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The end of exploitation

1. Events of the extreme kind

We hardly dare offer once again the over-used image of the Sword of Damocles as a metaphor for the current state of affairs. Nevertheless, given the apparently never-ending story of fundamental threats to the global economic recovery and the positive mood on the stock exchanges, the image of fate hanging by a slender thread remains almost irresistible. The same applies to the latest news: does the end of Osama bin Laden also mean the end of international terrorism, or will it, on the contrary, result in another 9/11?

Does “Sword of Damocles” have a plural? We might feel almost comfortable, were we to be faced by just one single universal threat. The reality is, though, that we are confronted by a series of varied, but very serious problems. If we seek a more modern metaphor, one of Stephen Spielberg’s Indiana Jones films comes to mind; the one in which the audience is faced first by a nest of serpents, then by a swarm of tarantulas, and then by a colony of scorpions.

Let us try once again to group the key events of the last twelve months into clusters, or at least to do some rough categorisation. We will probably not be far wrong, for example, if we form an “ecology cluster”. On 20 April 2010 a drilling rig in the Gulf of Mexico, belonging to the British oil company British Petroleum (BP), exploded. Only after five months and five million barrels of oil-spill were specialists able to plug the resulting leak. Experts and politicians of every colour, shocked by the dramatic and threatening pictures, forecasted the end of deep-sea drilling, and even a shift to more nuclear power. On 11 March 2011, after the tsunami that followed the catastrophic earthquake, individual blocks of the Fukushima atomic power station began to go out of control. It is still far from clear how serious the damage to people and the environment will prove to have been. But one thing does seem clear: the near-meltdown on the anniversary of the Chernobyl disaster will give a new twist to the discussion

about nuclear power; the tentative efforts to solve the CO₂ problem by means of reinvesting in nuclear power stations has been nipped in the bud.

That the result is greater importance for oil, and thus for deep-sea drilling, is one of life’s little ironies. It also reflects the second cluster of the last twelve months: one that, in the intervals between overwhelming media attention, and the resulting ennui must ever again attract our attention: the global supply of oil. The political upheavals in the Arab world threaten the security of production and supply. Let us be under no illusion: the global economy may be able to manage price increases for the time being, but a continued break in the supply from the Saudi Arabian wells, for example, would be absolutely catastrophic. The global economy is about as dependent on an uninterrupted supply of oil as the banking system is today on “quantitative easing” – that is, the continuous flood of liquidity from the wells of the central banks. This is the price to be paid for exhausting resources: where there are no reserves or supposedly unnecessary redundancies (for example, alternative sources of energy supply, or adequate equity for big banks) there is also no room for manoeuvre in extreme situations.

Cluster no. 3: state debt, the topic of a good few previous Investment Commentaries. Essentially, what has happened is exactly what we feared: the provision of ever newer and ever more expansive rescue systems has not only not reduced the problem, but on the contrary, has spread the contamination more widely, and drawn previously unchallenged, and thus fairly trustworthy parties into the mess. The public sector’s loss of creditworthiness reached its zenith (so far) when the rating agency Standard & Poor’s announced that it had downgraded the outlook for US debt to “negative” and confirmed the same rating for Japan. The problem with this state of affairs, long recognisable but made obvious by such events, is that the welfare systems of the developed nations are based solely on a foundation of state debt that is perceived as ultimately “risk-free”. The loss of credibility in this area has the potential for a systemic meltdown that will make the combined

impact of Chernobyl and Fukushima look like a minor bush fire.

What is fascinating about this situation is the seesawing between extreme anxiety, enthusiastically fostered by the media, and the almost apathetic acceptance of ever more shocking news on the one hand, and the emergence of a degree of “normality” on the financial markets, and in the economy generally, on the other. “*Prophete rechts, Prophete links, das Weltkind in der Mitten*” [Prophets to the left, prophets to the right: the children of this world in the middle], as Goethe put it – what has changed in our world that could justify such indifference, and perhaps even confidence?

2. Ecology: from alarmism back to normality?

It is probably an essential aspect of a social impulse that appears to be taken too lightly, that loud cries of alarm go up whenever the occasion serves. This was the case when the forests of Central Europe began to sicken. “Dying forest syndrome” was upon us, and the prophets foretold denuded landscapes, the death of the protective forests in the Alps, and the loss of all manner of woodland flora and fauna. It also always happens when unusual climatic conditions prevail – some days, or weeks, of hot weather, for instance. This provides a suitable occasion for the precisely timed publication of those articles on “climate catastrophe” and “global warming” that have been kept in reserve for such an opportunity, so as to achieve maximum impact with the public.

So, no surprise, then, that the latest two ecological disasters, the explosion on the Deepwater Horizon oil rig and the partial meltdown of the Fukushima atomic power station, have unleashed such a powerful global wave of anxiety. Depending on whether or not there are elections ahead, politicians react more or less energetically when demands are made, and abandon, without batting an eyelid, positions that had shortly before been proclaimed as “non-negotiable” – or, most recently, in the words of Frau Merkel, “alternativlos” [without any alternative]. The problem with these ecological demands, made with an alarmism bordering on the hysterical, is that, both among the general public, and particularly among politicians, the half-life of such changes of heart is short, and a reversion to “business as usual” is pre-programmed.

We spoke of “ecological disasters” though, and that is exactly what we meant. Ecological demands are certainly justified. We are all aware of the short-sightedness of our exploitation of the natural environment. Particularly from the per-

spective of an investor, for whom short-term calculation is a poor advisor, questions of sustainability – properly understood – must be given serious consideration. Just as it is misguided, out of sheer enjoyment of the (short-term) return on equity, to neglect long-term elements of importance such as a forward-looking personnel policy or maintaining a responsible corporate culture, in the overall evaluation of a company or its stock, it is equally misguided to dismiss ecological issues as “uneconomic”. On the contrary, they are extremely economic.

For it is from economics that we have the concepts of “externalities” and “public goods”, and it is precisely these that lie at the heart of ecological issues. We can illustrate externalities by means of a simple example. Pretty much every one of us drives a car. It would not occur to any of us that it is wrong not to let the exhaust pipe terminate within the car. We casually assume that it is entirely in order that the cost of our activity – the exhaust gases – should be distributed over an indefinite number of our fellow creatures. Exhaust gases are a classic example of externalities. The air they pollute is a public good, which is not consumed when it is used. There is no price for its use. Public goods suffer from the handicap that it is difficult to determine their ownership. And where there is no ownership, there is little responsibility. Those who find this hard to believe might wish to take a look inside a public lavatory. Public goods are abused, exploited and wrecked.

The “Tragedy of the Commons” lies at the heart of the global environmental problem. From an economic perspective, there are two ways to deal with it: either we try to mitigate the disaster by means of social controls, tax incentives, rationing and compulsory measures, or we define property rights better. Both strategies are subject to the constraints of cost-efficiency. And both strategies end relatively quickly in political resistance. That exhaust gases will one day be discharged in the interiors of cars is highly improbable, though this would undoubtedly provide the greatest possible incentive to innovation ...

Environmental protection based on alarmism generally heads in the direction of controls, rationing and compulsory measures. For they harbour the seductive charm of the absolute, and in the absolute lies the logical reaction to the alarm. What then actually happens is another matter entirely. Solemnly signed environmental agreements are hardly worth the paper they are written on; “environmental protection” as such is, sadly, just another public good, and is subject to the same incentives to abuse and moral duplicity as

all other public goods. Catastrophes like the one at Fukushima show clearly how controls can engender a false sense of security, and easily become subject to slackness and corruption. Interestingly, it was not nuclear technology, in the strict sense, that failed in Eastern Japan. Rather, it was relatively trivial shortcomings – such as the lack of emergency electric power – that led to the disaster. Items that are required to function in any country hospital (and in any respectable bank) failed in a nuclear power station. The power station's containment had probably been inspected hundreds of times, but not the proper positioning of its emergency generators.

But let us for once offer a positive forecast. The variety of environmental catastrophes that we have experienced, and the foreseeable lack of enthusiasm on the part of the general public for further hysterical outbursts, might enable discussions of the ecological issues to shift towards less absolute solutions. The fact that less ideologically fixated elements of society, including businesses, are now seriously tackling environmental issues offers the chance of more serious discussions. The rapid abandonment of nuclear power advocated in certain circles involves serious risks to the achievement of other important environmental goals, such as CO₂ reduction. Manufacturing the countless solar panels required by the solar power lobby would take a very great deal of raw materials and energy; the same applies to the many thousand wind turbines intended to be spread across the landscape to wait for the wind to blow. None of the strategies advocated in the aftermath of Deepwater Horizon and Fukushima is without serious inherent drawbacks and risks. Ecological realism is aware of the impossibility of the absolute achievement of goals. We believe that when the Fukushima tsunami has ebbed away, there will again be space for a debate on ecology that is founded on the normality of a relative achievement of goals. The main reason for thinking this, however, is not the cooling of overheated fuel rods and feelings, but rather the prospect of sustainably high oil prices, to which we shall devote the following section.

These days, our clients often ask us about so-called “green investments”. Those who know us as advisors, or are familiar with the views expressed in the Investment Commentary, will be aware of the reservations we have long held about investment vehicles with green labels. We were particularly sceptical about the euphoria that prevailed for a while (2008) with regard to solar power stocks. We found the danger of abuse that the excessive state subsidies inevitably involved to be too obvious. Without abandoning this funda-

mental (and obviously justified) scepticism, today we take a positive view of technology companies that are aiming at greater energy efficiency. The rise in the cost of raw materials that we have already seen, and the foreseeable continuing shortages of supply will put a fair wind behind this sector.

3. Where robbers rule

The Arab world has in recent months become the most unstable region in the world. In almost every country along the 30th degree of latitude, from Morocco in the west via Tunisia, Libya, Egypt, Lebanon, Syria, Saudi Arabia to Yemen and Oman in the east, the military and/or the police have turned armed force on their fellow citizens. The only exceptions are the United Arab Emirates and Qatar. The background to the explosive internal political situation in these countries is undoubtedly to be found in the uniformly prevalent form of government: autocracy, sometimes concealed by a cloak of nominal democracy. The people's lack of political rights goes hand in hand with corruption, no or little separation of powers, arbitrary rule, and often crassly preferential treatment for a group of loyal and servile lackeys.

The Arab countries are poor, their birthrates are high, and at around 20, the average age is very low. Even Saudi Arabia, perceived as “rich”, is relatively poor, measured in terms of its GDP: a population of some 27 million generates just on 450 billion US dollars per annum, which roughly corresponds to the GDP of Belgium, with a population of just 11 million. The only rich in Saudi Arabia are a thin layer of those more or less closely related to the ruling royal house. Most of the Arab countries spend a disproportionately large amount on their military: in Saudi Arabia a good 8 percent of GDP, 6 percent in the Emirates, and over 7 percent in Oman, not including the police and paramilitary forces. This compares to the military expenditure of countries that deserve to be taken seriously in terms of security policy, such as China, France or the United Kingdom, which is between 2.0 and 2.5 percent of GDP. None of the Arab countries really has any external enemies: their autocratic rulers effectively have a de-facto alliance with Israel. Thus, their only enemies are their own people.

Weak economic growth, high military expenditure, a rapacious ruling class: little wonder that the gap between rich and poor gapes ever wider and despair is rife. Many commentators see in this the main reason for the political upheavals of recent months. And because these commentators also see in the underprivileged classes the breeding ground of extremist Islamism, the fear is that

the whole process might end in a triumph for Al-Qaeda.

We disagree vehemently with this analysis. On the basis of all the information at our disposal – thanks to the Internet – and the historical evidence of how successful revolutions come about, we absolutely do not believe in an uprising from the bottom of society. Rather it seem that it is the bourgeoisie, often humiliated and disgraced by their rulers, but still present in many of these countries despite everything, and despite everything relatively well informed, who are at work. Neither the French Revolution nor the October Revolution was instigated by the proletariat. The liberal impulse of 1848 was also the work of the bourgeoisie. The pan-Arab upheavals clearly lack those religious or nationalist elements that would be most likely to motivate the underclass. So, we interpret the events of 2011 as a shattering defeat not only for the ruling autocrats, but also for Al-Qaeda.

Or, put differently: in the pan-Arab movement may lie the seed of a shift to a better situation. The main reason that the upheavals have occurred now, and neither earlier or later, is the greatly increased cost of living, typified by the sharp rise in the price of bread. Those who manage their own little businesses more or less successfully, but still find they are going hungry are entitled to rage and despair. And there is no way that this rage can be overcome by temporary gifts, like those distributed by the Saudi royal house.

The sceptics argue that a credible move towards more democracy and the rule of law is difficult and will take a long time. And that the prevailing view of this world, that of Islam, militates against any such move. This is another view we do not share. Countries like Turkey prove that Moslems too are capable of democracy. The country with the second largest Moslem population in absolute terms, India, with around 160 million Moslems, also demonstrates this. But what does much more to reinforce our relatively optimistic perspective is the fact that, thanks to today's information and communication media, it has become a good deal more difficult to deceive the people. Unless you lock them up, or are in a position to threaten them systematically, as in Iran: autocracies are past their sell-by date.

We therefore assume that, after Syria, the wave will, sooner or later, roll over Saudi Arabia too. Inherent in this perspective is, of course, the maximum potential threat to the world as a whole and the global economy in particular. For, as the case of Libya and its long outdated leader, Gaddafi, shows, the reasonably peaceful replacement

of an autocratic regime is the more unlikely the more spoiled the regime has been by oil revenues, and the longer the ruling tribe is successful in retaining the loyalty of well-equipped soldiers.

The dilemma facing the developed world is palpable: on the one hand, it would be excellent to be rid of various rulers, and Gaddafi in particular. On the other hand, similar, if not indeed more problematic figures have been the pillars of the stability policy implemented so far. And this stability policy is apparently required to ensure the uninterrupted and decisively important flow of oil from this unattractive region. In the long term, it is not possible to bombard one autocrat (relatively unsuccessfully) and protect all the others. Such an inconsistent policy in one and the same region is not sustainable. If we are correct in the assumption that the Saudi royal house's hold on power cannot be everlasting, then there is a relatively rapid need for a doctrine that creates adequate clarity on the transition process. Intervention against Gaddafi by an alliance of the Western states, supported by NATO, simultaneously with non-intervention in Yemen; de-facto approval of Saudi Arabia and the Emirates' paramilitary action against demonstrators in Bahrain (where the US Fifth Fleet lies at anchor) and the West's foreseeable non-intervention in Syria: these all have their own specific reasons, but together they significantly increase the state of instability. Both sides, the autocratic regimes and the rebels, are offered expectations that will not be able to be completely fulfilled.

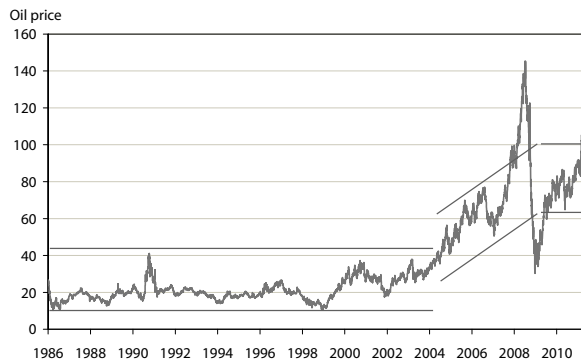
Any such doctrine, whether a conservative one in favour of the existing autocratic regimes or one that supported the new freedoms and the development of reasonable structures would, by comparison, have a positive effect to the extent that it would reduce the probability of further bloodshed. From today's perspective, it would be absurd to forecast the development of a pan-Arab doctrine. In no Western government are there currently figures who would be capable of such a great achievement of global policy. The conclusion must be that the restructuring of the Arab world will continue to be bloody and dangerous, characterised by set-backs, and will, in the worst case, work in favour of those forces that, like Al-Qaeda, have so far been at a disadvantage.

4. Oil: from exploitation to "normal" calculations?

If, despite all these reservations and anxieties, we hold to the basically positive scenario of a trend towards greater democracy and the rule of law in the Arab world, then in our view, this will involve a number of further considerations concerning the supply of the oil that is of such decisive impor-

tance for the global economy. The existing volume – that is, the oil wells and the dubious reserves (50 percent of the world’s oil and 29 percent of the annual production are concentrated in the Arab world) – have so far been, as mentioned above, managed by “rapacious” regimes. What do we mean by “rapacious” – at first glance a not entirely non-judgemental description? Not so much allocation to a moral category as a purely economic description. For if we analyse the calculations on which these autocratic regimes have based the management of “their” oil, it is noticeable that for a very long time – at least between 1980 and 2004 – both the supply and the price of oil have remained close to the available capacities and the marginal production costs. Since 2004 the rates have shifted tendentially, but not fundamentally, for reasons of demand (China).

Oil: too cheap



Note: The figure shows the development of the WTI spot price in US dollars.

Source: U.S. Energy Information Administration; Wegelin & Co. analysis

Put differently, the “business model” of autocratic oil producers assumes that raw materials still beneath the ground have no value. Everything that can be squeezed out of the earth, or bubbles up out of the desert sand without much assistance, flows into a current account that has on its cost side the expenses of production, refining and transport. Oil prices that are above this cost generate profits for the rulers’ pockets or for placatory presents for the populace. The lower the price of oil, the more must be produced to cover the current expenses. To avoid a “race to the bottom”, an out-and-out price war, the OPEC cartel was set up, and operated very successfully in the 1970s; since then it has lost its decisive impact on pricing. For one thing, oil has acquired competition, from, for example gas and nuclear power (sic!); for another, like any cartel, OPEC suffers from the characteristic, based on economic behaviour, that the incentives for an individual member to cheat the other members are enormously high.

Oil in the ground is valueless: what are the economic implications of this? Exactly what we described above as the main problem of the ecological issues: it means that oil, by its nature an easily delimitable, and thus private good is treated as if it were a public good. The desert no longer as a common on which camels can simply be driven hither and yon; but rather as an apparently inexhaustible source of chance wealth, which can be made use of unrestrainedly, depending on the immediate current requirements. As we pointed out above, public goods can be abused, exploited and wrecked. The oil-producing countries are exploiting what is wrongly regarded as a public good.

The often observed, unbalanced and generally very weak overall economic performance of commodity-rich countries is precisely the result of the inadequacy of the economic calculations on which production formulas are based. The value of oil reserves is not included in the calculations; the most important asset that these countries possess, apart from the production factor of labour, is simply disregarded. The result is a tendency to oil prices that are too low, production rates that are too high (and in our view are a key component of the inadequate development of these countries), and only very limited incentives to exchange the oil produced for more or less sensible alternative assets.

There are two reasons why we believe that the “rapacious” public-good model for oil production will soon be replaced by a formula that makes more economic sense – one that allocates adequate value to oil beneath the ground, and thus includes incentives to manage the reserves. Firstly, there is good reason to suppose that in the wake of the current upheavals the previously inevitable flow of cash towards favoured cliques will be interrupted. Unless everything goes terribly wrong (which, it must be admitted, is entirely possible), then more democratic conditions may bring with them more rational economic policies. More rational? Is wishful thinking taking the Investment Commentary off into some rose-tinted illusionary universe? Not necessarily. For the second reason almost inevitably involves a change of thinking in this direction. The collapse in the price of the US dollar against oil, and also against gold, always a popular reference medium in the region, is alarming. There’s no need for a degree in economics to feel frustrated by the dubious attractiveness of exchanging real, and in future probably ever more valuable (because in many instances difficult to substitute) oil for nominal dollars. Paper money, whose value decreases continually, on which there is little or no

interest to be had, and for which capital-destroying crises are organised at regular intervals in the financial system. When state debtors too, which so far at least have been rated as completely risk-free, start to wobble – would it not make more sense to leave one’s wealth in the ground?

A move by the oil-producing countries to a more sustainable production formula is overdue. Both political and economic conditions argue for such a paradigm shift. The obsolete autocratic regimes can no longer deviate from their exploitative model; their need for cash is too great. Matters are different with a change of power: what began at a lowly social level as a protest against the rise in the price of food (ultimately the result of the flood of dollars and the continuing devaluation of the US currency) would find its logical continuation in an economic policy based on intrinsic value.

The industrialised part of the world faces tough challenges. We have already mentioned the geo-strategic dimension of the need for a consistent doctrine. The West’s comfortable de-facto arrangements with unappetising regimes is coming to an end. Berlusconi will no longer be able to (or be obliged to?) kiss Gaddafi’s ring. Lucrative arms sales to the Arab world are likely to decrease. That is one aspect. But much more significant will be the West’s adjustment to sustainedly higher oil prices. Rising prices will hit the economy and society at a weak spot, and above all, at an inconvenient time. For external inflationary pressure is extremely unwelcome right now. Which brings us to the third cluster of our current multi-dimensional drama: the state debt crisis and the question of whether we are faced with an imminent burst of inflation.

5. Inflation: a matter of perception

Whether or not inflation threatens was a central topic of public discussion before the latest announcement by Ben Bernanke, the Governor of the Fed, that he would maintain a low-interest monetary policy for the foreseeable future. In our view, the issue can be reduced to two fundamental questions. On one side, there is the policy, practised for four years now, of making money available extremely cheaply, effectively for free, from the central banks. As we know, this was instituted against a background of the threatened collapse of the banking system. As the velocity of circulation was then approaching zero – hence the catchword “collapse” – the monetary authorities could reasonably argue that there was no likelihood that money – the relevant component for an equilibrium between money and goods – would

experience dangerous inflation. This generous monetary policy has since been continued with similar arguments, by pointing to what is for the US an atypically sluggish upturn after such a deep recession. Unemployment remains stuck at the high level of 9 percent. The real-estate sector may have stabilised, but there is certainly no sign of any recovery. Other indicators, however, look a good deal more positive: manufacturing, for instance, or – not unimportant from our perspective – the stock market. So are we threatened with inflation, or not?

So far, the official indicators have remained in relatively moderate zones, particularly as far as “core inflation” is concerned. The reason for this, and this is the other side of the story, is surely to be found in the practical impossibility of an inflationary spiral developing. Overall, for the last ten or twenty years, we have experienced deflationary pressure, resulting from globalisation and technological change. We have often mentioned the global “output gap”, an excess of capacity brought about by the rapid pace of efficiency improvement. This situation, based on the realities of the real economy, appeared to almost indefinitely expand the central banks’ room for manoeuvre in supplying the financial system with dirt-cheap money at no consequence.

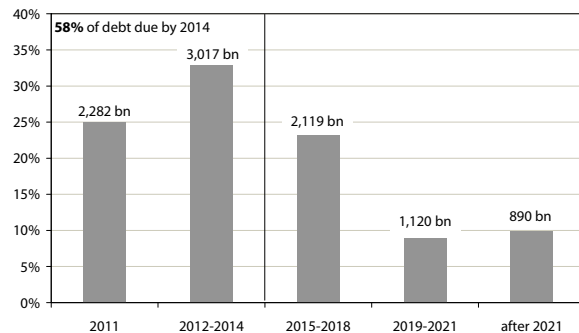
Reality has now overtaken this form of monetary policy, which corresponds to the well-known and highly improbable “free lunch”, from a different side. Firstly, the relevant monetary area for the US dollar is not simply the territory of the USA, but half the world, and in particular the emerging markets, whose national currencies are mostly tied to the dollar. In the emerging markets, there is inflationary pressure. Secondly, the official core rate of inflation may be low, but when it comes to the inflation perceived by ordinary US citizens, things look very different. Their cost of living has risen sharply, above all as a result of the rising price of petrol and heating oil, and the fact that they cannot pass their problem on in the form of demands for higher wages is cold comfort indeed. Put differently, at individual level, it has begun to smell like stagflation. On account of the many important imported goods needed on a daily basis, the policy of low interest rates and a weak currency is having a fairly direct and far from insignificant impact on individual households.

Hard times, not without domestic political impact, for the individual citizen; hard times at macro-level too. The downgrading by Standard & Poor’s of the outlook for the USA’s debt rating – for the first time in 70 years, by the way – was long overdue, given that indicators like budget deficit or

the ratio of total debt to GDP (9 and 97 percent) are not significantly better than those for Greece. What is less well known to the general public, but in our view is a more serious threat than a change in rating, is the US Treasury's refinancing situation. No doubt on account of the comfortably low short-term interest rates, the US Treasury's liabilities have been massively shortened; the majority of US debt on the market will fall due within the next three years.

The decisive next three years

Term structure of US debt (in % of total debt)



Note: Debt as at 31 March 2011

Source: U.S. Treasury, Monthly Statement of the Public Debt; Wegelin & Co. analysis.

This has two consequences: firstly, creditors will have to be found in the coming months and years for enormous sums. And this precisely at a time when the Fed would like to discontinue “quantitative easing”. So far, the Fed has taken up a significant part of the Treasury auctions ... Whether, or on what terms the capital market will provide this service is now not merely a quantitative problem, but threatens to become a qualitative one as well, should there be concerns about the creditworthiness of the debtor, and somehow just a bit of anxiety about inflation. Secondly, we need to be aware of the US budget's serious vulnerability to interest rate risk. The abandonment of long-term refinancing comes at the potential price of considerably higher interest rates in the future. That too sounds like hard times for domestic politics.

We are not among the Cassandras of inflation. But what we do expect is some normalisation of interest rate levels, adequate risk premiums, in particular for state debtors, including the USA, and a paradigm shift with regard to the USA's hitherto cherished self-image as a country with an omnipotent, unconstrainedly available capital market. Here too, there are signs of an end to exploitation. It will be interesting to see how Americans cope with the novel experience of rigidities in their capital market.

6. Stocks: no alternative – or something more?

It only remains, at the conclusion of this Investment Commentary, to include our advocacy of broadly diversified stock investments, as we have done regularly for a year now. It is admittedly difficult at present to make this recommendation without reservations. For each one of the three clusters discussed above has the potential for a crash of the century. What if the supply of oil to a large part of the world failed, and what if this affected the emerging-market countries in Asia in particular, on whose prosperity and demand our exporters are so dependent? What if as a result of the decommissioning of nuclear power stations, there were interruptions to the electricity supply and Russia blackmailed us over gas supplies? What if the state-debt show-down affected not just Greece, Ireland and Portugal, but quite other, bigger countries? There are thousands of reasons not to be able to sleep at night from sheer anxiety, and there are just as many reasons to give stock investments a miss.

But there are also, in our view, at least four important reasons to invest in stocks nevertheless, if one has sufficient appetite for risk. Firstly, there is the question of alternatives. Would it be better to concentrate on cash – that proud saviour during the financial crisis? But is that really such a good idea, with inflation raising its ugly head here and there, and when the yield on short-term money in most currencies is absolutely zero? And if cash after all, then in what currency? In the highly valued Swiss franc or in the structurally weakened euro or in the systematically depreciating dollar? Focusing on bonds? Tricky when a normalisation of interest rates looks likely and debtors are being put through the mill. Gold? By all means, as protection against inflation, in reasonable quantities, but also in the knowledge that the precious metal has been dearly bought. Commodities? Perhaps. But which? And specifically, with which instruments? Real estate? Is expensive, generates ever decreasing returns and is sensitive to interest rates. Whatever – none of the alternatives to stock investments really offers the prospect of a better night's sleep. So the argument doesn't really hold water.

Secondly, we think that of the entities to which one might, as a creditor or an investor, entrust money or capital, businesses belong among those that are most likely to survive in the face of all the clusters, and may even be able to derive advantages from some potential developments. Businesses are organisms capable of taking strategic action: in the era of globalisation they can change focus quickly. They have been toughened by the

frequent crises in recent years. Businesses want to make money. Concentrating on this one single, indisputable goal makes them less susceptible to ideologically inspired errors. This cannot be said of other social organisms.

Third reason: we have a bad decade for stocks behind us. The table below shows how infrequently such bad decades occur on the stock exchanges. Only the 1930s are comparable with the first ten years of this century.

Probability of another negative decade?

	Performance	Dividend	Total return
1930s	-42%	13%	-29%
1940s	35%	108%	143%
1950s	257%	211%	467%
1960s	54%	56%	110%
1970s	17%	58%	75%
1980s	227%	162%	389%
1990s	316%	107%	423%
2000s	-24%	15%	-9%

Note: Figures based on the S&P 500 Index. Total return includes reinvested dividends.

Source: Bloomberg; Wegelin & Co. analysis

Now, even if this will earn us a clip round the ear from the statisticians, we think that the probability of a repeat of the debacle we have experienced in recent years is low. Risk-bearing investments – and stocks are certainly that – must generate a

positive, above-average return over the long term. It is some consolation that the stock markets will once again provide evidence of the correctness of this law of economics.

Fourth and last: it will not have escaped attentive readers of this Investment Commentary that the three clusters we have described share a common factor: a contempt for real resources. Whether we carelessly pollute our environment, or whether we extract oil from the ground at horrendous prices in order to burn it (and thus again damage the environment), or whether we trust a system that continually makes promises that are ever less capable of fulfilment – this is all exploitation. The past 20 years on the financial markets, since the shift in interest rates in 1991, have been the preserve of increasingly illusory promises, of nominal values. The exploitation of the creditworthiness of state debtors, the central banks and the financial system in general is drawing to an end. A return to intrinsic value is inevitable.

KH, 2.5.2011