Deflation?

1. No exit

When the discussion turns to inflation, those in authority in the central banks assume expressions of professional responsibility, and speak in technocratic jargon of “core inflation”, “imported inflation”, “output gaps” and “implicit inflation expectations”, and the forecasts to be derived from these concepts; they profess, in creedal mode, their faith in price stability, and convey the unmistakable impression that they have events entirely under control. The necessary instruments for the timely reduction in money supply are all in place, and no-one should be in any doubt whatsoever that action would be taken if required, however unpopular it might be. But this is something that all central bankers are well aware of and anyway, with their independence guaranteed by law, they are of course free from the influence of any vested interests whatsoever. Given that in the politics of money, perception is at least half the battle, such a well practised behavioural reaction is undoubtedly to be welcomed. The only potential problem is that nobody has had any experience of inflation – or fighting it – for over twenty years; the generation that now has the responsibility for monetary policy has nothing to offer by way of proven achievements, and their credibility thus increasingly relies on elegantly formulated statements alone.

When the discussion shifts from inflation to deflation, there is a visible change in the body language of the central bankers. It now becomes almost ceremonious. Ceremonious and minatory. Inflation – certainly not a good thing. But if it cannot be avoided (because the money supply was turned off too late), it can at least be fought against. Deflation, on the other hand – uncontrollable, disastrous. The next level after deflation is depression – and the sermon often culminates in the dark years of the 1930s and the Second World War. Wailing and gnashing of teeth. Depression is to be avoided at all costs, is the universal view.

In this strange and peculiar year 2010, characterised by the coexistence of debt crisis and economic upturn, of record levels of liquidity supply by the central banks and record low levels of credit provision by the commercial banks, of booming bond markets and a dizzy rise in the price of gold, the mood in monetary policy has meandered between the fear of inflation and anxiety about deflation. Thus, until this spring, the expression “exit strategy” was highly fashionable. This described the process by which the central banks would be able to disengage themselves from the policy of “quantitative easing”, by selling off the large amount of securities purchased under the policy, and raising interest rates. As no-one has had any experience whatever with quantitative easing – there has never been anything like it before in monetary history – it is no surprise that a degree of nervousness prevailed with regard to “exit strategies”. Would it be possible to disencumber the central banks’ balance sheets without causing serious upheavals on the bond markets? Would the timing be right? What would be the impact on the credit markets, and on banks’ lending activities? Might the result be a collapse? Thus went the discussions, which, if we are right, are by no means over yet.

Exit strategies have gone out of fashion in the wake of the euro crisis of May/June 2010 and the increasingly bleak economic figures from the USA. The key topic now is deflation. According to recent remarks, Ben Bernanke, the Governor of the Fed, would be prepared to fully reopen the sluices of quantitative easing in order to combat deflation. And in the run-up to the November elections, the Obama administration is outdoing itself with proposals as to how further stimulation programmes could be launched, at the expense of the already extremely stressed national budget. As mentioned, deflation is to be combated at any price, even if there is no effective means of doing so.

The verbal resoluteness of the (monetary) politicians contrasts sharply with the general perplexity prevailing on the stock and currency markets. The apparently pointless ups and downs on the stock markets and the inexorable erosion of the US dollar and the euro as reserve currencies are having a demoralising effect. As deflation is increasingly represented as the spectre confronting the West, so it stifles our pleasure at the signs of success in the business sector. It is time for us to get to grips with the phenomenon of deflation, and to attempt to draw relevant conclusions for investors.

2. Inflation and deflation: not mirror-images

First, we need to clarify some of the theory. Both concepts, inflation and deflation, concern the monetary side of the economy, and indicate imbalance. With inflation, the production of real goods is continually accompanied by too much money. With deflation, the opposite occurs. The money supply declines, while the production of goods is reduced at a slower rate. The reasons for such imbalances may be found on either the money or the real side. Productivity increases, due, for example, to important inventions such as the steam engine or telephony, will result in increased production with a constant money supply: prices fall. Conversely, if a weighty trade partner defaults on import deliveries, a shortage in goods can occur: prices rise. Faulty management of the money supply by the central bank will not affect the production situation in the economy, and its impact may be either inflationary or deflationary.

As we have to deal with real people in the economy, with thoughts and feelings, and not with robots that merely respond to commands, modifications to both the real and the monetary side of the economy result in changes in expectations and in behaviour. When it is generally believed that prices will rise, people will buy things today rather than tomorrow. If prices are falling, on the other hand, the purchase of goods and services is likely to be postponed, unless they are needed to meet immediate requirements.

With inflation, money resembles a hot potato, to be passed on as quickly as possible; the velocity of money circulation is high. In a deflationary situation, by contrast, it comes to a virtual halt. The circulation of the money needed by the economy is thus determined both by the money supply made available by the central bank, and by the velocity of circulation, based on the prevailing expectations. This is an important conclusion with regard to the record low interest rates and the obviously very low velocity of money in key regions of the global economy (the USA, Japan and Europe): *the lower the velocity of circulation, the less effective is monetary policy*. Quantitative easing represents an act of monetary desperation, an attempt at expectation management. We'll come back to our surmise that quantitative easing and stimulation via an (over-indebted) exchequer achieves precisely the opposite, namely to further dampen expectations and keep the velocity of money circulation consistently low.

Both inflation and deflation become a threat when they degenerate into self-perpetuating spirals. When general inflation via wage increases raises production costs and these are then rolled over in their entirety to the prices of the goods and services, a national economy is then in the grip of an inflationary spiral. However, the central bank has an effective means of putting a stop to the spiral through rigorous increases in the interest rate, as the velocity of money circulation is high, and the system therefore reacts. As mentioned, this situation does not apply for deflation; the monetary weapon is blunt, so that the demand for stimulation via the exchequer appears only logical. Otherwise, a continual fall in the price of goods and services would result, almost endlessly, in lower wages, and increase the burden of debt – domestic mortgages, for example – in relative terms. This would force households to reduce consumption. As a result of the fall in sales, companies would earn less and invest less, which would result, among other things, in yet lower wages. When deflation becomes depression is by then a merely semantic issue. Thus, the threatening picture of the deflationary spiral.

Unlike phases of inflation or even hyperinflation, deflationary spirals that end in depression are rare in historical terms. Strictly speaking, they are extremely rare, for the Great Depression of the 1930s is the only one worthy of the title. The Japanese economy has been extremely sluggish over the last twenty years, but there is no case for describing this as sustained deflation, and certainly not as depression. In particular, we regard it as a massive exaggeration to apply the spectre of depression to the current economic situation in the USA or Europe. In our view, the events of the 1930s do not offer an adequate basis for the theoretical concept of a "deflationary spiral". It might rather have been a case of an unfortunate concatenation of catastrophic economic mistakes.

3. Productivity as key factor

The concept of the deflationary spiral rests on the idea that a fall in companies' sales due to dwindling demand must inevitably result, via lower prices, in lower earnings. This does apply if production costs are regarded as fixed. However, if we build into the concept the possibility that companies adjust to the changed circumstances and make every conceivable effort to increase their bottom-line earnings, then the spiral comes to an immediate stop. “Every conceivable effort”: that represents exactly what we describe as entrepreneurial behaviour: innovation and investment. Capital-intensive processes enable earnings to rise even as prices fall.

The precondition for innovation and investment in bleak economic times is the prospect of being able to earn more in the future as a result of the efforts then undertaken. When, however, on account of threatening national deficits, the expectations concerning future marginal revenue (after tax …) turn negative, then tendentially, people will refrain from investing time, effort and money in improved processes. Herein lies the crux that we have already mentioned with regard to stimulation packages: that they arouse increasingly negative expectations concerning future marginal revenue.

Falling prices are not bad as such, even on a broad front. The key question is how much latitude the various economic agents have to adjust to the changed circumstances. Falling prices are by no means synonymous with a sluggish economy. Au contraire: important technological developments are deflationary by nature, inasmuch as they reduce production costs, productivity then rises and ultimately, not fewer, but more goods are consumed at lower prices. This can be defined as “good deflation”, a term that is occasionally encountered in the literature.

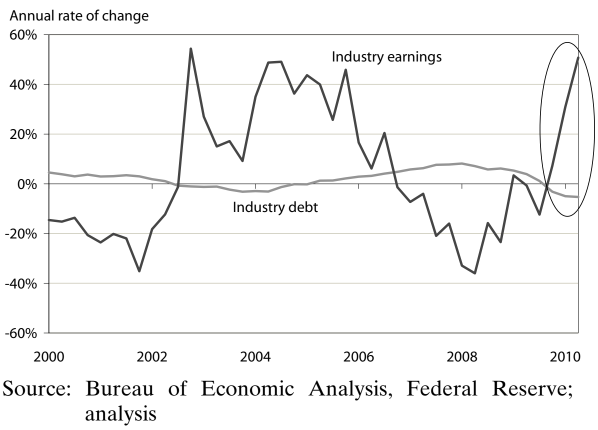
The degree of latitude available for adjustment to new circumstances is naturally not only a question of the probable (fiscal) conditions, but also of one’s own financial situation – that is, the extent of one’s debt. Being in a deflationary phase with a high level of debt may end in going under. Why? Because the cost of servicing the debt is fixed, so that expenditure cannot be adjusted here. Deflationary phases are thus, whether caused by recession or technological developments, periods of restructuring. Essentially, debt must be transformed into equity, after old equity has been written off on account of insolvency. An artificially protracted restructuring process merely hinders the release of innovative energy and delays investment. In this regard too, many stimulation programmes that are principally focused on the preservation of jobs, and thus of ossified structures, are aiming in exactly the wrong direction. Nor is cheap money, which can be used to keep the level of debt bearable, of any help to the restructuring process.

A serious underestimate of companies’ flexibility in achieving higher productivity and the systemic inclination to preserve excessive levels of debt (including state debt) at its illusory intrinsic value: these are the pillars of the flawed recipes advocated by Keynesians such as Krugman or Stiglitz, and implemented politically in both the USA and Europe. With the blatant failure of such measures, criticism of them is at last becoming louder. Whether it will suffice to bring about a change of course may well be doubted.

4. Macro vs. micro

At the start of this Investment Commentary, we referred to the “strange and peculiar year 2010”, with its coexistence of phenomena that should not occur simultaneously. The depiction of the efforts to banish the spectre of deflation by the use of ineffective means – indeed, at the cost of counterproductive effects as far as future expectations are concerned – is one, dark side of the story. It contrasts with a generally astoundingly positive picture where businesses are concerned. Excessive debt? Certainly not in the business sector. The figure below shows the rising and falling level of American business debt over recent years, set against the development of GDP. To depict “Main Street” – that is, the so-called “real economy” – and not the highly leveraged “Wall Street”, we have excluded the financial services sector. In our view, it is perfectly plain that the bursting of the 2002/2003 technology bubble unleashed precisely what we described above as a “restructuring process”. Debt “disappeared” – was either written off or transformed into equity – productivity improved significantly, and with it revenue, and the new recession of 2008/2009 was used to continue the restructuring process.

Is this what deflation looks like?



Source: Bureau of Economic Analysis, Federal Reserve; analysis

Note: Industry earnings and debt expressed as percentage of GDP.

With all the reservations associated with generalisations, we can state that the same also applies to businesses in Europe. For the Swiss business sector in particular, we can say with great satisfaction that there are virtually no obvious financial distortions or bottlenecks to be seen – and this after one of the most radical collapses in global trade since the Second World War. That's a ray of hope, on the horizon at least, by any standards. However, and this may be the reverse of this glistening medal, it may be suspected that investment by Western businesses would have been a good deal higher, had enthusiasm for the deployment of capital not been continually dampened by the expectation of the higher marginal tax rates implied by a massive expansion of state debt. There must be an explanation for the fact that economic growth rates over the past twenty years have overall remained very moderate, during a period when the real economy has witnessed one technological advance after another – and every single one of them equivalent in impact to the invention of the steam engine. So, it might be the case that a splendidly flawed macro-policy has deprived us of the fruits of a potential productivity increase on the micro-side. That would be bitter; the once so progressive West would thus have taken itself out of the mainstream of the global economy.

Does this contradict the statement that our businesses have been doing relatively well since the crisis of 2008/2009? No. For they have long learnt to produce in the locations with the most attractive conditions, to research where there is a constant supply of intelligent and industrious talent, and to take their profits where corporate taxation does not threaten to become exorbitant. Macro versus micro: the game is far from over. The problem is not the supposed threat of a deflationary spiral: neither in Japan for twenty years now, nor in the West since the financial crisis. Rather, it is the standstill imposed on both the economy and society, which businesses are continually endeavouring to circumvent, and which continually results in new setbacks. But here too, we believe that we can detect a ray of hope or two, on the horizon at least.

5. Individuals are much more efficient

We have mentioned the series of technological advances with no less significance than the invention of the steam engine; let's attempt to determine which these are. First, undoubtedly, the enormous increase in the calculating power of computers. Not even those who can still remember the first, extremely expensive PC of the 1980s, or who previously had to manage with the cumbersome mainframe computers in the universities, can really grasp the unbelievable increase in performance that has occurred at our desks. What is interesting is that since the beginning of this exponential development, its end has been continuously forecast, but has not yet occurred. In other words, the technological advance of enhanced computer performance is still in progress.

As such, calculating power does not bring about any gain in productivity. What does is the application of the accomplishments it enables. There seem to us to be two of these, and they are both of explosive social and economic potential. One is the communication revolution, which has, through the Internet and mobile telephony, made information a globally available and dirt-cheap good. The other is process control, without which neither an industrial plant nor a modern motor vehicle can now function. Measuring, controlling, correcting: these are the highly reliable and fully automated functions that ensure that everything works as it should, in coffee machines, aircraft and production lines.

An unrelated technological advance, though one that also obviously profits greatly from enhanced calculating power, is occurring in microbiology. We are slowly beginning to understand life itself. The realities and processes involved may be hard for lay people to understand (the articles, of literary merit indeed, written by the retired microbiologist Gottfried Schatz for the NZZ may provide some remedy here), but one thing is clear: as our knowledge and our actions reach into the tiniest components of humans, plants and animals, so all our preconceptions and constraints also change, from medicine via nutrition to the consumption of natural stimulants. In the same way, the range of our possibilities is being expanded through the developments in nanotechnology or the exploitation of the spectrum of electronic waves, from a source of warmth via light to the ultra-short waves used mainly in communication technology. Essentially, this all involves a significantly better use of the available resources.

The fascinating aspect of this development is that in very many cases this better use affects the so-called "end user": the consumer or, more generally, the individual. We have already mentioned cars and coffee machines; we could add to the list mobile phones, smart phones and the iPad. Are we really aware that these instruments have made us unbelievably richer in real terms? "Richer" in the most fundamental economic sense, in that we enjoy many more personal benefits than before. Today, everyone has their own personal café in the kitchen, can transform their stove into a pizza oven at the press of a switch, and can later download “La Dolce Vita” from the Internet for their home cinema. Everyone can take almost professional photographs with a – really not expensive – single-lens reflex camera, and everyone can operate a sound studio on an almost professional basis, using “Garage Band” or some similar program. E-mail and other programs mean that office work has become a minor matter to be dealt with in the evenings. And at the same time literally nothing now prevents us from gratifying our thirst for information and knowledge: newspapers, magazines and books are all immediately available electronically. With Wikipedia, we have access to the most comprehensive encyclopaedia ever created, in every conceivable language. And we can also gratify our enormous need to communicate with one another – a leftover from our ancestors in the trees – via “social platforms” like Facebook (to be clear about this: enhanced economic benefit for individuals is not necessarily congruent with higher-order concepts of value, but that’s another matter).

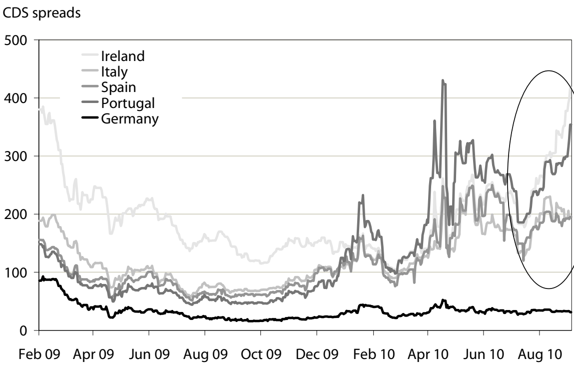
What is also fascinating is the fact that this technological advance has not been to the benefit of a small and wealthy elite, but has, as it were, been socialised down to the level of the slums. There was recently a report about an aboriginal tribe in Papua New Guinea, which still hunts with bows and arrows, and from time to time knocks off the odd Indonesian soldier, in the interest of greater independence. They communicate via mobile phones … The enhanced benefit at individual level can, of course, also serve to increase violence and crime. Nevertheless, we maintain that essentially, we have all, from the top almost to the very bottom of the social scale, from New York City via Appenzell in Switzerland to the Pacific islands, become significantly richer over recent years.

This “windfall profit” from the various technological advances of the last twenty years is, however, hardly visible in the economic calculations, for the enhancement of individual benefit is not included in economic calculations, unless it can be ascribed to a value creation process between the raw material and the consumer. The incidental and the free of charge do not qualify as “value creation” and so are not registered. On the contrary, the immediate consequence is that the previous value chain obviously suffers from the loss of goods and services previously in demand. This is where the impact of “good deflation” becomes particularly evident. We do believe, though, that the secondary effects of this increase in wealth will increasingly vitalise the economic cycle in the years ahead, which is why we refer to a “ray of hope on the horizon”. It is already manifest in the emerging markets. It is not – or certainly not nearly to the extent that has been assumed – a wise or clever policy mix that has empowered countries like China or India. Far more, it is the impact at the individual level of the fruits of emancipation through efficiency that accounts for the enormous growth in those parts of the world. And similar phenomena should also be observable in more developed countries, at least to a lesser extent. So, what we argue for is a “wealth effect”, a surge in growth due to greater prosperity that must come into effect over the next few years. This is ray of hope number two.

6. Learning to live with big risks

There is a third ray of hope on the horizon: the price of a Greek 10-year government bond, and the recent rise in the price of CDSs (Credit Default Swaps) for financially stressed European countries. This Greek debt is currently being traded at around 70 percent, with a yield on maturity of about 11 percent. By way of comparison: the yield on a German bond with the same maturity is around 2¼ percent. The figure below shows the relative prices of CDSs. It makes clear that the debt crisis in the eurozone, glossed over by so many politicians and line-toeing media, is by no means over from the perspective of the financial markets.

Crisis time again, and no-one’s noticed



Source: Bloomberg; analysis

A credit risk insurance whose premium is more than zero implies a probability of default. A bond whose yield is significantly above that of comparable bonds indicates a creditworthiness problem concerning the debtor. In the wake of the rescue package agreed by the eurozone, the Greek bond should be close to 100, and the yield around 5 percent. The CDSs for Ireland, Portugal and Spain should be close to those for Germany or France. This is not, however, the case. When creditworthiness problems and default probabilities are evident from the prices paid in the market, how on earth can this look like a ray of hope?

Quite simply, because there are such prices at all. And further, because there have been no new crisis-like events on the financial markets in the last couple of weeks, despite the recent rise in risk premiums. On the contrary, the euro has been able to stand up to the US dollar, and even to regain ground. We are obviously beginning to accept the new reality of sustainedly distressed state debtors.

This point deserves a closer look. What do we mean by "crisis" and "acceptance"? What are the mechanisms and instruments for getting from one state to the other? We have had no lack of examples of the notion of crisis from the financial markets over the last ten years. Reduced to the lowest common denominator, the same pattern has always been repeated: the valuation of certain assets goes out of control, which becomes increasingly apparent first to one or two notorious prophets of doom, and then to a growing number of market players. This process of recognition happens not gradually, but eruptively or explosively – much as when a major disaster becomes apparent with a volcano: first there are a few outbursts of gas on the slopes; then there is some smoke from the crater; then things appear to calm down again; till suddenly, the eruption suddenly takes the broader public by surprise, and buries Pompeii. Because the prophets of doom are a tiny minority compared to those who are in some way interested in maintaining the status quo, and because hardly anyone is able to come to terms intellectually with structural change, crises inevitably cause more damage than the actual developments would have necessitated. Sticking one's head in the sand is obviously more convenient than looking increasingly evident facts in the face. But it is also true that the instruments required for a sober analysis of the situation are often lacking.

Honestly then: how many of our readers really knew about these ominous CDSs one or two years ago? Who was watching their prices then? We citizens of Pompeii obviously lack the binoculars and telescopes with which to observe the volcano… Crises feed on the feeling of being exposed to unknown threats of unknown extent. Guy Kirsch, an economist from Fribourg, distinguishes this indefinite feeling, which he defines as "anxiety", from the "fear" that reflects the reaction to a definable and evident danger whose impact can be estimated (*Angst vor Gefahren oder Gefahren durch Angst?*, NZZ-Verlag, 2005. A crisis can thus be defined as the transition from anxiety to fear.

Are we currently anxious, or are we afraid? It is evidence for this ray of hope that we are in the process of losing our anxiety about the big risks that trigger crises – the American real estate market, its over-concentration in the balance sheets of the big financial institutions and the fatally indebted Western nations. We are better able to estimate the extent of the damage. It now has a price on the market: 70 percent instead of 100 percent for Greek government bonds, and shockingly high CDS premiums for other European countries. With these market values comes also an allocation of the damage. They may, of course change – for better or worse – depending on additional information and insights. And of course, these instruments are by no means immune to misinformation or illusion. Nevertheless, we now have binoculars, telescopes and seismographs, and thus equipped, we are now in a position to continue living, and carrying out our business, on the slopes of Vesuvius.

As long as, that is, we can move away in an emergency! Unsurprisingly, the institutional spin doctors of our social system take little pleasure in such instruments. This explains much of the recent regulatory activity. The most worrying in this context seems to us to be the prohibition of short selling, introduced unilaterally in Germany, and recommended for adoption by the rest of Europe. This is about as senseless, indeed immoral, as if the Roman authorities in 79 AD had forbidden the inhabitants of Pompeii from fleeing the city.

7. What we need: CDSs for individuals!

The clarification of circumstances as a process during a crisis: this is exactly what market forces are able to provide with the instruments available to them. CDSs belong among the most important financial innovations of the last decade, to the extent that they enable a significantly more realistic estimate of the risks associated with state debt. State debt represents a large part of all outstanding global liabilities (and thus of private assets), so its existence is of absolute importance for all those who wish to find shelter from the eruption of larger or smaller volcanoes. The price of credit risk insurance thus has incalculable value as information; indeed, we would go as far as to state that it is precisely this information that ultimately motivated – perhaps, obliged – the governments of Ireland, Spain, Portugal and the United Kingdom to start making savings. The EU Commission is well known to have been blind and toothless with regard to deficiencies in the budgets of its member states, and will apparently remain so, given its almost embarrassing potential for imposing fines on future defaulters. The most effective fine there is, is the sanction delivered by the financial markets in the form of prices and premiums. This fine achieves what politics could never ever do, even if it really wanted to.

But there are still volcanoes whose existence is known, but whose profile is unclear and shrouded in mist. They arouse anxiety, and this anxiety weighs on the prevailing mood, and that weakens economic growth to a significant extent. These are all the undertakings of the social state vis-à-vis its citizens with regard to pensions and healthcare. The shortfall in the coverage of these undertakings is known, and its extent is suspected. However, the accounting regulations for national budgets do not require exact quantification, it is not even necessary to book them, they can simply be omitted! Nor is it at all necessary to provide concrete economic reinsurance for these undertakings; a verbal indemnity, so to speak, will do. Debtor states profit from the "benefit" that these liabilities do not need to be financed on the financial market. Which means that, sadly, there is no market value, in the form of CDSs, for this sort of volcano.

It is thus not possible for individuals to take out economically appropriate insurance for one of the most significant risks in life: the probability of delivery of one's old age pension and healthcare insurance. This is extremely unjust and unsocial; indeed, like the forbidden short-selling, "immoral" in the strict sense of the word. It corresponds to a prohibition on leaving the city for Pompeiians. The lack of hedging instruments means that the general public is deprived of information on the potential extent of the looming catastrophe.

If there were one financial innovation that would be extremely appropriate for the decades ahead, it would be some form of credit risk insurance for individual pensions, insofar as no capital cover is envisaged (and on condition that such capital cover cannot be modified, reduced or even eliminated at the stroke of a pen by the legislative power). CDSs for individuals – given the threatening demographic gap in Europe, there would be no lack of takers. Whether it would be possible to find counterparties ready to carry the risk is another matter altogether – but they do exist for "normal" CDSs.

8. Grounds for a little more optimism

"Pricing in": this somewhat unattractive expression goes to the heart of the matter. Volcanoes cannot be abolished. Nor is it possible for individuals to adjust the probability of their eruption. For our man-made volcanoes, that would mean that a large collective would have to come to its senses. Illusions about the lack of danger, excessive anxiety about supposed problems, insights that come too soon or too late – if there is a mechanism that can allocate a price to a given state of knowledge, it will ensure that the necessary value adjustments will not be postponed. And postponed value adjustments are precisely the cause both of too little growth, because anxiety reigns, and of crises, because there has for too long been reliance on the further linear development of familiar conditions.

At the start of this Investment Commentary, we rejected the danger of a deflationary spiral ending in depression. This, mainly with the argument that neither the business sector nor consumers are subject to fixed formulas for production or consumption, but can make continual adjustments. Indeed, we believe it is possible to speak in terms of "good deflation", given the unprecedented improvements in productivity at both business and individual level. We regard the various attempts at stimulation, which cost a great deal but obviously achieve very little, as counterproductive, and the macroeconomic situation as correspondingly burdensome. Against this, we set three rays of hope on the horizon: first, the obviously stable situation in the business sector; second, the multiple enhancement of individual possibilities; third, the fact that the world is learning to live with the by now notorious big risks of overindebted states. Significant foreseeable losses are increasingly being priced in. Such a restructured basis offers not just the continuation of existence, but a degree of hope for the future.

If this – cautious, let it be clearly understood – optimism is not entirely unjustified, then we believe that in the wake of the recent crisis the valuation of stocks is now at the lower end of the scale. None of the usual indicators (price/earnings ratio, price/book value ratio, etc.) points to any dramatic overvaluation. Many investors are obviously weary of the enervating ups and downs of 2010. We thus repeat our recommendation to increase the strategic position of stocks, in the place of the very highly valued bonds, not least as the dividends are often much above the bond coupons. Despite continuing currency risks – neither the dollar nor the euro is particularly appetising – we recommend broad global and sector diversification, for good, attractively priced stocks generally compensate currency losses relatively quickly.

Deflation? Let us not be induced to attach too much importance to the idea, however much it may be talked up by interested politicians, and by doing so, forget that the world is on its way to becoming more productive on a broad basis. This is what we want to have a part of, not the financing of decadent Western state structures.

KH, 4.10.2010