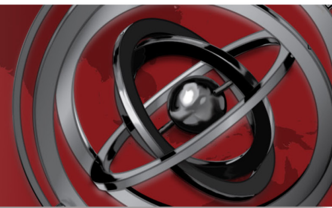


Once Upon a Time On Wall Street

“Those who cannot remember the **past** are condemned to repeat it.
To covet truth is a very distinguished passion.”

George Santayana

Let’s start with the conclusion. ***History demonstrates that the world is cyclical****. As George Santayana pointed out, we ought to learn from history.*

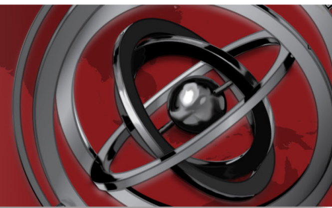
Our recent commentary, entitled ‘The Renaissance and the Entropic Arrow of Time,’ contrasted current times to that of a half-millennium ago. This one, contrasting our current environment with that of a mere half-century ago, may seem almost contemporary by comparison. Both, in different ways, **strongly support the case that ‘now,’ more than ever, is a particularly important time to think independently.**

As this commentary was being penned, Quentin Tarantino released “Once Upon a Time in Hollywood,” an homage to the 1960’s. This movie encapsulates society’s emerging nostalgia for the 60’s and sets up many of the points this commentary strives to make. While Tarantino seems to lament the end of the 60’s Hollywood, this missive suggests that the ‘Go-Go years’ of the nineteen-sixties serve as a good analogue for the current environment on Wall Street. Now, 2019, is admittedly a supercharged version of the late 60’s/early 70’s, but that era is still an excellent source of instruction as to how to successfully navigate this environment. The movie has an excellent soundtrack, but we’ll stick with the ‘soundtrack’ we were using “pre” the movie’s release.

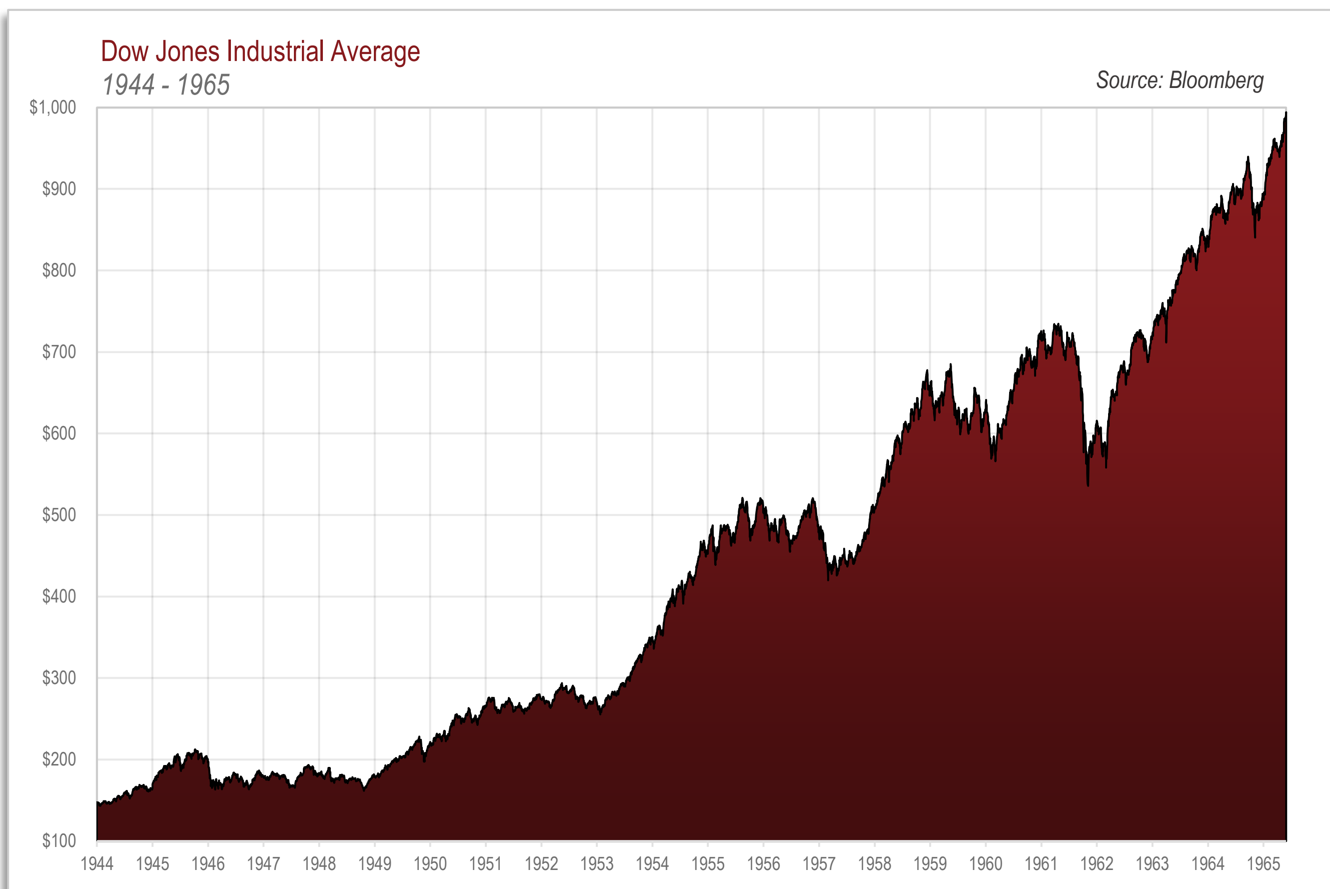
Let’s begin with “For what it’s worth (FWIW),” a song written by Stephen Stills in 1966, to glean some insight into the extent to which 2019 rhymes with the late 60’s. The song is widely regarded as sort of the anthem of the age, an era eerily like our own; hence its prominence in this commentary. It was a hit for Buffalo Springfield; their only hit despite a wealth of talent including Jim Messina, Richie Furay, and Neil Young, as well as Stills.

“There's battle lines being drawn
Nobody's right if everybody's wrong
Young people speaking their minds
Getting so much resistance from behind
It's time we stop, hey, what's that sound
Everybody look what's going down”

-Buffalo Springfield

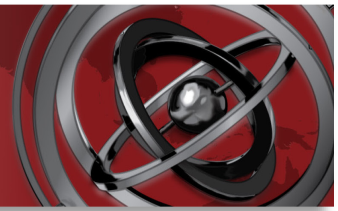


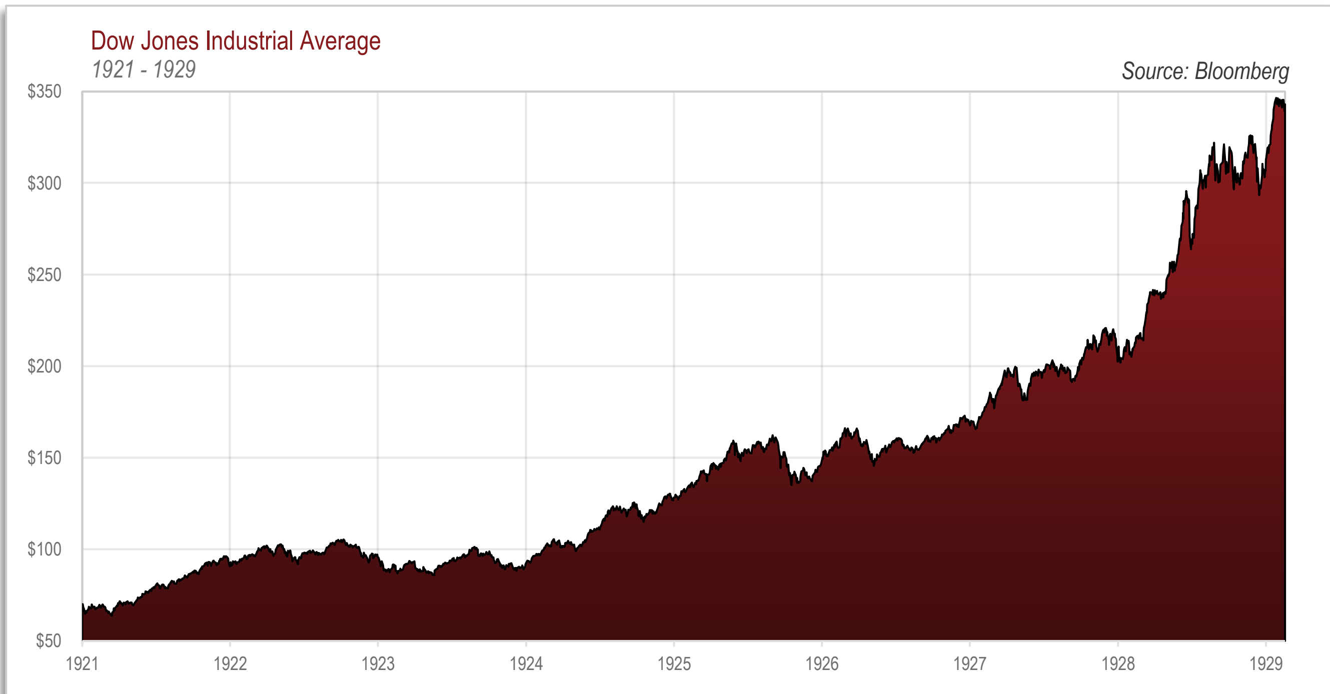
So, what was 'going down' in the late sixties? Growing disgust with the war in Vietnam, for one. Not surprisingly, many believed the song to be about Vietnam War protests. But, while war protests were indeed becoming increasingly common at the time, people's dissatisfaction was much broader. The song was actually about protests of a curfew being imposed on young people on the Sunset Strip. That is beside the point. Whether the protests were about the antiwar movement, or curfews on youth, or race and inequality, the song became "widely regarded as sort of the anthem of the age," because it was an age when society was so deeply divided, and protests were becoming uncomfortably common. With 'the establishment' being increasingly challenged by the burgeoning 'baby boomer' contingent, and with corporate America and the U.S. government increasingly becoming distrusted, it is understandable that the stock market was under such pressure. Oh wait, that's not what happened. As the chart below attests, the market was charging obliviously and relentlessly higher. The Dow Jones Industrials surpassed $1,000 for the first time ever, the very same year when the depths of society's troubles inspired Mr. Stills to write the song.



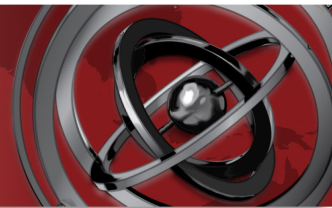
With the market up more than seven times, off of its World War II levels (and twenty-five times its depression lows of 34 years prior), investors were in no mood to let troubling fundamentals interfere. After all, *America was on a roll, businesses were prospering, and technological leaps were improving everyone's standards of living.*

Things were going very well for America during that stretch. But, as it often turns out, that 'time of plenty' would have been a fortuitous time to have done what we are attempting to do now; examine history, look for lessons, listen for rhymes. And as the chart below suggests, the 1920's would have been a highly instructive place to start.





After all, in the 20's, too, *America was on a roll, businesses were prospering, and technological leaps were improving everyone's standards of living.* In WWI, as in WWII, the U.S. had emerged as the clear winner. There was so much to be optimistic about. But, too few were cognizant that the central bank's massive printing of new currency was the driving force behind the Dow Jones Industrials' impressive seven-fold rise. As Ludwig von Mises later pointed out… "There is no means of avoiding the final collapse of a boom brought about by credit expansion." The following chart shows the infamous final collapse that followed the credit expansion of the 1920's.

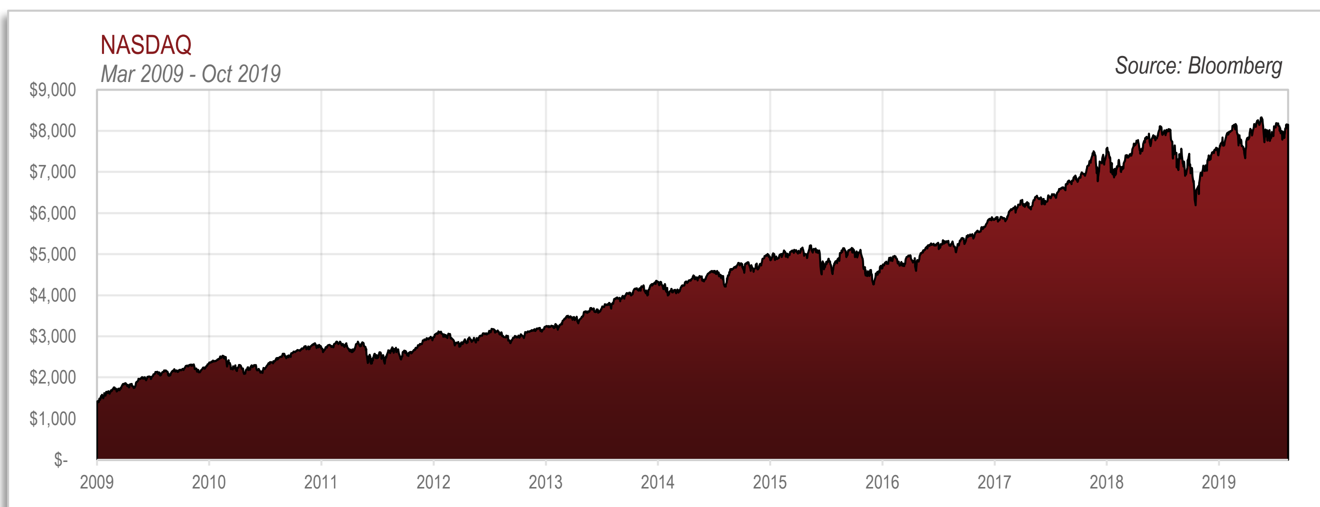


For more on the subject, “The Lords of Finance,” by Liaquat Ahamed is an interesting read. Among many other topics, it makes clear that the ‘prosperity’ of the time was not shared equally, and masked a lot of pain underneath the surface. Nationalism and communism were on the rise in Europe.

The next chart illustrates that despite the street protests, the increasingly divided society, the large budget deficits, and the general anti-establishment backdrop, the stock market resiliently bounced back to the $1,000 level for the next half-dozen years. All the same, the chart also demonstrates that heeding the warnings of history would have spared the investors, circa FWIWs release, a lot of pain. In fact, the pain was much worse than this chart conveys. While the Dow index fell ‘only’ 40% post-1971, inflation began to really pick up in 1966, making the drop much more significant when adjusted for the cost of living. The 90% plunge, post 1929, occurred during a deflationary time period. It took investors several decades to recoup their losses, in real terms, following both of those bear markets.

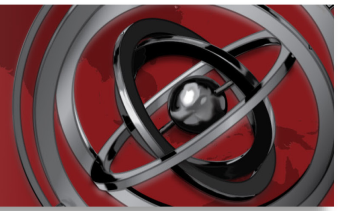
Dow Jones Industrial Average
1965 - 1974
Source: Bloomberg

With that historical foundation in place, let’s take a look at 2019. Like the late 20’s and 60’s, 2019 is a time of prosperity. Since the beginning of bull market, probably not coincidentally, the market is up seven-fold again (as measured by the NASDAQ composite index). And once again, according to consensus, *America is on a roll, businesses are prospering, and technological leaps are improving everyone’s standards of living.*



And once again, the Federal Reserve has blundered, causing a speculative market. Whereas the 1920's excessive monetary stimulus is believed to have been an attempt to aid an ailing Britain (and perhaps others on the Continent, too) and the monetary misadventures of the 1960's were an attempt to fund "guns and butter" as it was colloquially known (funding the Vietnam War and the 'Great Society' social programs), the contemporary monetary missteps are a little more complicated and problematic. The errors have been serial and are building. Early attempts to cushion the blows of the Asian meltdown, Russian debt problems, and the blow up of Long-term Capital Management amounted to figuratively 'pouring gasoline' on the fire of the developing TMT (tech/media/telecom) bubble of the late 1990's. When that bubble predictably popped, the Fed's efforts to reflate the NASDAQ led to the real estate/mortgage bubble, which of course devolved into the Great Financial Crisis. And, once again it was determined that the cause of the problems was likely to be the best solution to the problem. The Fed Board members are presumably fans of Homer Simpson, who seems to have anticipated quantitative easing, when he said, "here's to alcohol: the cause of, and the solution to, all of life's problems." Now, most people believe that QE1 (the first round 'quantitative easing'/money printing) was a good and necessary thing, so my opinion that capitalism requires that imprudent firms be allowed to fail, is being set aside here. More relevant, and more controversial was QE2, which occurred after the financial system was well out of harm's way. QE3, a massive round of unprecedented money printing, at a time when markets were well into a bull phase, the economy was humming along, and job growth was reasonably strong, was something that **theoretically can be condoned by no one**: monetarist; Keynesians; Austrians; Conservatives; Liberals, et al. The only plausible motive was to turn the bull market in assets into a mania, and further the distance between the haves and the have nots. The Fed subsequently handed the baton to central banks in Japan, Switzerland, England, China, and Europe in a well-orchestrated and choreographed effort to further extend the bull market. They bought bonds and stocks and mortgages and foreign securities, and who knows what else. They, of course, have succeeded wildly, creating what is increasingly referred to as "the everything bubble."

So here we are in 2019, seemingly well in rhythm with the cycles of the past. A la the late 20's and the late 60's/early 70's, we have a stock market at all-time high levels, at nosebleed valuations, late in a credit and economic cycle, and absent any fear of government dysfunctions, class divide, excessive debt, and of course a marked increase in protests across the globe. Despite the fact that the All-Country World Index (ACWI) peaked out in January of 2018, the only thing that investors fear is "FOMO" (fear of missing out), missing out on the apparent easy money to be made from buying financial assets. And yet, the parallels with the late 60's (and late 20's) dictate some level of, if not fear, attentive caution. Money printing has long faced the accusation of causing inequality, class divide, and discord. After a half century of relative calm, turmoil is, once again, evoking memories of the late 60's. It didn't take long after the advent of QE for the Arab Spring to spearhead a series of global protests. Looking at the pictures (shown later), one wonders if the Watt's Riots of the sixties were that much different than Baltimore in recent years, Kansas City circa '68 or the recent riots? D.C. as depicted in the movie 'The Post' versus the photo from one of



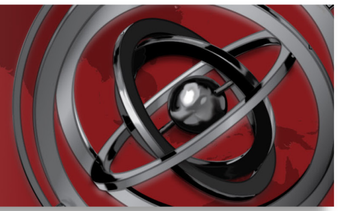
this year's protests? Up until recently, the knock against the younger generation was that they had no attention span. They could get indignant about something, but before long their attention went back to video games, Netflix, social media, and other versions of modern-day equivalents of Roman bread and circuses. This seems to be changing. Certainly, the recent photos from Prague, Chile and Hong Kong suggest that protests are, once again, big and global.

"What a field-day for the heat
A thousand people in the street
Singing songs and carrying signs
Mostly say, hooray for our side"

-FWIW

"What a field-day for the heat
A thousand people in the street
Singing songs and carrying signs
Mostly say, hooray for our side
It's time we stop, hey, what's that sound
Everybody look what's going down"

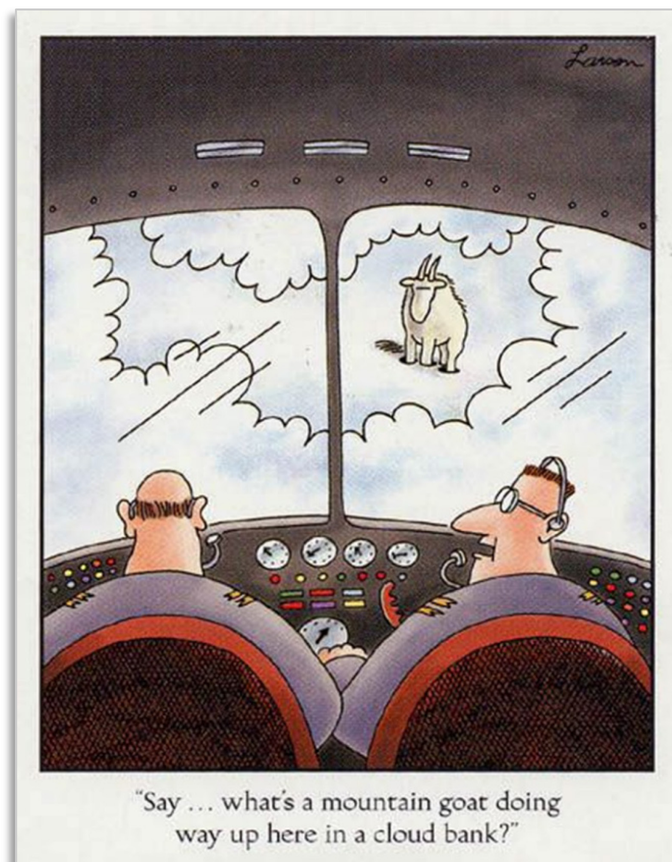
-FWIW



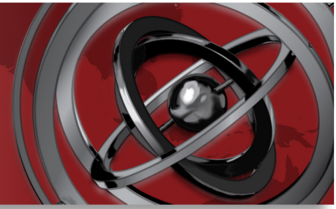
As we wrap up part one of Once Upon a Time on *Wall Street*, let's segue back to Once Upon a Time in *Hollywood*. Similar to this commentary, Tarantino takes us back to the sixties. It is a tale of happy times, but of changing times. Step by step he builds our anxiety, preparing us for bad things to come. And because it's Tarantino, and because we know about Sharon Tate, we know to anticipate the worst. A gruesome worst at that. Following, is an excerpt from a movie review that was published July 25 by Matthew Singer:

> *Everyone knows that on the night of August 8, 1969, three brainwashed hippies broke into the house of director Roman Polanski and his pregnant wife, actress Sharon Tate, massacred five people, and in the process drove one final knife through the heart of the Sixties and the utopian idealism it promised but never delivered.*
>
> *What Quentin Tarantino's new movie presupposes is: What if something different happened?"*

Was the anticipated ending not forthcoming because Tarantino is a master of nonlinear storytelling or because we now live in the age of 'false-truth', of 'alternative facts', of 'unicorns', and of 'happy endings'? Expecting gruesome, we got comedy, amusement, even hope for the future. Hmmm. Take a bunch of bad sh*t, **build up to the gruesome ending that we all know is coming, and then magically slap a happy ending on it. If that doesn't capture the current mood in Washington and especially on Wall Street, I don't know what does**. Now we have to admit that the contemporary era is kind of fun, but, we strongly believe that von Mises knew what he was talking about with the aforementioned thesis, "there is no means of avoiding the final collapse of a boom brought about by credit expansion."



"Say ... what's a mountain goat doing way up here in a cloud bank?"



It should be clear that the current global follies, fiscal and monetary, must end badly. But it should also be understood that challenge and opportunity walk side by side. Part two of this letter examines the half-full part of the proverbial glass. **While on the surface the seventies were a lost decade on Wall Street, significant returns were garnered by those with their eyes open**. Let's return to the past for more guidance.

"Paranoia strikes deep
Into your life it will creep
It starts when you're always afraid
You step out of line, the man come and take you away
We better stop, hey, what's that sound
Everybody look what's going down"

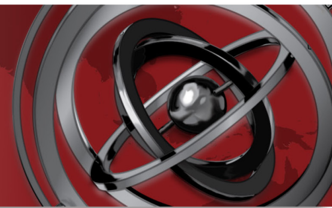
-FWIW

There are many, many things that investors ought to be very worried about. Yet, the market is rife with opportunities as well. The current situation, while extreme, is not something new under the sun. Central banks have caused bubbles for eons. Rather than go into it here, readers can enjoy reading about past bubbles: John Law and the Mississippi Scheme in "Millionaire," by Janet Gleeson; "The Lords of Finance," by Liaquat Ahamed, about the 'Roaring Twenties' bubble, and more; "The Bubble Economy," by Christopher Wood, about the Japanese bubble; and any of the many books and articles about the 1972 Nifty Fifty stocks and the 1999 TMT mania. "Bull", by Maggie Mahar looks at the causes of bubbles from many different angles. Central banks try to help, things get way better, then the bubble pops and things get way worse. "Extraordinary Popular Delusions and the Madness of Crowds", by Charles Mackay, written in the nineteenth century, is as relevant as ever. "Devil Take the Hindmost", by Edward Chancellor, also looks at various bouts of speculation. The bankers make the same mistakes over and over, and the investing crowd falls for it over and over. The biggest winners during a speculative bout tend to be the biggest losers during the inevitable crash. The 'ugly ducklings' during the 'good times' often blossom as previous over-inflation rolls from financial assets into real assets. Let's head back to the past once again to see what opportunities availed themselves during other very challenging times.

"There's something happening here
What it is ain't exactly clear"

-FWIW

Let's start with a commercial from the 70's that was a big hit for Natural Light beer. The character says, "you can call me Ray, or you can call me Jay, or Johnny, but you doesn't have to call me Johnson." Re-watching it, it didn't age well, but it did bring to mind the recent re-implementation of Quantitative Easing (QE) in the U.S. Which has returned with great fanfare along with a lot of advisements that "you 'doesn't have to call it QE." You can call it 'repo rescue' or whatever else you like, but don't ever call it QE. The monetary system is failing. While logic and history both argued that an exit from QE wasn't possible, the Fed assured everyone that they had a strategy and over the past several years they attempted to exit. They failed miserably. Following several years of attempted tightening, in December of 2018 the credit markets started to fail, and the stock market hit an air pocket. It wasn't a surprise to many that the world's central bankers reneged on their promise to exit the post GFC quantitative easing strategies (in fact promising a return to money printing). That is when Secretary Mnuchin infamously called upon the Plunge Protection team. Since that time, the NASDAQ has rallied 31% from the December 24th bottom. More recently, despite the NASDAQ being up 20%, year-to-date, the Fed has resumed printing money. First, they responded to problems in the repo market and this month they officially announced $60 billion of monthly T-bill monetization. While the future is unknowable, given the Fed's colossal failure, inquiring minds certainly will be interested in knowing how investments performed the last time the currency system failed; when Nixon had to renege on the underpinnings of the Bretton Woods monetary

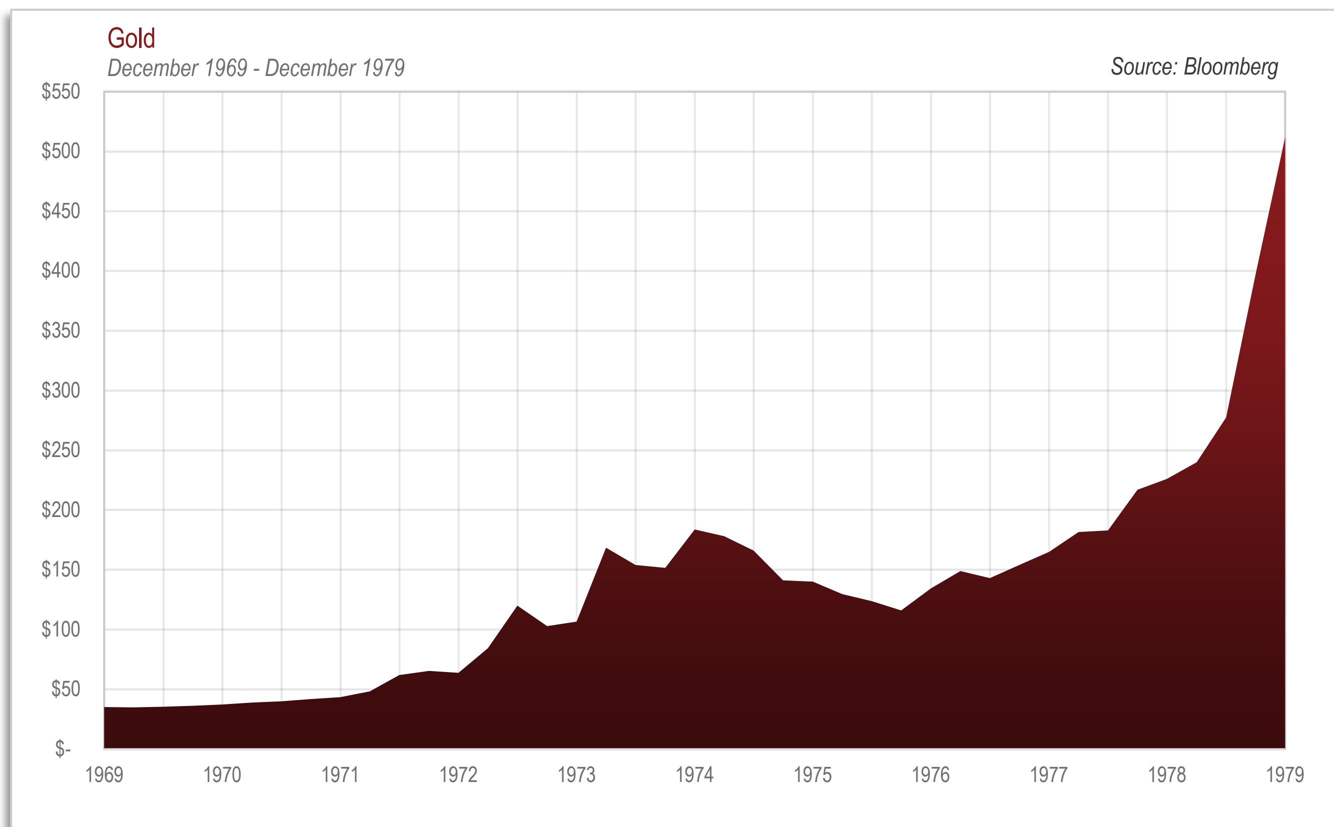


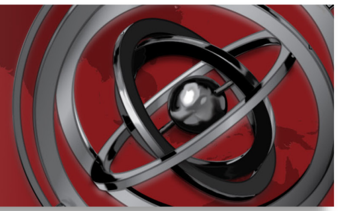
system and the obligation of the U.S. to allow conversion of dollars into gold at a ratio of $35 per ounce. This default, years in the making, occurred five years after Mr. Stills penned his anthem of the age. Subsequent to Mr. Nixon's closing of the gold window, stocks rallied, hit an air pocket, and then rallied 31% from November to the market peak 13 months later. A painful, decade-long, stagflationary bear market followed for stocks and bonds. If the current environment of fiscal lack of discipline, monetary accommodation, currency system breakdown, societal divide, political discord, global strife, long bull market, and historic valuation extremes, rhymes with the era that Buffalo Springfield sang about, it makes sense to look at which investment types proved successful back then.

“And there's no tellin' who
That it's namin'
For the loser now
Will be later to win
For the times they are a-changin'"

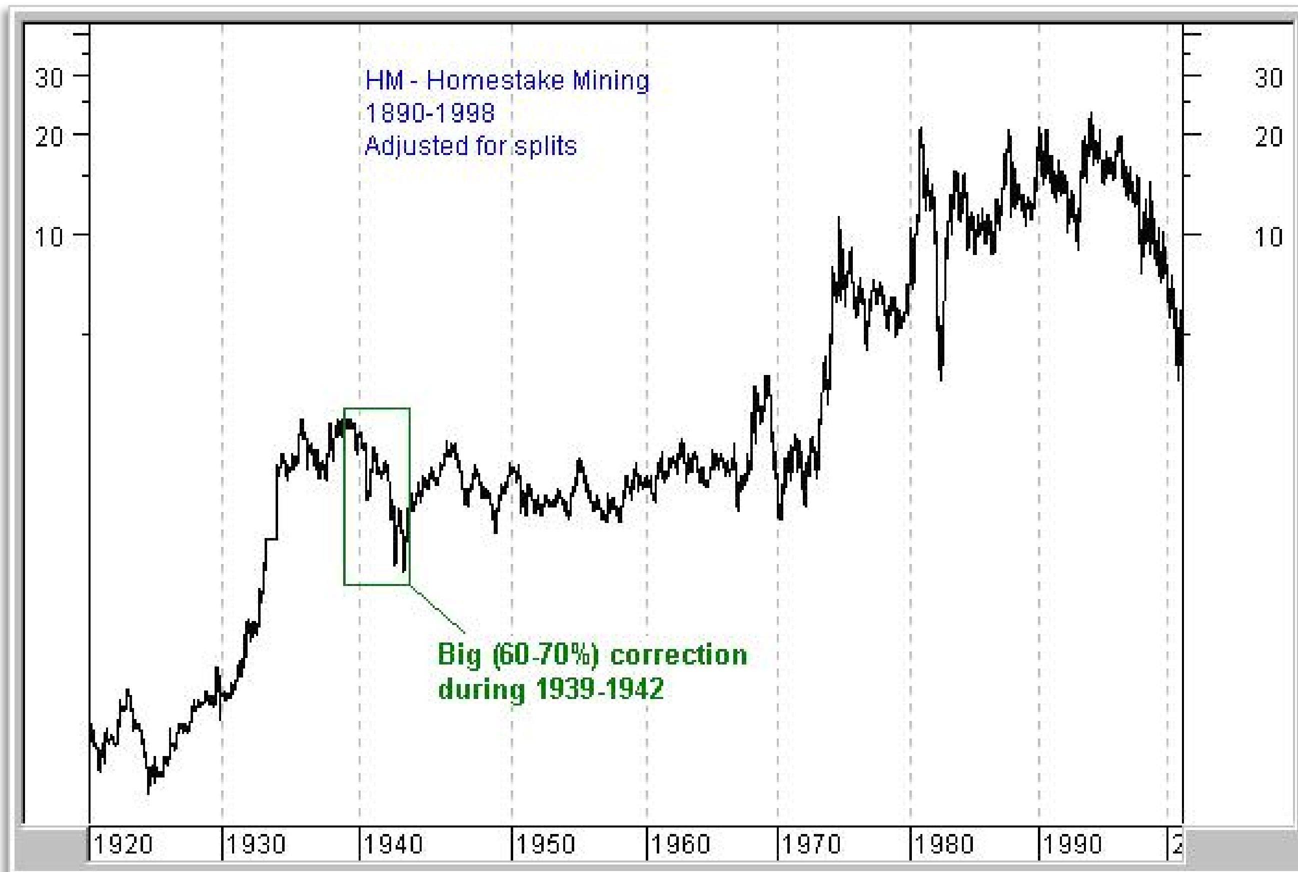
-Bob Dylan

Fortunately, there were many good investment options! Forgive us, but there really isn't a better place to start than with gold, as nothing compares during trying times. We will get to other assets shortly. During the fallout that inevitably followed the turbulent 60's, gold rallied admirably, as the chart below illustrates. Gold rallied while popular stock indices got crushed, falling hard despite rising earnings. Investors back then remembered that price matters. Bonds did worse than stock indices and faced a long, grueling bear market that took ten-year rates from a couple percent to sixteen percent.

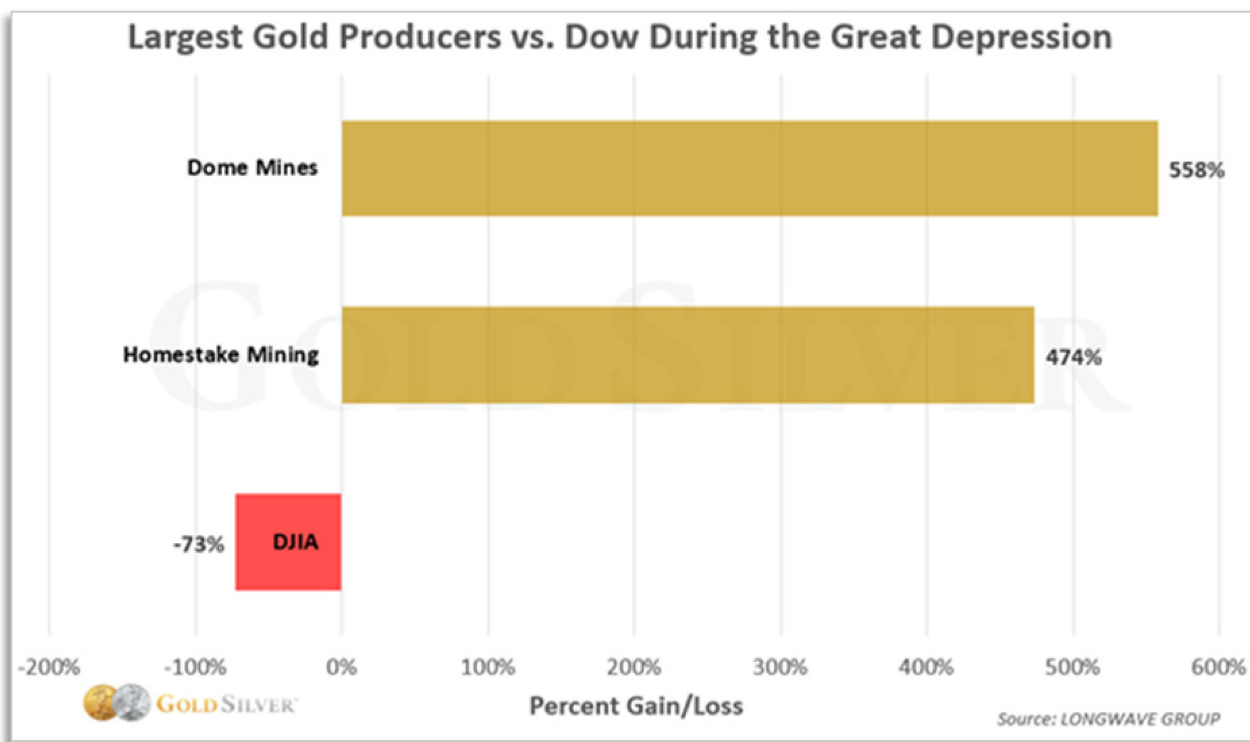




Gold, (as shown on the chart above) was obviously a premier investment vehicle at the time. It rose from $35 to $835, which represented almost a 24-fold increase over the decade of the 70's, equating to an average of 37% per annum. Even better returns awaited those who ventured into gold mining stocks. Below is the chart for Homestake Mining, the bellwether gold miner for decades.



Two more points are worth making before moving on from gold. Some may protest that the seventies were an inflationary time, and thus not worthy of comparison to the modern, "disinflationary" world. While we believe that this is a misconception, the point is deserving of analysis. Let's take a look at the deflationary 1930's. Gold rose over seventy percent as FDR reset the price of gold to $35/ounce. More importantly, look at the performance of the gold mining shares during this time, depicted on the chart below. Notice the DJIA lost almost three-quarters of its value over this timeframe.



Secondly, some may challenge the premise that we're witnessing the failure of the currency system. That sounds too dire to many. But upon reflection, it's actually not dire at all. One could make a case that a **currency system failure is merely business as usual**. The U.S. dollar has lost 90% of its value over my lifetime (per CPI; in actuality – closer to 98%), and things have generally gone very well for the world, and particularly for the U.S. over this period. But, even during good times, it seems that Voltaire was correct, "paper money eventually returns to its intrinsic value – zero." This is not a dire prediction at all. Governments inevitably succumb to the temptation to devalue their currencies, yet economies continue to function. Currency failure is by no means Armageddon, but it is imperative that investors, savers, and citizens understand the implications. Jim Grant (Grant's Interest Rate Observer) points out the math associated with the Fed's stated goal of 2% inflation per year. Prices will go up five times over an average person's lifetime! An eighty percent loss of purchasing power! So, **perhaps system failure can be viewed as the central banker's ultimate goal.** Rather than being feared, it should be planned for, or at least factored into one's thought process. A final word, if what we are witnessing is the system unbroken, it in no way diminishes the point, nor the investment implications.

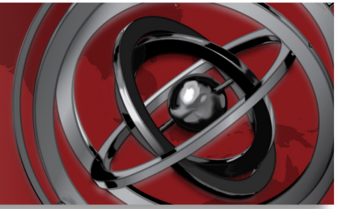
"If you don't own Gold, you know neither history nor economics."— Ray Dalio, *May 2018*

Druckenmiller, *May 2016* - from the Sohn Investment Conference stage in New York. Gold "…*remains our largest currency*."

In early 2017, Einhorn mentioned on an earnings call that he was*: "…keeping gold as a top position"*

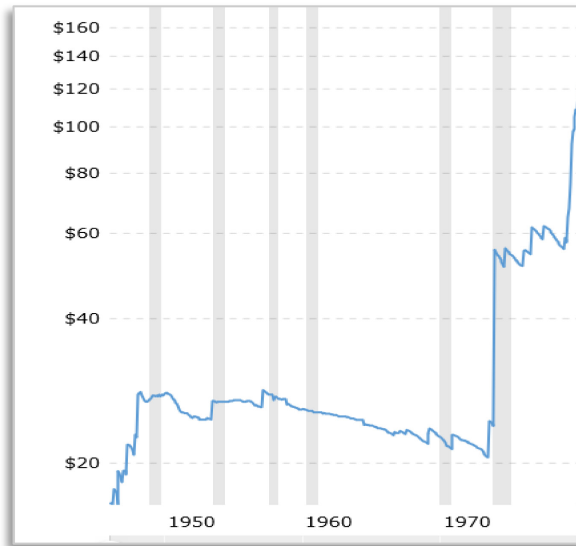
"Gold and commodities broadly should benefit this year." – Jeffrey Gundlach, *January 2019*

Moving on. The price of oil went nowhere for decades. But, with the growth of the population and the growth of the money supply, take a look at what happened in the stagflationary 70's!



Crude Oil - Inflation Adjusted Price

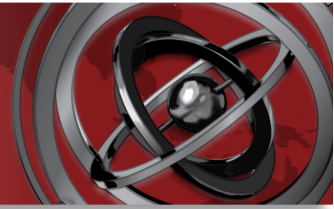
West Texas Intermediate (WTI, NYMEX) 1946 - 1980



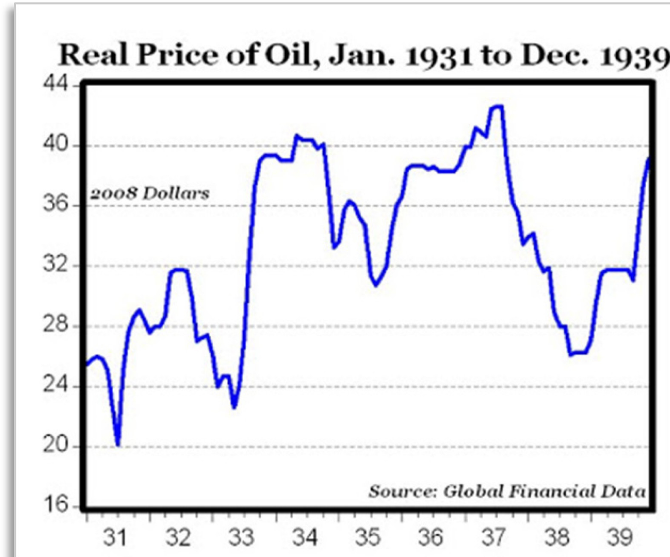
Source: Macrotrends. "Interactive charts of West Texas Intermediate (WTI or NYMEX) crude oil prices per barrel back to 1946. The price of oil shown is adjusted for inflation using the headline CPI and is shown by default on a logarithmic scale."

As the chart highlights, it went up six-fold, adjusted for CPI. It was a great time to own oil and to own those companies that provided services to the oil companies. Check the chart for Schlumberger, as it soared to become the largest market cap on the planet.

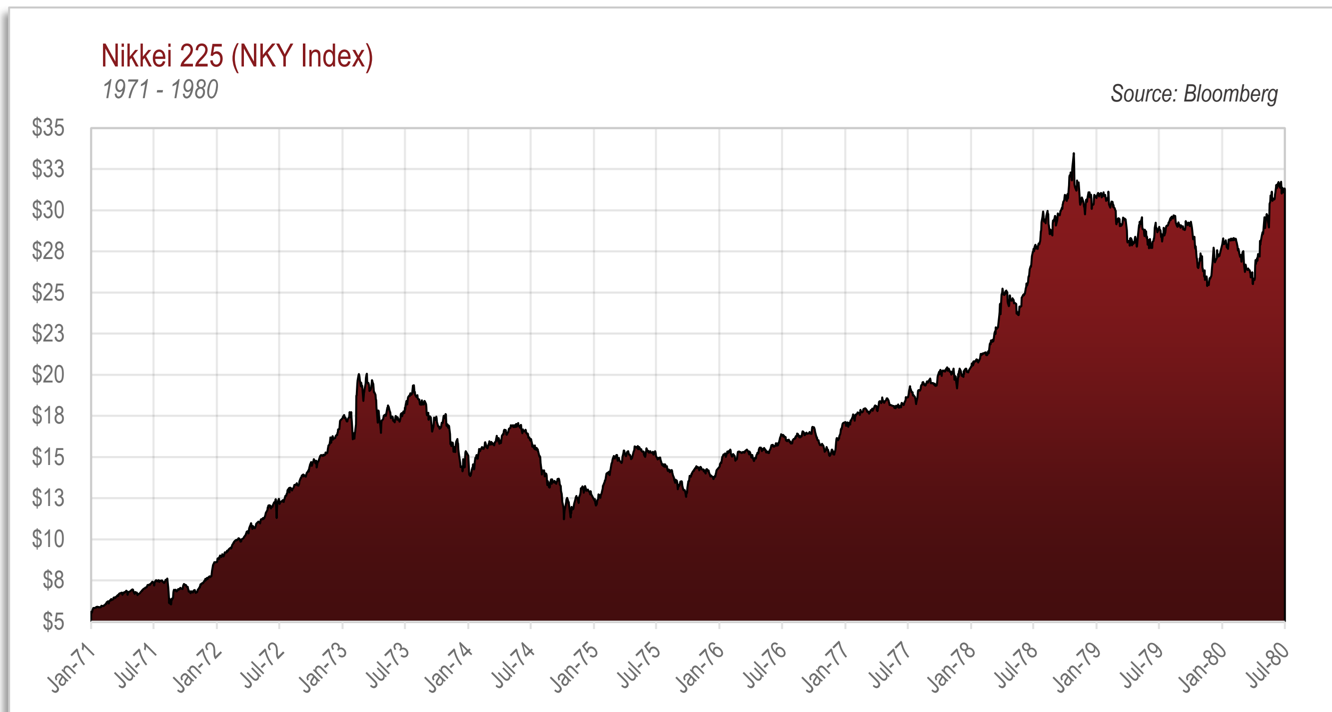
Schlumberger Limited (SLB)

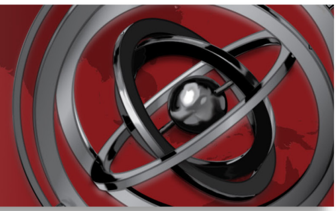


And here again, oil wasn't a bad place to be invested in during the deflationary 1930's.



To accommodate those who would love to move beyond commodities, let's move on. We have written before about how John Templeton (whom we admire) invested during the stagflationary period of the 1970's. He put a significant portion of his portfolio in Japan. As the chart testifies, this decision served him well.





Japan was an obvious place to invest since it was growing, and its stocks were shockingly cheap. Yet, very few people took advantage of the opportunity. It was foreign. And, as we pointed out several years ago, it was the 'Russia' of that era. It had been at war with the West. It had 'lost' the war. It was known for its corruption, mafia, shoddy goods, nationalist tendencies, suspect financial system, and was continually villainized in the media. Sound familiar?

Conclusion

We see abundant opportunity in this market, but it isn't in the popular indices. There we see much more risk than upside. It is sometimes lucrative, but always risky to pay dear prices for stocks. High prices represent high confidence in the future. While the future invariably turns out fine, and no one should bet against it, it seldom meets exuberant expectations; money is customarily lost. While it is always risky to buy things that are priced for perfection, the late 60's/early 70's were a particularly unfortunate time to do so. It was a time when Wall Street saw only good things while Main Street saw turmoil and change. Mr. Stills captured the era perfectly with FWIW, but one could have chosen any number of songs from any number of music groups. The times, they (were) a changin' (Dylan was a step ahead, writing this anthem of change in 1964).

"Come writers and critics
Who prophesize with your pen
And keep your eyes wide
The chance won't come again
And don't speak too soon
For the wheel's still in spin"

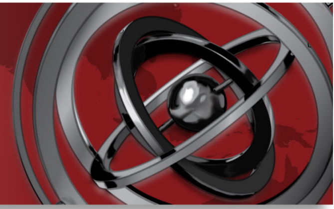
-Bob Dylan

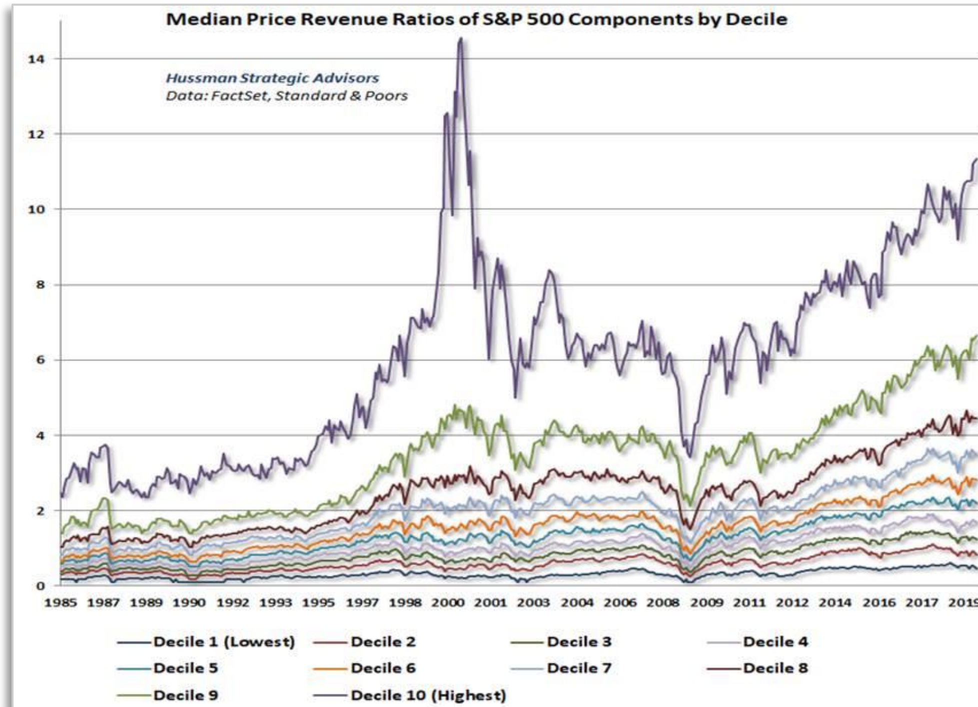
Fast forward to the year 2019, and Wall Street has high optimism for the future. Investors believe that central bankers have their back. They believe that there is a figurative put on the stock market. Many seem to believe it is a literal put on the stock market. Implicitly, the world's capitalists are wholeheartedly behind a centrally planned economy. The "central banks will never allow the market to fall, and neither will Donald Trump" is the mantra of the day. Investors are paying a high price for this confidence. At the extreme, they are accepting negative rates of interest. That's right, they are buying bonds that are guaranteed to lose money over the life of the bond, presumably on the hope that a greater fool will come along later and pay them an even more ridiculous price. Yet, in addition to songs, anyone paying attention to the movies coming out of Hollywood (and everywhere else) can get a sense of the unrest out there. Change is likely at hand. And anyone watching the political debates knows that politicians are calling for extreme change, perhaps greater than anything we've seen in decades. It seems an odd time to be paying aggressive prices for stocks. Bonds remain unfathomable.

"If your time to you is worth savin'
And you better start swimmin'
Or you'll sink like a stone
For the times they are a-changin'"

-Bob Dylan

We miss free capital capitalism and hope that it returns post the breakdown of the centrally planned experiment. We are grateful that the current experimentations have created **unprecedented levels of mal-investment and concurrent bifurcation of values. This is precisely what active managers seek in order to thrive.**





Source: Bell Potter

We are thankful that we have history as a guide to help substantiate the investments that logic suggests will perform best over the coming decade. We believe Kopernik's current portfolios are very attractively priced and offer tremendous optionality, whether the future brings on harsh times or a Hollywood ending. And that is our view, For What It is Worth.

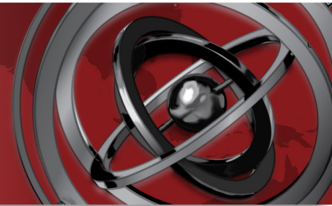
Cheers,

David B. Iben
CIO, Kopernik Global Investors
October 2019

Longest period without a recession
Longest period without a bear market
Highest valuations for stocks ever
Highest valuations for bonds ever
Highest debt levels ever
Negative interest rates ($17 trillion)
CLOs are very popular
Low doc loans are the norm
Bond ratings are much lower than the past
New deals are starting to drop on issue or be pulled
Public issuance of unprofitable business exceeds 1999
Student loans exceed $1.6 trillion and 20% are in arrears
Car loans exceed $1.1 trillion
Possibility of impeachment PROCESS
Brexit
Syria
Rising nationalism
Tariffs and trade barriers
Transfer of jobs from humans to machines
Mistrust of capitalism
Rising support for socialism

The future should be fine, but has the market priced in any of the above?

Some may protest that, even if some of these issues are worth worrying about, the world's central banks stand ready to create whatever level of inflation is necessary to ensure that stocks go up in nominal terms. Certainly, the central banks have done everything they can to embolden such beliefs. How effective they are, which stocks benefit, and how this works for bondholders, are to be determined. This will be the topic of our next Investment Commentary; coming your way soon.



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