



The Devil's Advocate.

by Joe Average,

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“...during the canonization process by the Roman Catholic Church, the ...Devil's Advocate (Latin advocatus diaboli), was a canon lawyer appointed by the Church to argue against the canonization of the proposed candidate. It was his job to take a sceptical view of the proceedings, to look for holes in the evidence and to argue that the miracles attributed to the candidate were fraudulent, etc.”

Wikipedia, the free encyclopedia.

Still fighting the last war.

Tension is rising as inflation rears its head and begins to unleash its fury on the world in the form of skyrocketing oil, precious metal and commodity prices, as well as on bloated financial asset and real estate prices.

Over the past several years Central Banks have driven interest rates down to historic lows while continuing to print money furiously, flooding the globe with liquidity, in an attempt to avert a recession following the stock market crash of 2000 and the perceived threat of possible Japanese-style deflation.

Most pundits are convinced that the Deflation Monster has been well and truly slain, and that the real threat now is that excessive credit creation will drive us headlong into a devastating Hyperinflation where cash savings will be decimated and all asset classes will surge in value on a rising tide of liquidity that “raises all boats together”.

Deflationists at the moment are very thin on the ground and on the verge of becoming an endangered species.

Devil's Advocate: “What if the Deflation Monster is not dead, but merely hovering in the wings, waiting to strike should the world economies ultimately buckle and implode under an enormous and increasingly onerous debt burden?”

The question is...“Are there any true contrarians left out there to argue the case?”.

Three who seem ready to rise to the challenge are the irrepressible Robert Prechter (www.elliottwave.com), Michael Shedlock, The Survival Report (www.whiskeyandgunpowder.com), and Antal E. Fekete, Professor Emeritus, Memorial University of Newfoundland.

These deflationists might argue that Central Banks and Governments are still fighting the last war.

Like the out-of-touch Generals of World War I who threw cavalry and infantry with bayonets against machine guns entrenched in gun pits to be slaughtered. Like the French who built the “impregnable” Maginot Line after World War I to defend from future German invasion only to have the Nazi **blitzkrieg** bypass it altogether with lightning speed. Or the British Forces who waited in Singapore with heavy artillery pointed defiantly out to sea, only to be overwhelmed in weeks by a Japanese force that appeared from the rear on bicycles.

“Mish” Shedlock argues that Inflationists are confident that **Central Bankers understand they have no choice but to “inflate or die”**; that recession can only be averted by prolonging the monetary expansion so that the world-wide real estate and credit bubbles can be given time to deflate slowly and the consumer can continue to prop up the economy through continued spending.

Shedlock tells us: **“It seems that everyone feels the Fed is all powerful, and that the Fed can defeat the business cycle by forever printing money. That is the fallacy of the inflationist arguments. It can not be done. The root cause of the great depression was an overexpansion of money and credit. “Helicopter Drop Bernanke” (cannot) cure that by printing more money...**

Banks can print but they can not force consumers to either borrow or spend. If bankruptcies expand faster than borrowing, the net of money supply and credit will contract. That is deflation.”

Thus it seems a lot depends on the consumer remaining confident and prepared to keep on spending. The moment that confidence evaporates and consumers become unwilling to go deeper into debt, or begin to reduce debt and increase savings...that is the moment the Fed will find itself “pushing on the proverbial piece of string”.

Professor Fekete adds this insight: **“...in our more sober moments we should admit that inflation cannot survive as a permanent monetary policy...just print money rain or shine. We know from history how inflationary adventures inevitably end. There could be nuances of difference, but deflation that follows inflation as night follows day cannot be avoided, no matter how much government is monetized by the central bank.**

They tried that approach in Bolshevik Russia, with results only too well known. The experiment was discontinued in Russia’s “Evil Empire” in 1990. Now they try it again in the U.S.... As Benjamin Franklin has said, experience runs an expensive school, but fools will learn no other.”

Anatole Kaletsky (The Times) writes that **“while the Japanese economy is now clearly growing (after 15 years of falling prices) most prices are still falling and therefore deflation, rather than inflation, remains the main risk to price stability.**

The talk about shareholder value, corporate governance and profitability...seems to have been replaced by the old mantra about expanding sales and profit share, regardless of profits or costs. One of Japan’s biggest companies boasted... “In flat-screens today there are many intense competitors, but in the end there will be only two or three survivors. We are determined to be one of those survivors and to make sure of this we must naturally undertake huge investments without worrying about profits too much.”

And finally, Robert Prechter’s take on the situation: **“Because of the tremendous, unprecedented build-up in credit, the deflation will probably be swift. So many debtors are on the margin of survival today, and so many others are right behind them, that once the weakest hands default, the dominoes will fall fast. When it hits, the whole system will succumb. Banks will fail. Insurance companies will fail. Many values that people think they own – in the form of mutual funds, stock portfolios, bond portfolios, commodity-indexed funds, bank accounts, insurance contracts, real estate, etc, - will evaporate.”**

Paying the price of Evil.

In my last article I borrowed from Gordon Gekko (Wall Street the movie), **“...greed is good. Greed is right. Greed clarifies, cuts through and captures the essence of the evolutionary spirit.”**

Don’t you just love that line?

Devil’s Advocate: “Is greed really good when it comes to doing business?”

Apparently, not always.

Sebastian Boyd (Bloomberg) describes how **“Citigroup...has suffered immeasurable damage to its reputation in Europe’s bond market.**

Almost two years after Citigroup riled the dozen countries in Europe’s government with secret trades codenamed Dr Evil, the debacle is hurting shareholders of the world’s largest financial institution. The United Kingdom’s Financial Services Authority ruled in June 2005 that Citigroup failed to consider risks or consequences when it authorised six traders in London to unload 12.8 billion Euros of securities in 18 seconds and then profit by buying some back seven minutes later at lower prices.

Since the Dr Evil transaction, Italy and Austria, formerly two of Citigroup's best customers...have shunned the bank.

And while the \$US26 million fine Citigroup paid was the equivalent of a rounding error on annual earnings, the New York- based bank has lost the chance to win lucrative fees...Citigroup is now 14th among advisers on European privatisations, down from third.

..."People didn't want to do business with them after the events of August 2004...It's not forgotten..."

God's Advocate.

Jill Rowbotham writes in The Australian newspaper **"Political leaders had failed to confront the big issues such as poverty and environmental sustainability and wrongly regarded economics as God, a senior church leader said today.**

In a parting broadside delivered during the Uniting Church's triennial assembly..., outgoing president Reverend Dean Drayton also slammed the role of churches in modern society, saying they were "enmeshed and compliant with those whose gospel is that if the rich get richer, all the rest will be a little better off".

He said there were not enough voices demanding (that we) face important issues. "With a concerted effort we could make poverty history, but instead the refrain is consume, consume, consume, with little concern for the tomorrows of our children and grandchildren."

In closing I would like to quote further from the Wikipedia piece on **Devil's Advocate**:

"The Office (Devil's Advocate) was established in 1587 and was abolished by Pope John Paul II in 1983. The abolition streamlined the canonization process considerably, helping to usher in John Paul's unprecedented number of elevations: nearly 500 individuals canonized and over 1,300 beatified as opposed to 98 canonizations by all his 20th- century predecessors. The increase suggests that the Devil's Advocate indeed reduced the number of canonizations; some hold the opinion it served a useful role in ensuring that canonizations did not proceed without due care and caution and that the status of sainthood was not lightly recognized."

It would appear that many of the world's bankers and governments might also benefit from the presence of a Devil's Advocate to ensure that major world-altering financial and political decisions "did not proceed without due care and caution".

All the best, Joe.

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[July 2006](#)

[June 2006](#)

[May 2006](#)

[April 2006](#)

[March 2006](#)

[February 2006](#)

[January 2006](#)

[December 2005](#)

[November 2005](#)

[October 2005](#)

[July 2005](#)

[June 2005](#)

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