



Saturday with Jim: Interview Transcript-John Maynard Keynes

John Maynard Keynes, 1883-1946, was "the most brilliant mind I have encountered" according to philosopher Bertrand Russell. Had Keynes' ideas been adopted, the world could have been spared the devastation of the 1930's depression. Let's interview Keynes to understand a bit of what we now face and how we might profitably navigate in the period ahead. Recall that Keynes was not only an economist; he was an active money manager, turning from speculator in 1932 (after losing about 80% of his capital) to value investor.

Gaia: Lord Keynes, welcome.

JMK: Thank you. I am deeply honored to offer my opinions to your clients.

Gaia: What are the comparisons of the current financial crisis with that of the 30's?

JMK: The causes of the two were remarkably similar, but the subsequent paths taken by events and policy makers were vastly different, as was the system of laws, regulations and social safety nets. Arguably, the depression of the 1930's evolved from a garden variety recession because of the inexperience of policy makers with the tools of modern finance. Many policy makers were clinging to the gold standard (gold fixes the amount of currency issuable) and they knew little about what has since become the science of macroeconomics - understanding relationships between supply, demand, employment, productivity, money supply and interest rates. They also, in tariff after tariff, failed to understand that restrictions to the flow of trade among nations depresses economic growth by stifling competition, inventiveness and demand - leading to an overall reduction in economy. Seemingly rational acts by one party are irrational and harmful to the whole. The depression eventually ended; the financial crisis of the 2000's is still playing out.

Gaia: How would you grade policy makers' actions so far?

JMK: Emergency measures seemed to have stemmed the deflationary forces (the abrupt cessation of commerce based on uncertainty and credit constriction). So far so good. Government must spend money it does not have to cushion the blow brought on by the collapse of credit following a long period of unsustainable expansion. Drawing on the experience of the 1930's, policy makers this time are likely to maintain stimulative policies longer than they are absolutely needed, which may result in mild inflation. But that's down the road. We are not out of deflation yet. Foreclosures are still rising, unemployment is still growing (in the U.S., anyway) and state/local government finances are bleeding red ink.

Gaia: How does an investor prosper in the current and future environment?

JMK: First and foremost - don't lose money. This does not mean that your investments can't go up and down in market price. Rather, it means that one needs to select solid investments which will not collapse under crisis, via bankruptcy, cessation of dividends or by being forced to adopt dilutive practices like raising more capital at disadvantageous prices. Losing money is the permanent loss of capital by investing foolishly, by getting on the investment bandwagon late in a move and refusing to believe it has ended. Income from dividends and interest should be prized, as the range of economic outcomes is so wide as to make price appreciation (growth) alone highly unpredictable. But this does

not mean that there not identifiable trends which can cause one to prosper.

Gaia: Such as?

JMK: The world economies are divided roughly into three: the relatively sick developed economies of the U.S, the U.K. and Europe, developing nations like China, India and Brazil and poor nations like Zimbabwe, Bangladesh and Haiti. Developing nations entered the crisis in good fiscal shape and thus far have shown remarkable resilience to the deflationary effects of brought on by the credit collapse. It is in that "middle group" where large profits can be made, albeit with much uncertainty and potential volatility. But ample opportunity exists in developed countries, too - as income producing securities are still well off of their highs and their incomes have not been crushed. Examples include pipeline companies, utilities and telecommunications.

Gaia: What are the risks?

JMK: The primary risk is that governments will make serious policy blunders. In bloating the money supply to beget a large amount of inflation, in permitting fraud and waste on a colossal scale, in withdrawing stimulus and loose monetary policy too soon and to hamstringing business with onerous regulations appear to be candidates for error. An investor needs to be nimble in the upcoming period.

Gaia: What surprises may be in store for us?

JMK: I think that many will be surprised at just how well policy makers are helping to reinforce the financial system so that it may be self sustaining. Many people are still very shell shocked by the events of 2008 and 2009 and have grown skeptical that a positive outcome may emerge. After all, fiscal and monetary authorities have poured gasoline on the tinder of consumer and investor demand in order to rekindle the fire in the animal spirits, those parts of us which take risks. So far, the policies have succeeded in the investment arena while the real economy lags behind. The moment of truth will come when the stimulative policies are withdrawn and attention paid to reducing the debt on the public balance sheets.

Gaia: Who will have to sacrifice?

JMK: In the developed nations, the rich will be soaked and those expecting rich entitlements may have to settle for a slimmer menu. The gap between rich and poor has grown in recent years and will be brought back into a bit flatter dispersion. Social class harmony may be sacrificed in the process. This said, a further crisis could well unite all classes, much as World War II and the depression brought a greater sense of community and purpose to the populace - albeit at huge costs.

Gaia: Do you see only darkness ahead then?

JMK: Not at all. Dark and light are relative. The past 30 years have certainly been filled with light for many while being dark or twilight for many more. The future will probably change the dispersion of "light" among peoples - social classes and nations. Investors who realize this large trend will prosper better than those who don't.

Gaia: What is the most dangerous thing an investor can do?

JMK: Invest outside of his or her area of competence and tolerance for risk. Take the grandmothers who were swept up by the tech and real estate booms. They probably entered late and stayed long enough

to see their investments halved or worse. Thus, they face not only relative poverty due to falling investment values (they "lost" by selling in panic near the bottom, not to return in a long time) but their attitudes have become sour and depressed. Investing is like using fire in that it's a helpful force in the hands of those who appreciate its dangers and quite dangerous to those who don't.

Gaia: If you were alive and writing today, what would you be saying?

JMK: My general theory was only a start. I would be looking at the intersection of economics, politics, investing and human behavior in an attempt to craft a new economic theory on which policy makers can build sound practices. Economics failed miserably to predict the financial collapse as few economists and policy makers clearly understood the forces that underlay the huge credit expansion that eventually brought down the system. There will surely be future crises as there have been past ones, brought about by much the same cause - untimely and mass speculation. Let us hope that humans in general are better prepared by virtue of education and experience to cope.

Gaia: Is there one book you would recommend we read to help us gain perspective?

JMK: Yes. Lords of Light by Liaquat Ahamed. This exquisitely written book provides valuable insight into human behavior, policy making and world currents which led to the disruptive period between 1919 and 1941 - a remarkable period in human history which essentially formed your modern world.

Gaia: Thank you, Lord Keynes. Your appearance has surely been an inspiration to many of us who survived the panic by not losing our heads and by reacting with alacrity when events called for quick decision. This being said, we would not wish that kind of band-aid approach on us in the future nor we would we wish it for our progeny.

JMK: You are welcome. Perhaps we can chat more in the future.

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11/21/09

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