



Sailors on a becalmed sea

The fossil record implies trial and error, an inability to anticipate the future, features inconsistent with an efficient Great Designer...

Carl Sagan, Cosmos¹

Nature has no central banker... if it did we would not have the slow, sometimes cruel path of evolution. It would be one of design. A merciful God would be given to divine intervention, unable to help him/herself as they watched a comet plough into earth destroying all the species he had so carefully nurtured for millennia.

Instead, in their wisdom, they decided to let the vicissitudes of nature control the source of events and not to interfere.

Whether you believe in evolution, God or whether he/she interferes or not, it is a helpful analogy for our purpose here.

Central bankers, omnipotent in financial markets, did not leave the markets be and let prices fluctuate in response to events and thus determine optimum allocation of capital. Instead, they had to "save" the market from itself, in 1987, then 1994 then 1997, 1998, 2000, 2001 and 2008. Each time the implicit underpinning getting bigger and bigger, each time the edifice it supported getting more and more fragile.

A deception arises, sometimes innocently but collaboratively, sometimes with cynical premeditation. Usually the victim is caught up in a powerful emotion - wonder, fear, greed, grief. Credulous acceptance of baloney can cost you money; that's what P.T. Barnum meant when he said, "There's a sucker born every minute". But it can be much more dangerous than that, and when governments and societies lose the capacity for critical thinking, the results can be catastrophic, however sympathetic we may be to those who have bought the baloney.

Carl Sagan, The Demon-Haunted World: Science as a Candle in the Dark²

The deception is simple – money is wealth.

As central banks control the supply of money, like the Overlord in Mad Max, they can open the spigot at any time and slake the masses' thirst or not...

Since money printing is essentially free and humans have a built in desire to co-operate and reciprocate, it is no wonder that central bankers turn on the spigots to avert any serious pain which economies stumble across.

And when the size of the delusion gets so great that pricking the bubble would be potentially as ruinous as perpetuating it, the stage is set for an exponential journey in inflation culminating in hyperinflation. Then the politicians have to find a scapegoat, internally or externally.

As the Governor of the Reserve Bank of Zimbabwe commented on 30th April 2008:

*"As Monetary Authorities we have been humbled and have taken heart in the realization that some leading Central Banks, including those of the USA and the UK, are now not just talking of, but also actually implementing flexible and pragmatic central bank support programs where these are deemed necessary in the National interests."*³

¹ Sagan, Carl. (1980) Cosmos, New York, NY: Random House; p. 20

² Sagan, Carl. (1995) The Demon-Haunted World: Science as a Candle in the Dark, New York, NY: Random House

³ Dr G Gono. First Quarter Monetary Policy Statement: A Focus on Food, Foreign Exchange Generation, Producer Viability and Increased Supply of Basic Commodities (30 April 2008) accessed at <http://www.rbz.co.zw/assets/aprilmps2008.pdf>

As a long volatility fund we have been experiencing a secular decline in volatility; short term volatility is at near multi-decade lows. It is all part of a cycle (just an annoyingly long cycle, ossified by central bank intervention).

Sailors on a becalmed sea, we sense the stirring of a breeze.

Carl Sagan, Pale Blue Dot: A Vision of the Human Future in Space⁴

The size of the global credit bubble has grown to cancer-like proportions and as such requires a delusion as big – hence the application of central bank support to ensure short term stability has had the desired effect... but for how long?

Investors are actively spurning protection of any sort – just the sort of complacency that we should expect at this juncture in a financial market cycle.

If you want to save your child from polio, you can pray or you can inoculate. ... Choose science.

Carl Sagan, The Demon-Haunted World: Science as a Candle in the Dark⁵

There is no need to pray OR inoculate they say, it cannot happen.

And maybe they are right. Notionally central banks can print any amount of money and make any market look like a permanent bull market with reference to money – but the proceeds might not buy a can of beans!

...intellectual capacity is no guarantee against being dead wrong.

Carl Sagan, Cosmos⁶

Either way, the road to the redemption of the financial system will be volatile.

If interest rates rise with the coming inflation, asset prices will fall precipitously, if interest rates are kept artificially low, asset prices will rise precipitously.

Finding the occasional straw of truth awash in a great ocean of confusion and bamboozle requires intelligence, vigilance, dedication, and courage. But if we don't practice these tough habits of thought, we cannot hope to solve the truly serious problems that face us --- and we risk becoming a nation of suckers, up for grabs by the next charlatan who comes along.

Carl Sagan⁷

In summary, volatility is historically cheap in a macro environment that is getting increasingly fragile.

There is no evidence of future volatility on the horizon which is EXACTLY why volatility is inexpensive.

But:

Absence of evidence is not the evidence of absence.

Traditional aphorism

If our 30 year history of witnessing volatility cycles is any guide, the evidence is just over the horizon.

⁴ Sagan, Carl. (1994) Pale Blue Dot, A Vision of the Human Future in Space, New York, NY: Random House; p. 377

⁵ Sagan, Carl. (1995) The Demon-Haunted World: Science as a Candle in the Dark, New York, NY: Random House; p. 30

⁶ Sagan, Carl. (1980) Cosmos, New York, NY: Random House; p. 14

⁷ Sagan, Carl. (1995) The Demon-Haunted World: Science as a Candle in the Dark, New York, NY: Random House; p. 305

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