



Veripath Q2 2021 Newsletter



Has Anyone Considered Letting Market Forces Set Interest Rates at Some Point?

I thought I would indulge in some gallows humor in this quarterly update and focus less on specific data or analysis but rather on the economic zeitgeist that prevails in the developed world. By that I mean the widespread ignorance of, or worse, the indifference to, the de facto insolvency of western nations that is simply being dealt with in the short term with the expedient of unrestrained money printing.

It has been quipped that history might not repeat but it certainly rhymes. Who can read the following quote from Andrew White recounting the hyperinflation of the French assignat in the eighteenth century and not see some striking similarity to current events?

“The first result of this issue was apparently all that the most sanguine could desire: the treasury was at once greatly relieved; a portion of the public debt was paid; creditors were encouraged; credit revived; ordinary expenses were met, and, a considerable part of this paper money having thus been passed from the government into the hands of the people, trade increased and all difficulties seem to vanish. The anxieties of Necker, the prophecies of Maury and Cazales seemed proven utterly futile. And, indeed, it is quite possible that, if the national authorities had stopped with this issue, few of the financial evils which afterwards arose would have been severely felt; the four hundred millions of paper money then issued would have simply discharged the function of a similar amount of specie. But soon there came another result: times grew less easy; by the end of September, within five months after the issue of four hundred millions in assignats, the government had spent them and was again in distress. The old remedy immediately and naturally recurred to the minds of men. Throughout the country began a cry for another issue of paper; thoughtful men then began to recall what their fathers had told them about the seductive path of paper-money issues in John Law’s time, and to remember the prophecies that they themselves had heard in the debate on the first issue of assignats less than six months before...”

Obviously, Mr White’s quote is unlikely to be anyone’s idea of humor but permit me to add the laugh track so to speak. For those of you unfamiliar with the assignat or for that matter Europe’s track record with fiat inflations, France and Germany alone have had 4 noteworthy and complete fiat currency failures (and counting?):

- France 1716: John Law introduced paper money to France in the form of livres. Louis XV required that all taxes be paid in livres. Ostensibly, the currency was backed by coinage. However, the new paper currency was rapidly inflated until nobody wished to hold worthless paper and demanded the coinage. After making it illegal to export any gold or silver, and the failed attempts by the locals to exchange their paper currency for something of actual value, the currency collapsed.
- France 1791: The French government tried fiat currency again - called "assignats". By 1795, inflation of assignats was running at approximately 13,000% per annum.
- France 1930s: The French government took over the Bank of France and introduced the paper "franc". It took only 12 years for them to inflate their currency until it lost 99% of its value.
- Germany: Post-World War I Weimar Germany is one of the most well-known episodes of hyperinflation in history. The Treaty of Versailles imposed heavy reparations on Germany. The German government took the expedient of printing the money to make the repayments. Inflation was so high that it was cost effective to burn marks to heat your home. Here is a brief timeline of the Mark/U.S. dollar exchange rate at 2-year intervals: April 1919: 12 marks, November 1921: 263 marks, December 1923: 4.2 trillion marks.

And yet governments and central banks keep on trying.

Global:	1970s	Today
GDP:	Exogenous shock to the global economy (estimated 10% contraction in GDP) driven by US default on its gold convertibility obligation and OPEC oil embargo to raise real prices	Exogenous shock to the global economy (estimated ~10% contraction in global GDP) driven by COVID
Fiscal:	Large US fiscal and current account deficits	G7 governments are running large fiscal deficits (20-30% of GDP in a single year)
Monetary:	Federal reserve responded to indirectly fund government deficits by increasing the money supply (printing money)	Global central banks responding by directly funding fiscal deficits by increasing the money supply (printing money)
Result:	Decade of high inflation and low growth – stagflation	TBD

Full marks for determination. Though given the asymmetrical distribution of the benefits to governments (funding) and the costs to taxpayers (inflation) perhaps there is something more premeditated in their dogged Keynesian devotion to nominal GDP growth. The successful rebranding and evolution of Keynesian economic theory to Modern Monetary Theory (“MMT”) is a perfect demonstration of the age old saying “*same old wine, new bottle*”. In a limited defence of Keynes’s it must be added that he did advocate for the money supply to be increased in periods of economic contraction but then decreased in times of economic growth. Its part two that most governments strangely neglect.

Regardless, you and I do not live in the nominal GDP world inhabited by governments and central banks. We live in the much more demanding “*real*” GDP world – the one with cash-flow, assets, liabilities, products, customers and all those other bothersome details. But you say, surely we must expand the money supply to stimulate demand and save the economy. Let us reflect on the thoughts of Jean-Baptiste Say on consumption:

“The encouragement of mere consumption is no benefit to commerce because the difficulty lies in supplying the means, not in stimulating the desire for consumption; and production alone furnishes those means. Thus, it is the aim of good government to stimulate production, of bad government to encourage consumption.”

How unfortunate and convenient that politicians and their Keynesian advisors have been obsessed with the wrong part of the economy for decades – absolute nominal GDP growth – versus real per capita GDP growth. Unlimited, deficit driven consumption is only possible, granted sometimes for an intoxicatingly long period of time, via the illusion of wealth created by an ever-expanding fiat currency. It does not, however, create long lasting prosperity as ultimately becomes apparent.

Just how bad are our problems? Difficult to quantify in the limited space available here, so permit me to fall back on another quote, this time from the venerable Ludwig von Mises. Though 70 years old it seems almost purpose written for today.

“There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as a result of the voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved.”

Many will argue Mises is wrong. I doubt he will be, although as he states the speed at which this will take place remains to be seen.

Some Asset Allocation Thoughts:

From 1998 to July of 2008 commodities materially outperformed based on the ratio of GSCI index to the S&P 500 index. Following the financial crisis in 2008 commodities have materially underperformed with the ratio falling to below 1 in mid- 2020 – underperformance of over 10% per year.

With commodities at historically low relative valuations (lowest in 30 years) and the tendency of commodities to outperform during times of accelerating inflation (low and/or declining real rates), investors may be able to improve their returns by adding commodities or commodity linked return drivers to their portfolios.

Ratio of GSCI to S&P 500 1998-February 2021



Source: CAIA Association

Some Themes:

Given the monetary, economic, and political conditions, our investment beliefs remain to be overweight investments:

- that are directly exposed to emerging economy growth in politically stable parts of the world;
- that eliminate or reduce counter-party risk – e.g. farmland versus wheat futures;
- that hedge inflation (ideally with suitable asymmetry to generate real returns); and
- whose products have inelastic demand curves.

Sources: CAIA Association, GSCI Index, S&P 500 index



About Veripath

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Veripath is a Canadian alternative investment firm. Members of Veripath's management team have been investing in farmland since 2007. Veripath is focused on risk first and invests in a way that seeks to reduce operational, weather, geographic and business-related risks while capturing the pure return from land appreciation for its investors. Our goal is to partner with farmers for the long-term using innovative lease arrangements and/or land-unit swaps to give certainty to farming operations.

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Sources: Canadian farmland data-FCC, CPI-Statistics Canada, SP500-10yr Bonds-Macrotrrends, FTSE REIT-Nareit, Veripath analytics, St Louis Federal Reserve, Statistics Canada, Macrotrrends, Hancock Agricultural, real rates = CAD 10 year bonds - CPI, Series runs to 2019