Glue Factory

People have long joked about the tulip bulb mania, the madness of crowds, stock market bubbles of all types, Florida land bubbles and many other examples of unfettered speculative fever, but nothing matches today's rush into currencies and government bonds. We are not aware of any formal measurement to define a bubble, but let us suggest that, if a completely unjustified portion of available savings flows into a given area, that could be described as a bubble.

And at this time, when a) governments are printing more than ever before, b) government deficits and debts are greater than ever before and c) governments are less in control of events than ever before, people are nevertheless more willing to finance them, to lend them money, than ever before. Far more money is pouring into government bits of paper than into anything else. In a way it is the biggest bubble of all time.

The great mystery is: Why? At least during the South Sea bubble people had visions of plunder from the Caribbean, the tulip bulb was new, exotic and scarce at a time when the Dutch were getting wealthier by the hour and building country estates with huge gardens, land has always had its own attraction, as has high tech from the days of Radio (RCA) in the 1920s to Nortel in the 1990s. The greater fool theory is, and always has been, a big part of the investment scene, and towering above everything is greed.

However this doesn't square with today's stampede into "cash", money markets and bonds. These afford zero prospects for capital gains and only microscopic income. There is the prospect that one colour of cash issued in one part of the world will deteriorate faster than another colour issued by another country, but playing one currency against another is a zero sum mug's game, albeit a mug's game being played by thousands of traders in dozens of one-acre trading rooms around the world. Even if one currency has slightly more integrity than others, the government involved has no alternative other than to intervene, to debase the currency in an effort to protect jobs. Witness Japan or Switzerland recently.

Rather than being a conventional bubble (if such a thing exists) driven by greed, the current rush for cash is a craze driven by fear. Investors are not desperate to make money, they are desperate to preserve it. Everybody (except politicians and economists) has legitimate concerns about the economy and this has traditionally terrified investors. And it's pretty easy to conclude that many ships of state are being piloted by the likes of the Exxon Valdez crew.

People have been brainwashed into thinking gold was "too high" (all the way up from $600) and stock market gyrations and economic concerns over the past few years have made investors fearful of equities. Yet many good stocks are trading at very cheap levels. Twelve-times earnings is normal for very big, very successful oil companies, and other values abound in the equity world.

Most investors simply don't grasp that buying a GIC is just as much an investment decision as one to buy Bell. The GIC crowd say they are "waiting" for a clear signal, but to convert all the money "waiting" on the sidelines into good stocks will be like fitting a camel through the eye of a needle.

It won't happen. When the market rallies again people will stare with glassy eyes and wonder why. They will see poor economic activity and make cynical comments about the fools who drive shares higher. They will deny the age old reality about money making markets go, but after the recent circus in Washington the tax option is pretty well off the table and all they have left is the

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printing press. One certain verdict from Washington is they plan to spend two trillion more than they expect to receive over the next year and a half. They didn't raise the debt ceiling for nothing.

All the excitement in Washington has diverted attention away from Euroland where things are going from bad to worse. Trillions of sovereign Euro bonds have been issued in recent years, mostly to banks. They were issued in happier times at a few beeps above German bonds — after all, sovereign Euro bonds had to be okay, right? The ratings agencies all said so. Now most of this paper is toxic but still they print more.

For decades one of the great arguments in favour of sovereign debt was that the issuing government could always, in a pinch, raise taxes to service the debt. Well, no longer. That's why the new idea *du jour* is growth. Yes sir, we are going to grow out of this mess. If ever the hope was father to the thought, this is it. Grow? How to grow when governments are all trying to curb spending?

The same mindset that drives investors into cash and bonds mitigates against putting money into factories et cetera. The more intense this cash/bond bubble, the less growth. Even the US cannot have it both ways.

The greenback may be the best looking horse in the glue factory, but...

All bubbles end in tears and often end with some sort of scandal. A bank? Ten banks? Is there a heavy short position in gold? Already European banks have been excused from writing down sovereign junk bonds; presumably North America is next. In Canada the condo world looks very vulnerable and that could have serious financial consequences. What will happen when the ratings people get around to a sharp look at Ontario?

When all the world's bonds are rated half way to junk (or worse), when the bubble is over, where will all the money go? Dare we suggest the stock market?

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