Money Mountain

Back in 2008/2009 many investors flocked to cash, bonds, money market funds, GICs and so on. They were scared. We were scared too, but we clung to our life-long preference for hard equities and gold in expectation of heavy duty printing. Sure enough they gave us QE 1, QE 2 and made it clear they would do whatever was required to keep the ship of state from sinking. *Plus ça change…*

Notwithstanding all the Qs, people generally hung on to their cash in the hope/expectation that things (meaning interest rates) would soon return to normal. Many establishment types encouraged this view. The cash crowd also wanted another chance to buy the stocks/gold they were too scared to buy in 2009 when bargains abounded. But 'twas not to be. Interest rates were kept low, the money market mountain grew, stocks and commodities appreciated yet the (Western) economy remained mixed.

With Europe a mess and China weakening we had another white-knuckle moment in late 2011. Once again the fear-mongers talked deflation, lower markets and the need for cash. Again the money mountain grew taller. And once again the money-printers went hard at it, this time both the Fed and the ECB.

Ladies and Gentlemen, we are going to have easy money until it's all confetti. We have to have easy money, not only to try (we stress try) to bolster the economy, but because nearly all Western governments are broke. Hypothesize that, if almost any Western country were to raise interest rates 200 bps (not that much, really), then connect the dots and you would probably increase the budget deficit by 20%. Or more. (For those who say Canada isn't so bad, just consolidate the Feds and the Provinces.) Whatever the ideology, whatever the inflation, governments cannot afford to carry the existing interest burden, let alone a heavier load.

The easy money die is cast, but as in the past, people are unlikely to take our word for it. That's OK, now we have Ben Bernanke saying, effectively, the same thing will prevail for three more years. Wow. An eternity of ease, from Ben. This beats the helicopters.

We don't see how those sitting on the mountains of money can ignore it. Four lost years in the money market must stir their bile and, as the saying goes, hell hath no fury… So, kicking and screaming, they will look to stock (and commodities) markets, swallow hard, and buy. We think they have already started—in the past three months, wonder of wonders, copper has rallied twenty percent. It's not our favorite metal, but it provides a hint of investor attitudes. According to the FT investors bought $15 billion of commodities in 2011 and $67 billion in 2010 as a place to park money.

That's the key, to park money. The economy may not do much, but flat sales (see breweries) do not preclude higher prices and earnings. Nor do they preclude higher P/E's. Companies buying back shares for cancellation are now a fact of life and this often produces a higher ROI than investing in new plant. And it's the strong, relatively inexpensive companies (the ones we should buy) who do the normal course bidding. The companies issuing stock tend to be overpriced promotions.

So when the paper mountain starts shifting into stocks, there is no law that says the supply of the good stuff will be adequate to meet demand. A good formula for a hot bull market.

However, particularly in the Canadian scene, assets require some definition. For example, this business of "ounces of gold in the ground" is, at best, a dubious measure. Are those ounces really there? Can you get them? Will the metallurgy render them uneconomic? Does management really know how to build a mine? And, above all, capex is likely to be so large that the mine is uneconomic. In fact, whether a pipeline, a tar sands complex or a big mine, capex projections are now extraordinary. So, when investing, consider whether the enterprise has already expended many of the costs to get in business (sunk costs) or is still at the dreaming stage. And if we are talking resource investments, the dream world is all too often a sinkhole.

It does not follow that a rising tide lifts all boats – too many have leaks or are just plain unseaworthy. But with the money mountain shifting into our kind of investments, we should have the mother of all bull markets on the horizon. Remember the old bard: "There is a tide in the affairs of man…"

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