



Mass Delusions:

invisible through the windshield but clear as day through the rearview mirror

Since around 1995 it has been a 'Golden Age' of the mass delusions that form speculative bubbles. There are simply not enough "What Were They Thinking Awards" to go around. The initial mass delusion of this period was the certainty that the easiest path to riches was to be long as many "dot-com" stocks as possible. It simply did not matter that the company had no product, no market share, and no income other than the funds from the IPO. It was a new age and the 'old economic rules' did not apply. Everyone was too busy making money from 'momentum plays' to notice that this emperor had no clothes. In a report to clients dated 08 August 2000 we urge the complete evacuation of the NASDAQ, as a collapse was imminent. After the dust had settled, after the NASDAQ had lost 78% of its value from 2000 to 2002, by then it had become obvious to all that it was all one big speculative bubble. By then it had become clear that the 'new economy' was nothing more than a mass delusion.

After the internet bubble there was the mass delusion that created the real estate bubble into the 2005 peak. Real Estate became a 'you cannot lose no-brainer.' Next in line was the mass delusion that inflated the stock market bubble into the 2007 peak. Then came the commodity bubble that burst into the summer 2008 peak, and then the Treasury bubble that burst in December 2008 at a 2.038% ten year note rate. And all of these various sector bubbles together formed the largest credit bubble in the history of the world - by several orders of magnitude. And as we have noted before, credit is debt. It was one big mountain of US Dollar denominated debt.

One issue that arises is whether there has ever been such an extended period of frenzied speculative, credit driven excess as the sequence of events cited above. I do not remember seeing an such period in my studies of economic history. The speculative excesses into 1929 were a tiny fraction of what we just lived through and the speculation lasted a fraction of the 1995 to 2008 duration just outlined above.

A second issue to emphasize is that in the later stages of each of the bubbles cited above bears were extremely rare. And the overwhelming majority were entirely confident that much higher prices were still ahead even as the bubble began to deflate. Even most of those calling it a bubble expected only a bull market correction. However those who knew their history expected much worse. We have noted many times that from the collapse of every speculative bubble in the history of mankind the ensuing price collapse broke well below the price levels that existed prior to the bubble.

Our third and final point - and the purpose of this article, is that point cited in the headline above. Like all man made disasters the collective delusions that inflate speculative bubbles are best viewed in hindsight. Why is it so difficult to see these excesses for what they are as they are happening? There is that proverb "You cannot predict what you do not want to happen."



The Next Mass Delusion:

- what do we all not want to happen?

All this brings us to the key issue. Is another speculative bubble now being inflated? What can we not now see unfolding because we do not want it to happen? What key evidence in this regard might have been over-looked? What is the next mass delusion of which everyone is convinced is a sure thing?

It is our contention that the present 'mass delusion' is the overwhelming certainty that a tidal wave of inflation is about to engulf the world. Who do you know that is not entirely convinced that inflation is dead ahead? What was the last time you heard an argument for deflation on a cable news channel or in a magazine or newspaper? The Fed has created all this 'money'. How can we possibly not get inflation?

Our proposed answer is as simple as it is overlooked. Inflation is, by definition, too much money chasing too few goods - thereby driving the price of those goods higher. The critical element here is not the "too much money" part. The critical ingredient is the "chasing" part. Inflation cannot arise if consumers are not spending and banks are not lending. Media everywhere are filled with dire and immediate forecasts for inflation and for the ensuing collapse of the US Dollar. Meanwhile virtually every single economic indication that I know of is strongly suggesting that deflation is the greater risk. We list below the top ten economic indicators and why we see them as signalling deflation ahead. We list them in order of their perceived importance to the inflation versus deflation issue.

Top Ten Economic Indicators and their deflation message

1. M2 Velocity - still in a sharp down trend
2. CPI and PPI - their annual rate of change is still negative
3. Unemployment - the real rate, U-6, is 16.5% and still growing
4. Manufacturing Capacity Utilization - annual rate of change still negative across all sectors
5. Consumer Credit - still negative growth (contracting)
6. Industrial Production - annual rate of change still negative across all sectors
7. U.S. Imports and Exports - still no rebound after the sharp drop from 2008
8. Commercial and Residential Real Estate - foreclosures and defaults still in an up trend
9. Bank Failures - still in an up trend
10. Gold Prices - still carving out a series of lower highs ever since the March 2008 peak

Does this look like a world ripe for inflation? So why is everyone still expecting inflation? Could part of it be that deflation is so widely dreaded? Could it be that inflation is predicted because we much prefer an inflationary expansion to a deflationary depression? Stay tuned.