Too big not to fail

1. Zero returns

Those who possess assets, or indeed live from them, assume that they will generate a return. Not every day, admittedly, or even every year. But at least in the long term, on average, and on condition that everything has not been bet, unwisely, on a single asset or category of assets. Investors – our clients – live from and with this quasi-axiom of positive returns, and so do we, who advise them and act with them in these matters. And all the complex portfolio optimisations of the insurance companies and the pension funds are based on this single quasi-axiom: on the "expected average return" – five, six or more percent for stocks, three or four percent for fixed-interest investments, one or two percent for short-term money – rest all the strategic and tactical decisions and guidelines regarded by the responsible bodies and the supervisory authorities as a more or less sacred mantra. They are sanctified under the rubric of "economic fundamentals". The assumptions for average returns are thus not a quasi-axiom, but a real one, not subject to challenge.

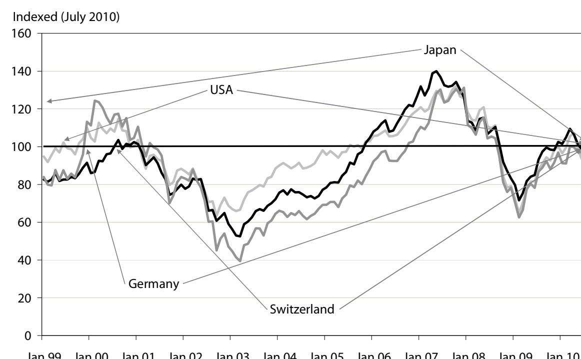
Far be it from us to call this "economic fundamental" into question. Basically, we believe in it ourselves (what else should we believe in?). It's just that real-time events currently – and, sadly, "currently" here means "for a considerable time now" – tell a different story. There's little or nothing to be made from assets. Returns have practically reached zero, and, regrettably, this applies to a good many of the relevant asset categories.

Let's start with money-market investments; with call and fixed deposits, money-market funds, and the like. In Swiss francs, there's no return under six months, unless the selected investment contains some sort of additional risk (Lehman Brothers …). Things are not really any better with the investment currencies, the euro and the US dollar, and certainly not for the yen.

Anyone wanting to achieve a return of at least one percent from a fixed-interest investment in Swiss francs must opt for a maturity of almost five years, if he wishes to entrust his funds to a reasonably reliable debtor. The yield on a ten-year investment in US T-bills is currently 2.6 percent; the yield on eurobonds is at a similar level, and, once again, there's not much to be had from the yen. Long-term bond investments are, however, exposed to a significant interest-rate risk. Roughly speaking, the potential fall in price if the interest rate rises by one percent is about equivalent to the weighted maturity of the bond. So far, it has been worthwhile accepting this risk, as interest rates have fallen further from an already low level. The rises in the price of bonds this produced have also been responsible for some of the returns generated on mixed portfolios. This agreeable state of affairs is now, however, gradually coming to an end, as long- and even longer-term (30-year T-bills) investments approach zero yields. The consequences of interest-rate risk are becoming increasingly asymmetrical.

And what about stocks, of which it is said that they should reward investors with a hefty "equity risk premium"? The picture could hardly be more sombre. Those who with their unbelievably ingenious tactical over- and underweighting have earned nothing, but at least made no mistakes – that is, those who have simply held stocks in their portfolio on a diversified basis – will have to go back ten or even, depending on the region, up to eleven (USA) or twenty (Japan) years to see a positive return. And this, nota bene, including reinvested dividends. The figure below shows clearly how stocks have been marking time. Given that very many deliberate investment decisions are made pro-cyclically, it is more than likely to be the case that a very large number of investors have been waiting a very long time for an appropriate return on their capital.

Stocks: the long wait



Source: Bloomberg; analysis
Note: Regional total-return indices (i.e. with reinvested dividends) in local currencies; S&P 500 for the USA, SPI for Switzerland, DAX for Germany

With returns like these, it is little wonder that people are increasingly wondering what the point of it all is. A realistic perspective on returns offers cold comfort. It is the case that inflation has also been low in recent years, so that holding on to the assets has at least not involved any significant loss of purchasing power. But no pension fund is kept going by zero returns, and nor is any satisfactory cash-flow generated from an individual pensioner's capital. Look at it how you like: those dependent on returns from their assets have been holding a bad hand for some while.

2. Perplexity as a phenomenon

At times when axioms and quasi-axioms come under discussion, when fundamental questions are being posed and when so many situations have "never been like this before", it's small wonder that those most easily observable indicators of the public mood, the stock exchanges, are wallowing around like a ship that has lost both keel and rudder, and whose sails are in shreds. The lack of direction on the stock markets over recent months has been almost unbearable for many market players, and the commentators have excelled themselves with overinterpretations of events of little or no significance.

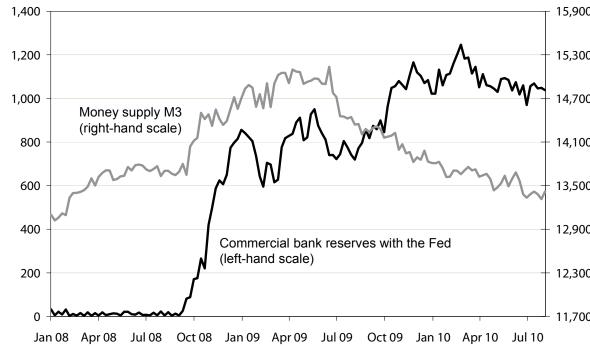
The most recent example of this is provided by the apparently so disappointing economic statistics from the USA. There is undoubtedly a remarkable amount about the country that invites negative reporting: the continuing high rate of unemployment for instance, the failure to restructure the real estate market, or the exorbitant rise in the national debt. We shall come back to these matters in this Investment Commentary, but they have all been known about for a good while now. But if the rate of acceleration of a couple of indicators, such as the quarterly change in GDP, slackens off a bit after the rapid upswing out of the recession of 2008/2009 (which was entirely predictable to any level-headed observer), then the suggestion that this presages descent into another recession can only be regarded as evidence of a thoroughly over-excited state of nerves. "Double dip" has been the new buzzword in recent weeks. Over-excitement is a poor counsellor: those who believe they can see a change of trend here will all too often to be deceived by natural fluctuations and the oscillation of data.

No, there are no key economic question marks, either in the USA or in Europe. Those who based their economic forecasts on an indiscriminate extrapolation of the rapid increase in industrial inventory (in the wake of the abrupt reduction in inventory caused by the extensive collapse of global trade as a consequence of the financial crisis in the previous year) were quite simply wrong. Those who based their profit forecasts directly on company figures fuelled by the rebound were simply too euphoric. The "lazy L", the wearisome economic recovery that we feared lay ahead for the next couple of years, seems increasingly likely to be the outlook for the western industrial nations – including, incidentally, Germany, and its apparently miraculous exports; here too, there is no call for the over-interpretation of a specific situation. The overall European situation is characterised by a much more sluggish track. With regard to economic issues, there is no real justification either for perplexity or for the enormous mood swings on the stock exchanges.

The problem arises with structural issues. Here, perplexity is more than justified. Let's begin with the banking system, as it presents itself in the wake of the financial crisis. How healthy is it really? Nominally, it doesn't look too bad – earnings, and particularly those of the institutions hard-hit by the crisis, have improved sharply. Balance sheets, for example those of UBS or Citigroup, have been seriously reduced. And the equity situation has improved correspondingly. So far, so good. But is the banking system in the western industrial nations actually fulfilling its economic function? Strangely, at a time of record availability of cheap liquidity from the central banks (hence the low money market rates in all the relevant currencies) there is almost no credit business going on. This means that the banks have remained almost inactive in their function as conveyor belts between the central banks and the real economy. Or, to put it more plainly, since the financial crisis the banks have remained in a dysfunctional state.

The figure below makes the situation abundantly plain. The money supply M3 in the USA, which is no longer calculated by the Fed (why not?) but is still tracked by intelligent people, continues to plummet, while the Fed's excess reserves remain at the highest level.

Misallocated money



Source: Federal Reserve, shadowstats.com
Note: Figures in USD billion; M3 = Cash + savings + time deposits

Of course, blame can be laid at the door of the real economy, which is obviously generating too little demand for credit: "You can lead the horse to water, but you can't make it drink". The lack of enthusiasm for investment is probably the mirror-image of the lack of risk appetite on the banking side. With interest rates very low nominally, and possibly negative in real terms, such behaviour on both sides is extremely strange, if not indeed off-putting. Something must be radically wrong somewhere: otherwise an investment and credit boom would be in full swing!

Low interest rates, record liquidity supplies, "quantitative easing" (which can be equated with the direct supply of capital to the system by the central banks), a farewell to the concept of an "exit strategy" (i.e. to an end to "quantitative easing"): according to current economic theory we should long have been feeling inflationary pressure. Hence the perplexity of the monetarist Cassandras: inflation has fallen to an all-time low on both sides of the Atlantic; there is no sign of any constraint on the supply of goods, on account of the productivity gains both in the emerging markets and in the domestic economies. It almost looks as if J. K. Galbraith, that veteran Keynesian, was right after all. He recently utterly dismissed any warnings about the negative impact of the extremely stimulating monetary and fiscal policy (*The Economist*, 12.8.2010, p. 60). By way of reminder: TARP, the American government's stimulation programme, amounted to USD 700 billion. Further, for fiscal 2009, the ARRA (American Recovery and Reinvestment Act of 2009) was created with USD 800 billion. The Fed's balance sheet was expanded from USD 943 billion (2008) to USD 2,368 billion (2010) for the purpose of buying up domestic debt. The European and Japanese totals look little different.

However, and here's another source of perplexity, Keynesian economics throws up more question marks than anything else – never mind about success stories. For even if it really is the case that an extremely stimulatory monetary and fiscal policy does no damage with regard to inflation, it has sadly also become clear in the meanwhile that it doesn't actually do much good either. Unemployment in the USA seems stuck at the high level of 9.5 percent (including those working part-time who would be happy to work full-time, it's almost 20 percent), the US real estate market has been at best stabilised, and the rallying cry of "Yes, we can!" now generates at best a weary shrug of the shoulders. Despite record low interest rates, average Americans are saving, while the state piles deficit on deficit. Having been close to zero for many years, the savings rate for American households is now 6.2 percent. The US government's debt has risen by 28.4 percent since the end of 2008. Put differently: one side provides stimulation as never before, but on the other side, this stimulation obviously achieves little or nothing.

Perplexity over monetary policy too. By now, the extreme stimulation of the system by practically all the relevant central banks has come under criticism not only from academic circles, but also from insiders, so to speak. The annual report of the Bank for International Settlements (BIS) devotes a whole chapter to the potential negative impact of the low-interest-rate policy (BIS 80th Annual Report, Basle, June 2010, p. 36ff). It discusses microeconomic misallocations by companies, as well as global distortions; the fear is expressed that the increasingly desperate search for returns will result in dangerous risk-taking by investors, and there's more in a similar vein. However, not one of the critics has ever indicated where the right – or at least an appropriate – interest rate might lie when there is practically no inflation, and the fear is rather of deflation. Criticism is cheap when there's no need to comment on the alternatives and their relative advantages and disadvantages.

3. A lonely student in a sea of flames

Perplexity in the markets, in all the institutions and at all levels: this cries out for some effort at explanation. Pictures are sometimes worth a thousand words – if they are the right ones. Let's try. With the burning steppes and smouldering tundra, with the Kremlin swathed in acrid

smoke, and a strangely detached President looking on from afar, Russia offered a variety of impressive images on the theme of "perplexity in the face of overwhelming events". The most striking image of all, though, was that of a volunteer (whatever that may mean in Russia), a young student armed with a fire hose from which came only a trickle of water, and a shovel to beat out smouldering fires, facing a wall of fire not a hundred yards off. Only the outlines of his face were visible, on account of the clouds of smoke, but they revealed perplexity, hopelessness, resignation and also grief. It's a shattering portrayal of helplessness in the face of the forces unleashed by nature.

So, where are the parallels with the prevailing perplexity in the economic and financial systems; how far does the metaphor work? Firstly, the concept of a conflagration seems to us to be entirely appropriate. In Russia, the fire did not start in one place only; numberless fires broke out across vast areas of the country. This happened because the structural preconditions were in place – after weeks of heatwave and continuing drought, the land itself was dry as tinder. Every individual fire no doubt had its own specific cause. In the aggregate of a conflagration, however, these are really of no further interest, any more than the hopeless individual efforts to contain the fires – all of them futile, given the scale of the overall problem. There are situations that are simply no longer manageable, even for nuclear powers. Neither the dismissal of regional governors, nor the deployment of vast numbers of volunteers, nor the mobilisation of all the fire brigades and fire-fighting helicopters, is any help when the heat becomes more unbearable day by day and there seems no end to the drought. Tinder remains tinder. What an unbearable idea for an authoritarian country: ultimately, and literally, to be dependent on the heavens above – or the rain falling from them – for relief from disaster.

Tinder remains tinder: Here is the heart of our chosen image. In the crisis of 2008/2009, the financial system of the Western nations was first hit by a conflagration. This was concentrated on the highly exposed, enormously large, extremely complex and closely interlinked financial institutions, which had all, over the years, got rid of their fire-fighting reserves, as, given the long period without any real danger of fire, they had come to regard them as mere ballast. What first appeared to be a problem for one sector revealed itself in the wake of the crisis as an overwhelming overall problem: the tinder of excessive debt was fanned into flame by the heat of the continuing low-interest-rate policy.

"Excessive debt": what does that mean from an economic perspective? That a particular deployment of capital is not matched by any real, feasible project. Real, in the sense that, as far as can reasonably be estimated, it should generate a positive cash-flow that can be used to cover the cost of both interest and principal. In the microeconomic context of a company, excessive debt means that it is overextended. If the accumulated liabilities are matched only by probably worthless assets, the company is insolvent. Insolvency is followed by restructuring, bankruptcy or the finality of liquidation. In all three events, creditors are obliged to write off some of the illusory value of their assets.

In the build-up of excessive debt in the financial system it was above all real but increasingly unfeasible projects in the American real estate market that served as the substrate: state-sponsored homes for the economically challenged. On this tinder devoid of intrinsic value, there grew up, over the years a gigantic structure of largely illusory character: business activity fuelled by lucrative commissions and based on a substrate of little or no real value. All this activity was endowed with dynamic stability by a central bank renowned for its efforts to ensure so-called systemic security. Thus was created the unattractive situation at the start of the financial crisis.

We know the results of the financial crisis. There has been restructuring – which is to say, write-offs. The figure for the American commercial banks is currently USD 1,200 billion. This represents about half the estimated real damage. With the TARP programme and "quantitative easing", a large amount of risk simply found its way into the supposedly safe haven of the state. Without the breathtakingly expensive support of the mortgage agencies Fannie Mae and Freddie Mac by the US exchequer, far greater write-offs would have been needed. Tinder remains tinder; it's just that now it's state tinder.

In the meantime, with the crisis over Greece – or the euro – the financial crisis of 2008/2009 has now spread to national budgets. Greece is a very suitable case for classification as a "real but unfeasible project". There seems little probability that it will be able to service its high level of debt properly from its own resources – that is, to manage interest payments, repayments and refinancing. Even after the so-called eurozone rescue package, which was mainly to the benefit of the seriously exposed French and German

banks, and the far greater emergency parachute for the financially shaky countries of Portugal, Ireland, Spain and Italy, Greek bonds are still trading at prices that indicate the likelihood of debt rescheduling. Now though – for tinder remains tinder – part of the tinder has shifted from the individual countries to the eurozone itself.

4. A battle of the giants – or not?

At the beginning of the euro-crisis, it looked rather as if a battle for supremacy was in progress between two battered giants, and that one giant had a clear advantage. Day after day, articles rained down from the USA, and the media channels it largely controls, laying into Europe and the eurozone. Without wishing to indulge in conspiracy theories, one thing is certain: the Americans are world champions in the concerted bashing of others. Between April and the end of June, the euro fell 10 percent against the dollar, and the European stock markets, particularly those of the countries most affected, sank into a blood-red morass. All the European efforts to turn the situation around – the unique cascade of ever-larger rescue packages and emergency parachutes – seemed without effect.

The situation of one of the giants improved, if only temporarily, when it became clear that the other giant was in at least as bad a way. It began with the threat of insolvency of some of the US states; then followed evil tidings concerning the slow-down in the over-optimistically regarded upswing, while the continuing miserable state of the labour market combined with renewed anxieties in the real-estate sector to spread a mood of hopelessness in sharp contrast to both the scale of the stimulation measures and the euphemisms that the Obama administration continued to employ.

Since the middle of August, we have no longer been watching a battle for supremacy between two giants. The financial markets – the stock exchanges and the currency markets – seem to have come to terms with the fact that they are dealing with two equally battered entities. A similarly pessimistic estimate is evidenced by the exchange rate of the Swiss franc: since the beginning of June 2010, the US dollar has lost a hefty 11 percent against the franc and, after the euro's brief recovery to 1.38, it is now, as this Investment Commentary goes to press, back to 1.32. The stock market wavers aimlessly hither and yon; only the momentary German export boom lightens the mood a little.

In the wake of these unattractive developments, the Fed announced that it would, for the time being, continue its policy of "quantitative easing" for an unlimited period. The European central bank is maintaining a somewhat lower profile on this, but there is no question of any end to the flood of liquidity, despite the positive German figures, for the rest of the eurozone continues to battle with serious growth problems. In Japan, the finance minister has invited the governor of the central bank to a frank and earnest discussion, as he blames the relative strength of the yen for Japan's being overtaken by its rival China. In other words, the three main global reserve currencies are all simultaneously experiencing the continuation, or repetition, of what Japan has been trying to do for almost 20 years now: to cudgel growth and stability into being through monetary policy.

This phenomenon, which affects the great part of the developed industrial nations, deserves somewhat closer analysis. We may begin by observing that the policy obviously does not work, or, put more forcefully, is condemned to monumental failure. Japan provides the long-term empirical evidence, and Europe and the USA are well on their way into the same troubled waters. Why?

5. Implicit unease

Back to the image of the young Russian volunteer facing the sea of flames. The problem is not the presence or absence of water to extinguish the fire. The problem is the incalculably large area of land threatened by the fire; the excessive amount of tinder that makes every attempt to contain individual fires seem hopeless. We have defined "tinder" as the excessive debt that was created in the developed nations through the financial crisis and its consequences.

But this perspective – ultimately an accounting one – may be too limited. The real problem is not the shortfall, expressed in dollars, euros or yen. These are at most the visible symptoms of a much more fundamental structural problem. This structural problem of developed social systems lies in the fact that the numberless claims and entitlements that characterise the institutions in these social systems – old-age pensions, healthcare, redistribution – are counterbalanced by ever fewer feasible real projects. Among other things, this relates, particularly when we think of Japan and Europe, to the inevitable decline in the number of young people who could carry out such real projects. The effects of the demographic challenge on the existing social systems are half-way understood, but, unattractive as they are to the current electorate, they are having far too little impact on everyday poli-

tics. The tinder of excessive debt is being built up, slowly, year by year, layer on layer; the mechanisms of democracy are not in a position to master the asymmetry between short-term political realism and the demands of long-term sustainability.

Going beyond the demographic problem, the developed social systems, including the USA's, also seem to be generally overwhelmed by the task of managing all the various claims and entitlements. For over 30 years now, the socio-political branch of sociology has been pointing out the defect immanent in democratic decision-making mechanisms: that the benefit derived from lobbying for specific advantages far exceeds the costs incurred for the tax-paying collective. When state institutions further conceal these costs, through the possibility of taking on more or less unlimited debt, simply handing the bill on to the next generation, and when it is also possible to keep the cost of interest on these debts artificially low, then there is a great danger that the result will be a practically irreversible spiral down into more and yet more debt.

It seems to us that the financial crisis and the euro-crisis have for the first time revealed this problem, to some extent at least. It is no coincidence that the risk premiums for state debt, observable in the Credit Default Swaps, are, for the first time in history, higher than those for private business debt. Unease at a situation can hardly be more effectively expressed than through the prices paid in the market. To this extent, what we see here is an explicitly expressed unease. More important to us, though, seems a hidden, not really articulated unease. In our view, this is what lies behind the rising rate of savings in the USA despite all the efforts to stimulate consumption; it lies behind the low level of credit provided by the banks; it lies behind the sluggish private-equity situation; it lies behind the inability, on both sides of the Atlantic, to get on top of the unemployment situation. The expressions of perplexity listed in Section 2 above become a good deal more explicable if we include the variable of "general unease" in the equation. More and more citizens, business people, investors have a vague feeling that things can no longer work out right. "Things": our social and economic system has become so large and so complex that it defeats its own ends; the whole problem is so large and so complex that ultimately failure is inevitable. Or, in terms of our metaphor, there is far too much tinder, and it is far too widely spread.

6. Counterproductive stimuli

The management of this build-up of tinder is what is known as "system stability". This concept has developed into an apparently unlimited free pass for the contravention of principles and guidelines, almost as pernicious as the "public interest" or "raison d'état" of days gone by. When the Swiss Confederation maintains a big bank in its original structure, instead of putting it through an orderly restructuring process, monitored by the supervisory authorities; when this same Swiss Confederation allows the banking secrecy it had previously upheld to be broken retroactively, in disregard of the guarantee of due legal process; when the European Union first saves Greece from bankruptcy and then organises a bail-out for other affected member countries in explicit contravention of legislation passed for precisely this situation; when the American government directly subsidises individual businesses via the "Recovery Act"; this all is being done in the name of system stability. It has become a free pass for the expansion and delivery of further, ever more exorbitant individual claims and entitlements.

There are of course, as is to be expected in such situations, some, apparently academic, proponents of such unconstrained claims management. For example, J. K. Galbraith, already quoted above (p. 3). On the limits of state stimulation, he remarked that "… there is no operational limit. The federal government can, and does, spend what it wants." Casual creation of debt simply reflects energetic saving by others at home and abroad. As to what the expenditure is used for – for real, feasible projects, or actually not, as the money ends up being socially redistributed or in misinvestments – on this, the professor from Austin, Texas has nothing to say. In Europe too, there are a large number of advocates of activist state economic policy. They all make the same mistake. They believe that a large collective is in a position to meet and manage claims, entitlements and activities in an effective fashion. They will not see that this planned-economy misconception has resulted in the ever more extensive accumulation of tinder. With increasingly desperate and interventionist actions, they keep attempting to put out individual fires, and in doing so fuel the system with further supplies of tinder.

The final, and most important link in the maintenance of system stability for this ever more hollow construct consists of the central banks and, as since the financial crisis they have either been nationalised or are in a state of extensive

regulatory and economic dependency on the state, also the big commercial banks. With low interest rates and the financing of state debt via their balance sheets they ensure that stability is not only talked into being, but is genuinely brought into existence. The over-indebted developed nations and communities of states need the low interest rates and "quantitative easing" to prevent the fact that it is all tinder anyway from becoming obvious. In the name of system stability the central banks have largely forfeited their independence. They and the big commercial banks have degenerated into aiders and abettors of excessive debt, suppliers of tinder.

The problem is that every step in this direction generates more of what we have described as "general unease": the anxiety that the system in which the developed societies have entangled themselves has become so big, so powerful, so complex and so uncontrollable that it is bound to fail.

7. A quicker shift in the centre of gravity

This of course raises the question of how it can have been possible to play this game for so long, entirely unnoticed by anyone, and above all by the creditors. This is synonymous with the question of how long this low-interest period, miserably devoid of returns, can last. This question is obviously highly relevant to the orientation of investment activity.

In normal circumstances, that is, when a currency's interest level and external value are closely correlated, this sort of monetary and fiscal policy should have come to an end long ago. The external value of the currency concerned would have come under strong pressure to depreciate, high import prices would have fuelled inflation, and interest rates would have had to be raised. But these are not "normal circumstances". Rather, a sort of lowest-interest-rate cartel has come into being, led by the most important reserve currency in the world, together with the yen and the euro. This provides the over-indebted societies with the necessary liquidity. The other global trading currencies, including the Swiss franc, are not relevant enough to be able to challenge this monopolistic equilibrium. And the only ones who might, as creditors, be able to disturb this lowest-interest-rate cartel, the Chinese, have little interest, for reasons related to their own highly important export activity, in changing this situation at all.

The long-term consequences for the developed world could hardly be more negative. After the deindustrialisation of the 1990s, as a result of which the Americans lost a great deal of their production capacity, the depth of value-added and the capacity for innovation are now also under threat, as a result of the "general unease" at the excessive size and complexity of the system. Core processes, hitherto closely guarded business and production secrets, and research and development are being transferred to countries characterised by confidence and hope, rather than by "general unease". What is being saved by companies on both sides of the Atlantic is being developed in Asia and Latin America. Hence our forecast that, as a result of the economic policy adopted by the developed nations, the centre of gravity will shift towards the emerging economies of the world far faster than had been supposed. What will be left will be geriatrics.

8. An insular ray of hope

This might sound a bit exaggerated, too negative, too bleak a picture. On the other hand, we can just as well argue that the assumption that these highly complex, highly indebted, enormously large, ultimately self-paralysing social systems have any chance of survival would also be a fairly bold one. It seems strange to us that intellectual circles in particular find it hard to think in terms of structural hiatuses. In a collection of essays on Switzerland's relationship to Europe, recently published by the Swiss think-tank Avenir Suisse, the possibility that Europe could come apart as a result of the crisis is only considered in passing. Our previously expressed fear that the consequence of the profound financial crisis might be "compulsion or collapse" finds little reflection. Is it intellectually honest to deliberately avoid thinking the "impossible", or even the merely politically incorrect? Can recommendations based on such a blinkered perspective have any strategic relevance?

Too big and too complex not to fail. The only government in the Western world that has understood both the problem and its urgency is the British. The programme that David Cameron, his sparring partner, Nick Clegg of the Liberal Democrats and George Osborne, the Chancellor of the Exchequer, have put together deserves our attention. Firstly, the savings targets are extremely challenging: the budget deficit is to be reduced from 11 percent of GDP to 2.1 percent by 2014. But the structural proposals seem to us still more important. Cameron intends thorough decentralisation, because the central decision-making bodies have got themselves into a state of highly complex inefficiency. Both the ideas and the programme of the new British govern-

ment go far farther than those of Margaret Thatcher. They turn the assumption that difficult questions can only be solved by higher-order bodies literally upside down.

One English swallow does not make a summer, and anyway, the government has to survive long enough to achieve (possible, but by no means certain) success. Nevertheless, when we consider the enormous influence of Thatcherism on Europe and the USA (what is nowadays dismissed as "neo-liberalism"), then it is at least conceivable that the British reversion to discipline and decentralisation might develop into a zeitgeist that renounces its love of scale and complexity. The opposite of too big and too complex not to fail is small, flexible, efficient, private, individual.

What does all this mean for investors? Firstly, there is no reason to expect a rapid shift to healthier economic and monetary policies in the big and powerful industrial nations. The lowest-interest-rate cartel will last longer than we might think. Interest rates will stay low, there will be no inflationary pressure, the dollar, the euro and the yen will fluctuate against each other excitedly, but real pressure to depreciate will be felt only by those currencies that cannot or do not wish to belong to the cartel. Because of the "general unease" at these monetary and economic policies, growth in the industrial nations will remain slight, while the economic power of Asia and Latin America will be further accentuated.

And stocks? For them to be really attractive, by which we mean annual returns between 20 and 50 percent, as in the 1980s, we need a return to confidence and happiness. A "Yes, we can!" not because of subsidies from a bankrupt entity, but because we want to finance it ourselves, and because the rewards of our actions are not likely to be immediately confiscated. Luckily, the world is big enough, and varied enough, that such conditions do exist. And this is precisely the focus of our new investment strategy and our investment products. Well-run businesses are very well able to cope with the prevailing conditions, and have long disengaged themselves from territorial dependencies and tribulations. So we still find broadly diversified stock investments (that is, "feasible real projects") more attractive than the guaranteed zero-return nominal values of ailing state debtors.

KH, 23.08.2010