John Mauldin – The Matterhorn interview Dec – Jan

written by Edward Maas | December 30, 2011
We are extremely pleased to feature John Mauldin in this month's Matterhorn interview.
The author and journalist Lars Schall covers a number of interesting topics with John ranging from how to solve the European problem, the fate of the Euro, gold and the gold standard as well as giving the world an extra injection of Jack Daniels.
We are pleased to publish, at the close of 2011, John's more balanced and slightly more optimistic view of the world, compared to my own somewhat graver concerns.

May I wish all our readers Peaceful and Healthy 2012

Egon von Greyerz

"LET THEM DEFAULT"

THE MATTERHORN INTERVIEW – December 2011 – January 2012

By Lars Schall

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Investment advisor **John Mauldin** explains his attitude towards austerity measures; a return of the gold standard; the euro crisis; and the willingness to bailout everyone that makes capitalism and monetary systems stop working.

John Mauldin, president of the investment advisory firm Millennium Wave Advisors, is a renowned financial expert, a multiple New York Times best-selling author, and a pioneering online *commentator (see http://www.johnmauldin.com/). His weekly e-newsletter, Thoughts from the Frontline, is the most widely distributed investment newsletter in the world. He also edits the free weekly e-letters Outside the Box and The Mauldin Circle (Mauldin Economics)*

Mr. Mauldin, who is a passionate traveler with business partners all over the world, has been published in virtually all financial media and he is a frequent contributor to The Financial Times and The Daily Reckoning, as well as a regular guest on CNBC and Bloomberg TV. His latest book *is "Endgame: The End of the Debt Supercycle and How it Changes Everything." He regularly* speaks to conferences and private groups including The Money Show, The Annual Strategic Investment Conference, The Agora Wealth Symposium, and other investment related venues. John Mauldin currently lives in Dallas, Texas, U.S.A.

Mr. Mauldin, one interesting fact about you is that you're the inventor of the phrase, "Muddle Through Economy." Is what we experience in the Western hemisphere a "Muddle Through Economy" on steroids?

John Mauldin: That's a very good question. When I think about "muddle through," I think about an economy that's growing in the, say, two percent range in the U.S. and one percent in Europe, that's below trend. Both the U.S. and Europe are certainly in a muddle through mode, it looks to me like Europe is getting ready to go into a recession. Depending on how bad your banking crisis is and how that fades into our system, it could be a recession year. Now, eventually we will get through it, all recessions pass, but I think the West in general is in for a muddle through, slow growth, sideways economy for most of the rest of this decade as we dig through the debt supercycle – we borrowed too much money on the country level, at a local level and at a personal level. De-leveraging cycles do not prevent growth per se. Nevertheless, leveraging is a wonderful thing on the way up, but it is a problem on the way down.

In your book, "Endgame: The End Of The Debt Supercycle And How It Changes Everything," you are making the case that we are reaching all over the world the limits of borrowing money by governments. If true, what consequences will that have?

John Mauldin: The consequences means that governments either have to cut back or they have in extreme cases to default on their debts. Greece is not going to pay 100 percent of its debt back; everybody knows that. It is not going to be too long before Italy will find itself in a position where they can't literally afford to be able to pay 100 percent of its debt back, they will have to discount their debt in some way. There are possibilities how you can do that without actual technical defaults, but the whole process will have negative impacts on economies. When you start going into austerity, to use that word that you can read about everywhere, it will affect the growth of your economy. One problem is, for many economies it is not a one-time austerity deal and then the affect goes away after about a year. It's like: we have to cut this year, then we will have to cut some more next year, and then we will have to cut some more the year after that, and then we will have to cut some more the year after that – so you put yourself in a permanent spiral of getting down to some place where you have balanced your budget.

This is done by cutting spending or raising taxes, depending on your ability to raise taxes. In the U.S. we have some room to raise taxes, I don't think it's a good idea, but we have some room to do so if we decided to. If you're France, you don't have much more room to raise taxes. So sometimes you will find yourself in a place where you really have to do cuts, and those cuts are difficult. When the biggest part of your economy is in transfer payments in forms of pensions, Social Security, Health Care or other government services and you have to cut them down, that's painful. It comes as much as a political problem as it comes as anything else. It definitely impacts the growth ability of the economy. The transition period is very tough, and politicians like to back off from the inevitable as long as they can, but eventually the inevitable comes, eventually you will reach the end of the road.

Related to debt: is the bond market of the last decades a dying dinosaur?

John Mauldin: No, a dinosaur would imply that the bond markets are going to go away. There always will be bond markets. Governments have been defaulting for hundred and hundreds of years, yet there are still bond markets. It's not a dinosaur, it is not going to get extinct. But people have again to come to realize that governments can in fact default and that there is a moral hazard to buying a sovereign bond. Let us look at what a sovereign bond investor really is. This is not a speculator, this is someone who wants to invest his money and get a guarantee of small amount of return back. He doesn't want to take risk. And when the bond investors realize that there is risk involved in investing in sovereign bonds, they want higher interest rates and they want to make sure that they will get their capital back.

That's why certain countries have to pay more. We have already seen that Italy had to go to 6 percent, and if it wasn't for the European Central Bank (ECB) stepping in, I think the interest rates would be 9 to 10 percent – and Italy makes a big difference: it's the third biggest bond market in the world. So if Italian rates go through the roof, then Italian debt becomes suspect, the losses are huge, and in fact too big for the private market to absorb, and then there would be a very disorderly crisis. To keep them going off that cliff, the ECB has to figure out how to give money to the Italian banks so that they can buy Italian sovereign debt if the ECB is not willing to do it directly itself. That is an interesting problem.

But can one solve the current debt crisis with more debt?

John Mauldin: No. It's like I'm drunk and my solution is to get another bottle of Jack Daniels. The problem is that there is already too much debt. Though in the short term supporting debt can help as a bridge loan to have positive cash flow. In Italy’s case such bridge loans might help to get there. So another little drink of Jack Daniels could help, if you will.

Quite a lot of people like to forget about the exotic derivatives that were a major factor in causing the global financial crisis as if this problem did not exist anymore. Do you think that the roughly $ 1 quadrillion in various worthless derivatives alone could be enough to bring the global financial system to its knees?

John Mauldin: Well, you got to be really careful what you mean when you say “derivatives“

Yes.

John Mauldin: There are derivatives of this sort, and there are derivatives of that sort. An option for IBM is a derivative, something in the futures market is a derivative, and I don’t think that those types of derivatives will bring the system down. They can go exponential, and while it may not be a useful financial exercise they are not bringing the system under threat. That is a completely different thing than to say that a derivative as a Credit Default Swap is not a problem. This market could in fact bring the system down, and it could bring it down in a very ugly, disorderly manner, that’s true.

How would a healthier monetary system look if the choice was yours? And do you think that governments have enough sense to introduce such a system?

John Mauldin: Well, the monetary system that we got would be just fine, when you don’t have the leverage, the credit and the deficits that we have. We have to come back to the natural check in a capitalistic system, and that is bankruptcy and default. You should just let them do it. When you are stupid enough to put your money in a currency and debt where the government does stupid things, debases its currency and hurts the value and the buying power of that currency, you should lose your money. This teaches you to be more careful where you put it the next time. That is the tool that makes capitalism work. When you don’t allow defaults and losses, when you try to bailout everybody, that’s when capitalism and monetary systems stop working.

As you know an increasing number of people are stating that we should go back to the gold standard. What is your attitude towards that question?

John Mauldin: I have two attitudes. Number one: it’s a non-starter, it will never happen. We can talk about it all we want, it is just a nice theory. For all practical purposes, Greece is now under a gold standard, which is called the euro, and they are in a place where they can’t get out of their position, they can’t work out of it, they can’t print their own currency and devalue, their labor is overvalued, etc. That’s quite similar to the classical gold standard. If you want to go on a gold standard, fine –but you have to recognize the limitations that you will have. The main problem that you face with being on a gold standard or being not on a gold standard is the willingness of super-bankers and politicians to get rid of the limitations and debase their currency. And I think most people when they say: I want to be on a gold standard – what they are really saying is: I don't trust central bankers and I want to have some neutral currency. I totally agree with that. I mean, I buy gold every month and take it in physical delivery. I hope I will never need it, though for me it's an insurance, I don't see it as an investment – I buy it because I don't trust the banksters.

Yes.

John Mauldin: I am an optimist, I hope it all will work out well, but just in case I buy it, like I buy fire insurance and health insurance – I hope I don't need either. Nevertheless, there are mechanisms of the growth of the money supply where you don't have a debasement issue of your currency. It's when you start to have Quantative Easings, when you start to mess with the system, then you're running into problems. The Swiss haven't had a problem, they don't need a gold standard – they are the standard. The problems are rather Central Banks and Governments who want to fix something, because everytime the governments want to fix things, they create more problems to fix. It's the fixing of the problem that creates the problem, if you will.

Do you believe the euro, that you have once called an experiment rather than a currency, is a thing to last?

John Mauldin: If the question is about the euro as it is today, the answer is certainly no. There is going to have to be some serious adjustments. An adjustment could be a fiscal union, if the voters in the various European countries vote to submit themselves to a central authority – or in other words:

if the German government get its will and create a father figure in Brussels, who tells the others how to run their budgets correctly and otherwise they got to do their homework.

But let's assume you were a European citizen: would you like to have such a father figure that rules over a core element of the sovereinity of your country?

John Mauldin: Well, what the Germans are asking for is a balanced budget or you can only run a 0.5 to 1 percent structural deficit, and that's a really good idea. This is what Keynes in his original work has said, not what is said about him today. Keynes' original concept was that in the good times you pay down the debt, and in the bad times you can borrow money – but you pay it back when things get better.

Yes.

John Mauldin: So you don't run up a never ending debts and built up a supercycle of debt. In the U.S. in the late 1990's we had actually reduced our total debt, and if we would have kept on that path, if the Bush government and the Republicans – I say this as a Republican – wouldn’t have run ever increasing deficits, we would have entered the credit crisis in 2008 with very little debt. So I think it is a good thing when the Germans are saying in essence that they want a limit on the ability of governments to run deficits, a limit on the ability of governments to spend money in order to prevent the creation of financial crises. This is reasonable. But they have to do it themselves, too.

Yes, of course, that’s quite ironic right now.

John Mauldin: Yes, nevertheless, in theory it’s a good thing. Will they do it? No. That is one of the reasons, if I am buying gold as an investment, I am not buying gold in dollar terms, I am buying gold in shorting the euro, I don’t buy gold in euro or yen terms, because I think they are in a worst shape than the dollar. Given the make-up of all the major currencies around, the U.S. dollar is the prettiest girl in a ugly girl contest.

With what kind of emotions do you look at the housing bubble in China? Do you think the Chinese economy will receive a very rude awakening?

John Mauldin: Eventually yes. They haven’t learned to repeal the business cycle, but it can go on for a lot longer than anyone of us can imagine. If you have a close capital system, which they do, the bank lending that we observe there can go on for quite some time. Now do they try to bring their housing bubble down? Yes. Will they be able to bring it down to a level where it can’t lead into a crisis? They may. Do they in principal have more people that want housing than they have adequate housing? Yes. The question becomes: adequate housing at what price? So they may have to go through a pricing adjustment mechanism. But that will be really a short term problem. Do I expect China to have a bigger economy that’s more successful and more intimidating in ten years than it is today? **Absolutely**. But to think that they can go through without some type of serious slowdown or recession for ever and ever, that is just not a reasonable thing. You can’t grow to the sky. Eventually you have to begin to settle the debts out and figure out how you get into the balance.

What advice would you like to give our readers in order to survive the hard times we’re going to have?

John Mauldin: I think that the readers should recognize that the hard times will be over the sooner or later in the next five to ten years, it’s hard to say, because politicians can try to kick the can down the road a lot longer than we can imagine – but we’ll get through it. Your goal now as investors should be to try to go through with as much capital and as much buying power to the other side as you possibly can. Because when we get to the other side, when the dust settles, I believe there will be a tremendous boom in the world. That boom will be probably more in the emerging markets, but there will be tons of new technologies, there will be tons of new things within Europe and within the U.S.A., that you will be able to invest in. To give you an example: we used to think of Japan as a problem, but there is a market over the last few years within Japan that's been up 50 percent, and it's their robotic stocks. If you would have just invested in robotic stocks a couple of years ago when they were at the bottom, you would have done just fine. Why? Because robotics is a booming industry, and it becomes more and more profitable. So there are places where we will going to find to invest money, and I want to be as cautious as I can during this inter-period, I want fixed income, I want hard assets, I want things that going to pay me money and that are going to get me to the other side, but I think there will be a big booming bull market coming, and we want to get as much capital as we can, we want to save as much as we can in order to get to that opportunity when it does come.

Do you think it is "too late to jump on the gold wagon" and invest in gold if one sees it as an investment? (1)

John Mauldin: If one sees gold as an investment, probably not, and certainly not when you are living in Europe, when you're in the euro zone – no. But what you have to watch closely is: If you think that Greece, Portugal and Italy will leave the euro, then the euro will become a lot stronger and you should sell your gold in terms of euros. If you see Germany leaving, then the euro could be a real screaming sell in terms of gold, and so your gold would become quite valuable in terms of euros. So it depends what you believe will happen in the case of a break-up, if the strong countries are leaving or the weak countries are leaving, I don't think it's clear yet. My guess is that the weak countries would be the ones that leave, so in the long term, two years from now, three years from now, the euro will be stronger, but in the meantime it will go down against the dollar.

Thank you very much for taking your time, Mr. Mauldin!

SOURCE:

(1) Compare Egon von Greyerz: "TOO LATE TO JUMP ON THE GOLDWAGON?", published at GoldSwitzerland on August 15th, 2011