extent where America assumed the mantle of the primary global source of capital - as the greatest driver of both economic growth and capital market activity. During the 20th century, this power largely devolved to the all-powerful financial institutions with increases in economic activity, employment and also asset prices correlated most closely linked to increases in the rate at which banks created new money in the form of credit (i.e. bank loans)

It’s a popular misconception that banks lend out the deposits that they hold but in fact it has been empirically demonstrated that each time a bank issues a new loan, it creates new money. At the onset of the Global Financial Crisis in 2008, the balance sheets of commercial banks represented 90-95% of broad money in circulation in America.

The balance sheet of the US Central Bank, The Federal Reserve, was, at the time, many times smaller. Since then, commercial bank loan books have roughly doubled, whereas the Fed’s balance sheet has grown almost 10 x, which has been a major factor in the total stock of money injected by the US Government into the economy growing to the extent that it now significantly exceeds the stock of credit created by banks (currently around $28.5 trillion as opposed to $22.2 trillion).

In short, in the last century, the primary driver of both economic activity and of asset prices was new ‘money’ created by banks.

This century, the main driver has been new money injected into the economy by the US Government.



What has brought about this change?

The policy response to the credit crunch of 2007-8 largely focused on ensuring that the financial sector has access to more capital than it might need to enable the banking system to both lend when demand materialises and also to absorb losses better than in 2008 if the need to do so comes about. Policy has been designed to prevent a repeat of the credit crunch.

However, there are unintended consequences to this approach.

Firstly, one significant difference between commercial bank lending and central bank lending is that bank lending can be used to acquire assets, stimulate business and personal consumption or fund investment into business activities, whereas the Fed's balance sheet tends to be used primarily simply for asset purchases.

This goes some way to explaining why the period since the GFC has seen asset prices, as a whole, race ahead at a much quicker rate of increase than economic activity. The liquidity created by the Fed for commercial banks doesn't solely have to be used for investment into capital markets but on the scale and at the speed that it actually has been produced, capital markets, such as stock lending by brokers and bond purchases by banks, have been the major beneficiaries because the scale of the commercial banks' balance sheets far exceeds the scale of their lending activities.

Secondly, even though presently there is significantly more liquidity than is expected to be required - in fact, there is so much liquidity that commercial banks currently have far more problems finding ways to profitably accept more deposits from their clients and account holders, which the Fed have had to find various creative ways to absorb - it's a recurrent observation throughout modern economic history that liquidity finds its ways into assets and into loan books and pretty quickly becomes illiquid. The surest way to create a credit crunch in the future is to produce a glut of credit today.

Thirdly, productive borrowing tends to be driven by demand. Excessive supply tends to force lending into unproductive projects, or sustain so called zombie companies or drive up asset prices by distorting the amount of demand from buyers and investors.

Finally, US (and British, German & French according to Lords of Finance) policymakers don't have a great track record of executing policy in a way that achieves their aims.

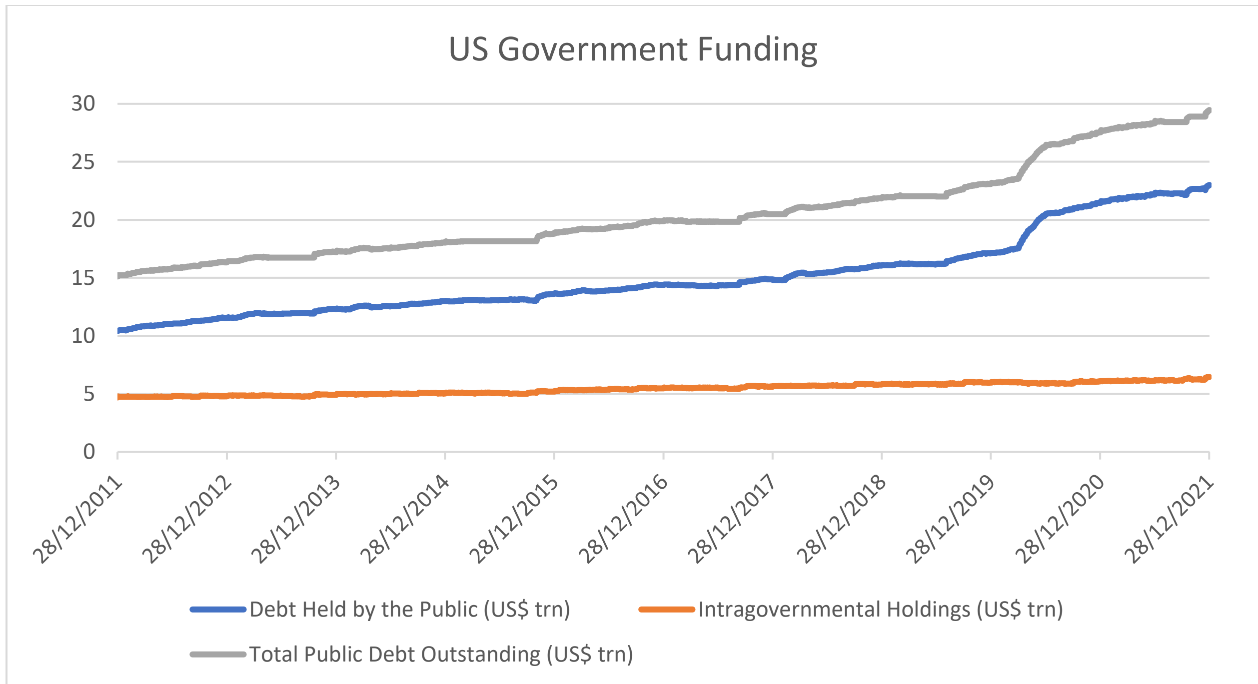
So, where does all that leave us?

Liquidity remains ample
This has driven asset prices (stocks and bonds, especially corporate bonds) to distorted levels
Zombie companies abound

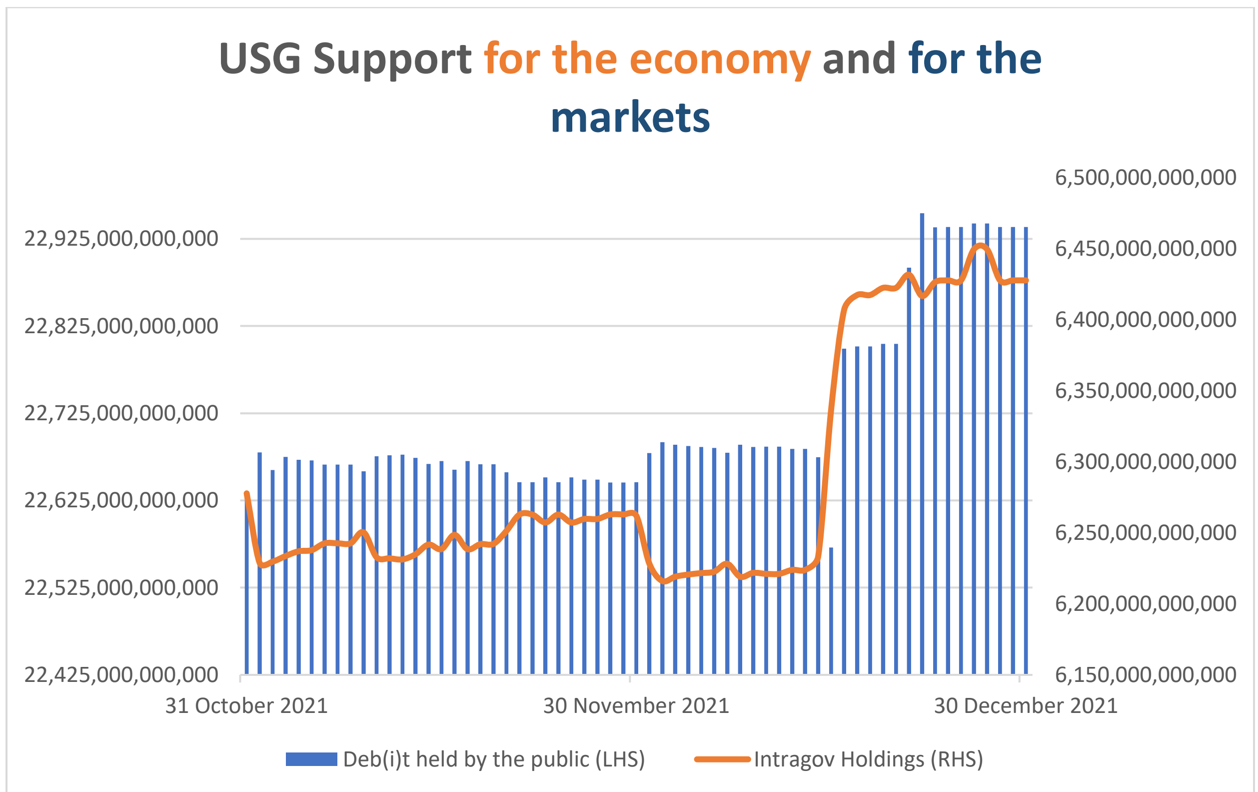
Distorted asset prices remain reliant on the huge expansion in liquidity being fed (no pun intended) into capital markets at a continuously increasing, ever faster rate.

In November, the Fed reduced its programme of buying bonds and mortgage assets by $15 billion, from a monthly level of $120 billion to $105 billion. In December, it reduced this by a further $30 billion to $75 billion.

However, this reduction in asset purchases is far from clear in US money creation data:



Even if we drill down to the most recent couple of months:



In short, the Fed's stated policy of reducing liquidity is likely to be extremely damaging, if not disastrous. However, liquidity is still being expanded. In fact, the rate of increase, which had been declining, accelerated again in December. Barring a dramatic volte face from the Fed, liquidity, especially capital market liquidity, will start to decline as a result of Fed policy. This won't immediately impact capital markets due to the available surplus reserves. However, the reversal of capital creation will begin the process of draining the surplus reserves. Once the surplus is exhausted, the flow of liquidity into capital markets will reduce, removing the support for asset prices, especially risk assets, leading to PE ratio contraction.

2022 looks as though it could be a 'game of two halves' – there are reasons to suspect that on balance the first half could benefit from the continuation of positive momentum, whereas the second half could see that derailed by the withdrawal of liquidity from capital markets. However, both of these assumptions are very much subject to changing conditions and 2022 is the year when strategy will need to evolve and adapt alongside those changes.

Winter is on my head, but eternal spring is in my heart- Victor Hugo

MBMG Investment Advisory

MBMG Investment Advisory is approved by the Securities & Exchange Commission of The Kingdom of Thailand (SEC) to provide investment advisory services under licence number ค06-0055-21. This license permits the Company to give advice to the public, whether directly or indirectly, about the value of securities or the suitability of investing in those securities and the purchase or sale of any securities, assets, or currencies. There are various different ways of describing what we do – fee-only advice, asset consulting, fiduciary but the short version is that our clients pay us to provide advice and, because we don't have the conflict of interest of being paid by product or service providers (something of a problem throughout financial services) then we're not exposed to conflict of interests (see fee-based advisory on the following pages).

Investment advice overlaps many other areas, such as taxation advice and compliance, where we also draw on the expertise of other parts of the MBMG Group, such as MBMG Corporate Solutions, which incorporates legal, accounting and audit experts. Chinese walls separate our entities which comply with strict data management and conflict of interest policies and regulations.

Global reach

The MBMG Group is a member of the invitation-only Geneva Group International (GGI) Alliance, the largest global multidisciplinary alliance of independent accounting, audit, law, and consulting firms, with almost 30,000 employees in 870 offices spread across 126 countries, enabling access to worldwide expertise and know-how.

The MBMG Group specializes in providing professional services to our personal, corporate, and institutional clients as well as government agencies and organizations.

These include digital and cloud accounting and management systems for business of all sizes as well as corporate legal and advisory services, with particular expertise in due diligence and valuation services, feasibility studies and start-up, tax advice, planning and compliance, corporate secretarial, legalization and visa issues, risk management, insurance, and M&A advisory and transactions.

Our personal advisory services include risk management, offshore trust, business and family asset structuring, broker account, private bank and investment account analysis, asset and currency allocation advice, inheritance planning (including. wills/trusts), insurances, tax planning and compliance plus real estate and residency services.

Fee-based approach.

	Fee-Only *Charging a flat rate for services*	***Commission - Based*** *Compensated with payment on investment transactions*
Income	Earned entirely from fees paid by each client, in line with a published price list.	Earned entirely on the products sold (i.e. insurance packages and funds) or the accounts opened for clients.
Suitability (SEC)	Suitability alone is insufficient as that is exceeded by the fiduciary standard.	Must follow suitability standard requiring recommendations to be made based on client's personal situation and needs, but no obligation to act in line with client's *best* interests.
Fiduciary (SEC)	Must follow fiduciary standard requiring each client's interests to be placed first, with advice solely for the benefit of the client as opposed to profit for the advisor. • Duty to clients over any duty to a broker, dealer, or institution. • Must conduct a thorough analysis and must both disclose any conflict of interest and also indicate the best execution or terms in any advice given.	No fiduciary standard applies to brokerages or banks (other than through any affiliated investment advisor entities, operating as fee-only investment advisors).
Strengths	• A greater degree of objectivity due to the method of compensation, unbiased by conflicts of interest. • A far greater opportunity set encompassing the entire global universe of stocks, bonds, funds, deposits, investment platforms, property, businesses, and management & advisory services. • Fixed fee advice creates a greater transparency that also places transparent limits on the fee levels, resulting in a very cost-effective service. • Homogenous fees across client types makes fixed fees even more cost-effective for larger portfolios • The best execution savings that can be generated from external product and service providers (such as institutional fund classes) often generates a portfolio fee saving exceeding the fixed advisory fees payable – whilst it would be misleading to describe the service as free, some, most or all of the service cost, or more, can often be recouped in savings.	• Suitability ensures a range of appropriate investments from a universe regulated or approved by the SEC (in some cases under IOSCO passporting). • Regulation of suitability ensures that advisors are obliged to adhere to standards. • Some clients like the, admittedly false, perception that if the fees are all embedded or hidden, they are getting something for nothing.
Weaknesses	• Fee-based services can appear relatively expensive, as commission-based services embed fees in a way that can hide or disguise them and encourage investors to believe that they're getting something for nothing. • Fiduciary services generally don't include execution fees or external product or service costs which have to be paid in addition. • The provision of professional services on a fee-only basis means that while this favours larger investors,	• Many commission-based advisors are only nominally employed by the firms whose cards they carry. Their remuneration can be significantly or even exclusively driven by commission earnings like self-employed, contractors to the firm. • The best interests of the individual advisor and the firm might be realized by maximising commission income through highly remunerative investment products, exceptionally high product fees, excessive trading frequencies and churning[13].

[13] Churning is the unethical practicing of excessive buying and selling of securities in a client's account to keep the portfolio in a constant flux with the primary purpose of generating fees and commissions for clients. (https://www.investopedia.com/articles/basics/04/022704.asp)

	it can be increasingly expensive for smaller investors (with say less than THB 1 million/£20,000/US$30,000 in advisable assets).	• Clients under common misconception of receiving free services face a lack of transparency in identifying or controlling hidden costs. Unlike the fiduciary model which requires costs to be minimized, the suitability model creates an incentive for costs to be maximized.

"The big difference between a fee-based advisor and a commission-based advisor is that the former collects a flat fee (a flat retainer, or an hourly rate) for investment advice or a percentage of assets under management, while the latter receives payment upon opening an account for a client or on the sale of a financial product by the company offering that financial product."

– Jason Van Bergen, 13th April 2018

Commissioned services may very well be the most suitable for some investors, particularly in the case of a smaller portfolio where less active management is required; paying the occasional commission is probably not going to be the downfall of the portfolio's returns over the long-term. Yet for anybody who has a larger or more active portfolio to manage, whose investment objectives necessitate frequent trades and active asset allocation, the rise of the fee-only investment advisor has been described as "akin to portfolio nirvana"[14]. It allows investment professionals to do well for themselves while taking their clients' best interests to heart.

While commissions remain the primary means by which investment firms make money, and it will likely stay that way for the foreseeable future, the Company has adopted a fee-only business model. Within this approach, the first step is to agree and specify client aims from a point of view of life goals and obligations, or specific financial planning scenarios in terms of areas such as taxation planning, currency management, liquidity requirements and appropriate levels of risk/reward.

Having done so, we then produce a proposal, such as this one for you, outlining what we understand the scope of work to be. If you agree and wish to proceed, we then invoice for our services and produce the report and then support that with any ongoing explanations, further information, or other assistance to enable you to act on the report.

"[MBMG] will listen to what a client's goals are, analyse what the client has to do to achieve those goals, and then, based on reasonable probability, tell them what they need to be investing yearly, how much they need to be earning and how much they need to be saving. Paul says in some ways it's a boring approach, "What we do is very practical, it's not very exciting, it's not very sexy. We don't go around saying 'this investment could be the hottest thing in the next twelve months.' We tend to focus on the risk side of things while coming up with reasonable, practical solutions."

– Interview with MBMG Co-founder, Paul Gambles, July 2015

[14] This comment has been made by other fee-based advisors – e.g. http://investtowin.com/ and therefore may not be impartial.

Fiduciary Standard

We advise based on the fiduciary standard, within our fee-only model, to ensure we are providing the *best* advice rather than merely suited advice, as per the suitability standard.

“The sole source of compensation for fee-only advisors is fees paid from the client to the advisor. When recommending investments to clients, fee-only advisors follow the fiduciary standard to always act in the client’s best interest. They must conduct a thorough analysis of investments before making recommendations, disclose any conflict of interest and utilize the best execution of trades when investing.”

– Ethan S. Braid, CFA on 8/05/2012

Disclaimers

1. It is vital to ensure that you understand the nature of the products, return conditions and risks before making any investment decision.
2. An investment is not a deposit and carries investment risks. Investors are encouraged to make an investment only when investing in such an asset or assets corresponds with their own objectives and only after they have acknowledged all risks and have been informed that the return may be more or less than the initial sum.
3. Investors should carefully study all offering documents in respect of any asset in which they are considering investing, including but not limited to the offering documents. They should retain a copy of these for future reference. If in any doubt, contact your advisor or analyst before proceeding with any investment decision.
4. If you wish to acquire more information or additional documents or have questions about an investment, you should contact your advisor or analyst and not proceed until you are satisfied that you have full and acceptable information.
5. Any information regarding the status or performance of any asset is provided in accordance with the assessment standards set by the relevant regulatory body.
6. Past performance of an investment may not be indicative of future returns.
7. The company allows its employees to make their own investment in securities as long as they acknowledge and act in accordance with the code of ethics and all announcements from the Chartered Financial Analysts Institute (CFA Institute), while disclosing the details of their investment to the company, which will accordingly monitor and employees' stock trades.
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