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Seth Daniels on Austrian Economics, Central Bank Disasters and the Coming Housing Bottom

With Anthony Wile - January 05, 2014

Seth Daniels

The Daily Bell is pleased to present this exclusive interview with Seth Daniels

*Seth Daniels is a Managing Partner at **JKD Capital, LLC** in Boston, which is providing analysis and research on the Canadian market for Spartan's Libertas Real Asset Opportunities, a fund allowing Canadian investors to hedge against a housing slump. Daniels subscribes to the Austrian business cycle theory and believes a decline in the availability of credit is likely to lead to a housing correction and recession in Canada. Previously, Daniels was a research analyst at Clough Capital Partners, LP in Boston. Daniels held a position as adjunct professor at Reykjavik University's M.S. in Investment Management program and has guest lectured at Boston University on equity analysis.*

Daily Bell: It's refreshing to speak to a fellow Austrian in the investing field. Tell us a bit about your educational and vocational background.

Seth Daniels: I started in the investment industry in 2000 working for a legendary growth investor in Boston. He has been in the business since the '60s, lived through the Great Depression and wrote his Master's thesis at Wharton on the disastrous history of fiat currencies. He would frequently rant about the money supply; to be honest, I didn't fully appreciate what he was talking about at the time but it certainly planted seeds in my mind.

I then went to work for an independent research firm that has been extremely successful over many years in identifying frauds and business model failures. However they are best known for successfully predicting Enron's collapse.

One of the portfolio managers from my first firm started his own fund, and I joined him there in 2004. In 2006 I became increasingly concerned regarding the credit and housing markets in the United States. In January of 2007 I went to work for a macro-thematic hedge fund in Boston. I spent five years there and then left to start my own investment management company. I majored in Economics as an undergrad and earned an M.S. in Investment Management.

Daily Bell: How did you come to discover the Austrian school of economic thought?

Seth Daniels: While I'd stumbled across the Austrian school via the Internet in college, I later returned to it more seriously when I was struggling to make sense of the investment world in 2000 and 2001. An analyst friend who sat next to me at my first firm had covered the gold mining industry in the past. I asked him questions incessantly, and he told me that my inquiries reminded him of the gold-bug Austrian school and referred me to Mises.org.

I re-visited the Austrian school, and came across essays by Tony Deden of Sage Capital, Sean Corrigan and many other luminaries that blew my mind. I honestly had no expectation that Austrian economics would have any practical impact on my investing; it was merely a hobby. I spent a great deal of time from 2001 on reading the Austrian primary works as well as economic history.

Daily Bell: Briefly describe your interpretation of Austrian business cycle theory (ABCT) and how you use it to identify and predict market trends and investment opportunities.

Seth Daniels: Austrian theory in general – not just the business cycle theory – informs all of my investment decisions: scarcity and choice, uncertainty, subjective value theory, the nature of wealth, the nature of money, entrepreneurship, the impact of government interventions into the free market and so on. However, economic theory by itself – even a framework as powerful as Austrian theory – does not by itself translate into investment returns, as Murray Rothbard and many other Austrians (both academics and professionals) have noted.

While I fervently believe that understanding ABCT—and indeed the entire corpus of Austrian theory – is a worthy educational pursuit in and of itself, I don't think that understanding Austrian business cycle theory is an important prerequisite for successful investing the vast majority of the time. The philosophy and principles laid out by Ben Graham in *The Intelligent Investor* and *Security Analysis* are likely sufficient.

I think that we are living through one of those rare periods where knowledge of Austrian theory is absolutely essential to successfully navigate the treacherous macro investment landscape. The period ushered in by Bretton Woods II – after Nixon defaulted by closing the gold window in 1971 – represent an unprecedented global experiment in a floating fiat monetary regime. This is the first time in recorded history that every currency in the world is unbacked by a commodity, as compared with thousands of years of cross-cultural experience with gold as money. The Bretton Woods II system nearly collapsed in 2008 and it has required truly unbelievable interventions to sustain it on life support since then.

Earlier on in my career, I was primarily a student of Graham and Dodd's investment philosophy, which purposefully excludes macro analysis. Relegating my macro analysis to the level of a side hobby led to several costly mistakes in 2003, and from 2006 on I became increasingly convinced that the macro environment overwhelmed much of my "micro" fundamental analysis. Brilliant value-oriented fundamental investors such as Seth Klarman, the author of the famous value investing book *Margin of Safety*, have come to similar conclusions.

In the current environment – one in which central bank actions determine the fate of the markets and economies to an unprecedented extent – it is foolhardy to ignore the macro even if the securities you buy appear to have a substantial "margin of safety." The scale of credit inflation and malinvestments around the world also make it extremely difficult if not impossible to determine true supply and demand, valuation, margin of safety, etc.

I use Austrian business cycle theory primarily on the short side nowadays. The best macro shorts are those in which both supply and demand are working against the company or industry. This frequently – but not always – coincides with the peak of a credit cycle, when artificial credit inflation has led to unsustainable oversupply in certain areas versus true market demand (malinvestments), and nearly all of the maximum potential demand from marginal buyers has already been artificially satisfied due to the availability of easy credit. A decline in credit availability then reveals the malinvestments that occurred during the boom, as described by Austrian business cycle theory.

Daily Bell: Give us a couple of historical examples where your Austrian analysis led to profitable investment decisions.

Seth Daniels: The 2008 crisis was my most profitable investment based on Austrian business cycle theory. Many investors came to the same conclusions without Austrian theory. However, I think that Austrian theory provides the most comprehensive and accurate explanation for what transpired in 2008. It also does the best job of highlighting the risks associated with government and central bank policies post-crisis; most other schools of thought – even those that managed to predict 2008 – cheer on the interventions.

Daily Bell: You are currently betting on a major collapse of the Canadian housing and mortgage markets. In a recent *Globe and Mail* article titled "The Hard-Landing Hedge Fund: A New Way to Bet Against Housing" you are quoted as stating that under Mark Carney's tutelage the Bank of Canada's (BoC) easy credit policy is responsible. Please elaborate.

Seth Daniels: To be fair, I won't put all of the blame on Mark Carney's doorstep. Anything that causes money and credit to artificially expand beyond the existing pool of savings in the economy causes a bubble. Central banks and fractional reserve banks are obviously central players in nearly all artificial credit expansions, and the financial system under Carney certainly expanded money and credit artificially.

The role of government-sponsored credit insurance in exacerbating the artificial credit boom is unique to Canada – I'm not aware of any other economy in the world that has been distorted to such a degree by credit insurance. So a large part of the Canadian credit bubble can be traced to the existence of the Canadian Mortgage and Housing Corporation (CMHC). I'll have several more scholarly articles published on this topic over the next few months. However, under gold money and a fully reserved banking system (or at least free banks) it is highly unlikely that you would see anything like CMHC. At the very least CMHC would be orders of magnitude smaller than it is under the Bank of Canada's fiat regime.

Daily Bell: Did the Bank of Canada's easy money create bubbles in specific regions or will your predicted correction be across the board, or national so to speak?

Seth Daniels: Vancouver, Toronto, Montreal and Quebec are the most overheated markets. There are parts of Canada that have not shared in the house price appreciation.

The monetary system is the lifeblood of the economy, and therefore, artificial tampering with money, credit, and interest rates will affect the entire structure of the economy. When the credit bubble pops Austrian theory implies that it will have widespread fallout as the malinvestments are cleared – even to those areas that did not see significant home price appreciation.

In the U.S., it was frequently argued by non-Austrians that "real estate is local", and that a national housing bubble was therefore an impossibility. I frequently hear the same argument about Canada today. Many parts of the United States did not see a significant rise in house prices. But the areas that did have a bubble – the coasts, Arizona, Las Vegas, etc. – were sufficient to nearly collapse the global financial system.

Daily Bell: There is widespread knowledge of the rampant corruption that existed in **the Fed**-spawned US housing market leading up to its well-documented collapse. Does similar corruption exist with Canadian lenders and insurers?

Seth Daniels: The short answer is yes, in spades. Ben Rabidoux of North Cove Advisors in Canada has done a truly excellent job uncovering corruption and fraud in the Canadian market as well as comparing the subprime and Alt-A markets in Canada today versus those in the US in 2004-2007. We've done quite a bit of due diligence ourselves in the lending, mortgage broker, and real estate broker channels and uncovered a shocking amount of "soft fraud" – or "fraud for shelter" (as opposed to "fraud for profit"), as it is known in Canada. The credit insurance system in Canada provides an enormous incentive for such fraud and moral hazard.

Daily Bell: Doesn't the State-owned CMHC insure most of the mortgages held by banks and other primary lenders? If so, what's to stop the BoC from just bailing out the lenders in a time of crisis? Wouldn't that cause a major depreciation of the Canadian dollar?

Seth Daniels: Yes. It seems likely that the government and the Bank of Canada will bail out CMHC and the big five banks. This will devalue the Canadian dollar. It's not widely discussed, but the Bank of Canada, CMHC and the US Fed bailed out the big five Canadian banks in 2008. The BoC and the government would dispute this conclusion, but from an Austrian perspective I consider their actions in 2008-2009 to have been tantamount to a bailout. I see no reason why there wouldn't be another bank bailout this next time around.

Daily Bell: How large a percentage correction are we talking about here in the more overheated housing markets? Can it be as deep a correction as witnessed during the 2008 US housing market collapse?

Seth Daniels: It will vary depending on the market, type of real estate, and so forth. In certain parts of the most overheated markets, I would easily expect a 30-50% price drop. Estimating nominal price drops is difficult in the best of times, however, and it is considerably more difficult when the government can change the measuring stick by depreciating the currency to bail out the system.

Daily Bell: How do you propose profiting from this collapse? Which sectors are you targeting to short?

Seth Daniels: For both regulatory and competitive reasons, we are unable to disclose our investments. In general terms, though, we combine top-down and bottoms-up analysis. From a macro perspective, we search for credit-induced malinvestments and other deleterious macro trends then drill down into the individual industries, companies, securities, etc. We target those industries and companies that we think are most vulnerable within the overall macro trend.

From a bottoms-up fundamental perspective, we use proprietary forensic accounting screens to triage the investment universe into those companies that show significant operating deterioration and creative accounting. We are particularly interested in promotional companies and those with untenable business models. We analyze these companies fundamentally and forensically. We identify clearly-defined triggers – from both a macro and security-specific perspective – that could force the market to converge on our thesis.

We are most interested in failed business models, promotional companies, companies with aggressive accounting, and highly levered companies that will be unable to survive a downturn; in other words, businesses that are likely to run into difficulties even if our macro analysis is wrong or our timing is too early (which is frequently the case).

Although it has become clichéd, we are looking for asymmetric investments – investments that confer a large margin of safety due to the discrepancy between price and valuation – where we don't lose much when we are wrong and we stand to gain a much larger amount when we are correct (conceptually similar to a put option). It is not always possible to find such an investment on attractive terms if it all, so sometimes we are forced to resort to crude short selling.

Daily Bell: When do you expect this correction to happen?

Seth Daniels: Timing the collapse of credit bubbles is notoriously difficult. The nearly-global QE and likely Canadian-government response to a bust could drag this out. However, barring a global catastrophe or rate shock, and taking into account continued global QE, I'd expect this to play out over the next 2-3 years in Canada.

I think that 2014-2015 will be pivotal years for Canadian real estate, as both supply and demand will begin working against the industry. On the supply side, we have an unprecedented number of Toronto condominiums due for completion in 2014-2015. On the demand side, it appears that most of the marginal buyers are already long housing. Canadian home ownership rates, housing unaffordability, household debt and use of HELOCs meet or exceed that of the US at its peak in 2006-2007.

The ability to purchase an asset on credit creates additional demand for the asset because it increases the pool of potential buyers. If Canadians were forced to pay cash for houses, the pool of potential buyers would be dramatically smaller because many Canadians have very little in the way of savings. But if the house can be purchased for a payment of a few thousand dollars a month, the pool of potential buyers will increase dramatically. Artificially increased credit availability leads to increased demand, which has been the case over the past decade or so in Canada and has been exacerbated by CMHC's insurance. This phenomenon also works in reverse: When the availability of credit decreases, it detracts from the pool of potential buyers. As Austrians know all too well, this will also reveal the malinvestments that occurred during the artificial boom period.

As an investor in an asset, you would ideally want the pool of available buyers to be small, which implies less competition. The ideal time to buy real estate, in my opinion, is when interest rates are high, when banks are refusing to lend, when few investors have cash to invest and prices are inexpensive (relative to rents, replacement cost, etc). However, when lenders offer easy credit (e.g., 100+% financing) due to government-subsidized mortgage insurance, the lowest interest rates in 50 yrs, etc. – as has been the case in Canada over the past 5+ years – this should represent nearly the maximum pool of potential buyers, as the market has become nearly saturated with credit.

At the same time, the Canadian regulators are now reining in credit availability: The B-20 rules governing mortgage underwriting were revised to be more stringent over the summer, CMHC will begin levying a "risk fee" and CMHC is approaching its statutory balance sheet limit. If banks were forced to underwrite mortgages without government insurance via CMHC, mortgage rates would rise to reflect their true risk. The foregoing and future policy actions should decrease the pool of potential new buyers on the margin, which will cause asset prices to begin to fall as credit becomes less available, and the entire process goes into reverse – the bust phase of Austrian business cycle theory during which time the market clears the prior malinvestments.

Daily Bell: You advise the Libertas Real Asset Opportunities Fund. Tell us about it.

Seth Daniels: I provide analytical and research services to the fund, and my partners at Spartan in Canada manage the fund. Based on Austrian business cycle theory, we think that fallout from a Canadian credit and housing correction could have far-reaching negative repercussions for the Canadian economy. It is clear from all of the macro statistics that the Canadian economy is over-reliant on artificial credit expansion and real estate price appreciation. Financials, insurance, and real estate (FIRE) account for more than 20% of Canadian GDP (v. US peak of 24%), 35% of the TSX Composite Index, and 46% of EPS contribution to the TSX Index (v. US peak of ~30%). Residential construction represents an additional 7% of GDP in Canada, and over 50% of all job growth in Canada coming since 2008 has been FIRE and construction-related.

There are few avenues through which Canadian citizens can mitigate their exposure to housing and its potential impact on their livelihoods and savings. The objective of the fund is to provide such an investment vehicle.

Daily Bell: Is it for **accredited investors** only? Can Americans invest or only Canadians?

Seth Daniels: I only provide research and analysis to the fund; Spartan can provide more information regarding eligibility. My understanding is that their fund is currently only available to accept Canadian accredited investors. Eligible wealth managers and brokers are able to buy the fund for their clients via FundServ, which is a Canadian electronic distribution platform for funds.

Daily Bell: Is there a US domiciled investment vehicle that offers Americans a similar investment strategy for targeted shorting of the Canadian housing and financial market?

Seth Daniels: Accredited investors outside of Canada can contact me directly for further information.

Daily Bell: After the Canadian market collapses and you close out your positions, assuming your predictions are accurate, shouldn't one be looking to the UK next, considering Mark Carney's new role as Governor of the **Bank of England**?

Seth Daniels: Ha. Well, suffice it to say that housing in the UK isn't exactly a deep value play, either...

Daily Bell: Okay, on a more serious note: Are you trying to time the market and if so how does that fit into Austrian business cycle theory?

Seth Daniels: Tough question. It depends on what you mean by timing the market. For example, if you are a "value investor" who will only invest when there are clearly defined catalysts that you think will cause the market price to converge on your perception of the true value of the company, are you trying to time the market? I don't think that I am trying to time the market the way the term is traditionally understood.

We are guided by Austrian theory, and think that our thesis gives us a certain margin of safety via macro headwinds. However, timing the bursting of a credit bubble is nearly impossible. We look for investments that are likely to perform regardless of the macro, and that will not suffer large losses if we are incorrect or early.

Daily Bell: What kind of hedging can be used to assure that any mistiming does minimal damage?

Seth Daniels: There are many hedging instruments that can be used, but Spartan is unlikely to use them extensively since that is not the goal of their product. The intention is that the Spartan fund is the hedge. It is envisioned as a small part of a larger portfolio, which is likely to be predominantly long Canadian housing, Canadian equities, Canadian dollar exposure, etc.

If our thesis is completely wrong, the rest of the clients' portfolios should more than offset the losses to the fund. If the thesis is correct, the client's portfolio will take a hit but the Spartan fund should offset some portion of that.

We also strive to minimize the carrying cost and draw downs to the fund in the meantime, until such time as we see a fat pitch in the Canadian market. Again, whenever possible I look for asymmetric investments that have built-in margins of safety and low carrying costs. I think that is the best hedge against mistiming.

I have signposts that I am looking for from both a macro- and micro-economic perspective. I'm unlikely to be aggressive in my recommendations to Spartan (for example, investments with large negative carry) until such time as I believe that the fuse has been lit. In the United States, I considered the failure of New Century (a subprime lender) in Q1 2007 to have been one of the signposts that the fuse had been lit and that it was safe to become more aggressive. Even so, it took over a year and a half from the demise of New Century until the actual crisis.

Daily Bell: Generally what kind of hedging tools can you use, if any?

Seth Daniels: We are able to trade any asset class globally so we have many tools at our disposal. Our primary goal whenever possible is to select investments that will not hurt us very much if we are incorrect. Again, the clients in Spartan's fund are sophisticated investors and will likely view the fund as a natural hedge against their existing portfolio, so they likely neither want nor need us to hedge against our positions.

Daily Bell: Are the trends you see in the Canada replicated elsewhere?

Seth Daniels: Yes, without a doubt. One of the best investors I know wrote an essay some time ago about an updated Triffin Dilemma that I think is applicable to your question. The US dollar is the reserve currency for the world. Our monetary policy affects everyone. At the same time, many of the other countries are pursuing the same types of policies independently.

The imbalances inherent to the Bretton Woods II monetary system, some of which are described in the Triffin Dilemma article – coupled with government and central bank policies post-2008 – have triggered a series of credit bubbles globally that are nearing collapse. Housing is the most leverageable consumer asset and therefore, housing bubbles are frequently symptomatic of these underlying credit bubbles. I believe that several of us started using the term Housing Bubble 2.0 contemporaneously, including Jesse Colombo at the Bubble Bubble.

Daily Bell: Is the **EU** in the same position as the US?

Seth Daniels: Is the EU in trouble? Yes. Is the EU's dilemma precisely the same as US's trouble? No. They have many issues that are **Euro** specific in addition to the typical **fiat currency/fractional reserve banking** issues. Bernard Connolly isn't an Austrian by any stretch of the imagination, but he wrote a thoughtful and prescient book many years ago that details some of the specific issues regarding the EU and the Euro.

Daily Bell: What about Asia and China? Doesn't China have a huge real-estate bubble?

Seth Daniels: Absolutely. China is a truly epic case study in Austrian economics – malinvestments due to artificial credit expansion, malinvestments due to the impossibility of economic calculation under central planning, the list could go on and on. It will not end well.

The idea that China can flip a switch and make a seamless transition from **mercantilist** exporter to domestic consumption powerhouse is a non-starter for Austrians. The theory relies on the **Keynesian**-style view of the economy as a simple algebraic representation (GDP=Consumption + Investment + Government Expenditures). Sean Corrigan wrote a great essay that eviscerated this view called "The Anatomy of Growth." The China thesis ignores, among other things, the Austrian view of capital structure (http://mises.org/daily/1114/), the impossibility of economic calculation in a **socialist** commonwealth (e.g., http://mises.org/econcalc.asp and http://www.nobelprize.org/nobel_prizes/economic-sciences/laureates/1974/hayek-lecture.html), malinvestments induced by artificial credit growth, the undesirability of attempting to build an economy around consumption, I could go on and on.

Daily Bell: Isn't Japan using the same kinds of strategies? What's going on in Japan?

Seth Daniels: There aren't many countries that I'm aware of that are deviating much from the Keynesian playbook nowadays. Abenomics is hardly a groundbreaking economic theory. Kyle Bass has written some excellent pieces on Japan's issues, as have Acting Man (http://www.acting-man.com) and Sean Corrigan at Diapason.

Daily Bell: Why not take positions abroad if the symptoms you observe are appearing elsewhere?

Seth Daniels: The Spartan/Libertas Real Asset Opportunities fund is exclusively dedicated to hedging out idiosyncratic Canadian exposure for Canadian investors. As concerned as I am about Canada – and I am extremely concerned – I have done extensive research on other countries whose economies are in even more precarious position than Canada. However, that is separate from the Spartan fund.

Daily Bell: And what about the US. Where is the US in in terms of your observations about Canada?

Seth Daniels: None of the underlying issues that caused the crisis in 2008 have been addressed, and if anything policy responses since then have made things worse. The risks to the US and global economy are heightened today compared with 2008. I'm expecting another US crisis as well; the only question is when.

Daily Bell: What do you think Canadian monetary officials will try to do to avert a collapse?

Seth Daniels: They'll likely follow the usual Keynesian playbook – lower interest rates, QE, raise CMHC's statutory balance sheet limit, ease the mortgage/CMHC rules, etc. The big five banks and provinces/municipalities will likely get bailed out. There will probably be a stimulus package.

Daily Bell: Would it be triggered by a US collapse?

Seth Daniels: It's certainly a possibility, but it's not something that I am counting on.

Daily Bell: Will anything be effective in staving off a collapse?

Seth Daniels: Mises showed that there is no way of avoiding the collapse. The banking system of Canada is an oligopoly, and much of the bad debt resides on the government's balance sheet via CMHC. So in some ways, they probably have more tools in their quiver to drag this out than the US did. The collapse cannot be avoided, but if they are able to drag it out over a sufficiently long time period, the average Canadian may not notice its true severity except via a stagflation.

Daily Bell: What happens during and after the collapse? Will insiders be hurt or just the middle class?

Seth Daniels: This will depend in large part on the governmental response, the rapidity of the collapse, whether it was triggered by a global crisis etc. I will say that insiders generally tend to avoid most of the pain that is inflicted on the rest of society. If the collapse is sufficiently large insiders may be hurt as well, a la Iceland.

Daily Bell: Where do you see the bond market headed once your forecasting proves correct? And where does the stock market go?

Seth Daniels: I don't find making predictions for the markets as a whole to be particularly fruitful – doubly the case when the central bank can change the yardstick by depreciating the currency and the government can perform massive interventions into the markets and the economy. If I were forced to make a prediction I'd guess that the BoC will attempt to suppress yields via monetization, so the collapse will eventually be vented via a significant currency depreciation. In real terms the stock market will go down substantially. In nominal terms it could easily reset by 25% or more, but the resulting government intervention could make it appreciate in nominal terms thereafter.

Daily Bell: Any plans to further exploit various instruments to take advantage of your insights?

Seth Daniels: Yes, we have investments worked out across many asset classes and instruments to hedge out the risks to Canada. Separate from the research that I provide to Spartan, I also have similar ideas around the world in other countries and across many asset classes.

Daily Bell: What will be the contagion effect? Will the West and Asia all move down together?

Seth Daniels: Very hard to say. Given the global systemic risks, there is certainly the potential for contagion or cascading cross-defaults that would move all of the markets down together. But given that we live in a fiat world, and most central banks can tap into the Fed if they run into trouble, and the central banks could unite to take even more extraordinary actions than they already have to date to prevent such contagion, how it actually plays out in practice is anyone's guess. It will need to be analyzed situationally in real time and take into account the ad-hoc policy responses.

Daily Bell: And if so, what will be the effect on the world economy?

Seth Daniels: Well, it certainly wouldn't be positive.

Daily Bell: We believe there is a Wall Street party going on but the effect of market stimulation now will lead to a greater catastrophe. What can people do to take advantage of the current market stimulation as well as downward trends?

Seth Daniels: I am unable to provide investment advice for regulatory reasons, but in general terms if one were concerned about the unsustainability of market stimulation and/or a downward trend, the best course of action for an average investor would be to avoid the situation entirely. The question then is what to do with the proceeds. To protect against a potentially unlimited increase in the supply of dollars and/or bank or counterparty failures, I usually come back to physical gold.

More tools are available to take advantage of downturns for sophisticated investors such as shorting or employing derivatives, but I would caution against the use of these tools by the uninitiated – it's treacherous enough even for professionals. Even if you prove to be fundamentally correct, you take on many risks including but not limited to counterparty risk.

I'd highly recommend the book *Selling America Short*, which tells the story of an extraordinarily skilled short-focused hedge fund – Copper River – that was fundamentally correct, but still was forced out of business during the 2008 crisis after Lehman failed. And don't forget that for every fund that made a fortune shorting subprime, there was probably a fund that was just as correct in its analysis, but put the position on a bit too early and was forced out of it before the ultimate payoff due to the carrying cost of the positions, impatience on the part of their investors, etc.

Daily Bell: What is your feeling from a moral standpoint? Do the people moving markets understand what they are doing? And if so, shouldn't they be wary of the consequences?

Seth Daniels: I think that there are a wide range of actors in the markets. I believe that a certain percentage of the financial actors are cynical, calculating and understand what they are doing – some of them even go so far as to cook the books or knowingly participate in fraud.

For what it's worth, I'd say that most of the senior financial players that I have met personally, however, I would categorize as True Believers – they have been fed a steady diet of erroneous economic theories in school and at work. While I can think of quite a few egregious examples to the contrary, I think that the majority of the financial C-level executives that I met with in 2007-2008 truly believed their own press, and were genuinely surprised and shaken by the meltdown. I think the same is true in Canada today – most of the senior-level financial people I've met with would be shocked if a catastrophe were to occur in Canada.

Daily Bell: Are these top bankers trapped by the system or could they help avert what is plainly a disastrous likelihood?

Seth Daniels: Friedrich Hayek once described this scenario as catching a tiger by the tail. Even the most intelligent, honest, well-meaning bankers will be unable to avert the disaster once credit inflation has sufficiently taken root. As Mises famously wrote: "There is no means of avoiding the final collapse of a boom brought about by credit expansion. The alternative is only whether the crisis should come sooner as the result of voluntary abandonment of further credit expansion, or later as a final and total catastrophe of the currency system involved." I don't think even Mises could have imagined the situation we find ourselves in today, however.

Daily Bell: Do we need to end this sort of central banking?

Seth Daniels: Unequivocally yes.

Daily Bell: Will it end of its own accord in a catastrophe?

Seth Daniels: I find it difficult to believe that it will end voluntarily.

Daily Bell: On that cautionary note, we'll end. Thanks for your time.

Seth Daniels: Thanks for yours.

Anthony Wile

The Daily Bell After Thoughts

Seth Daniels certainly seems to have a good idea regarding this hedge fund. Housing is volatile and as we saw back in 2007 and 2008, its deflation can precede a stock market crash or even precipitate one. Even more interestingly, the 1970s shows us that in a Golden Bull, housing prices can go up fast and then come down just as fast, especially when interest rates start to climb.

We're not done with this Golden Bull cycle in my estimation, though the elites attempting to control this business cycle have certainly done what they can to crush it. Instead, they've just extended it.

Austrians don't believe in technocratic forecasting generally, but business cycles are in a sense predictable because the entire economic environment is structured via central bank money printing. It is this artificiality that makes Austrian economic forecasting viable.

What one can never predict, of course, is the timing of the "turning." Exactly where we are in the business cycle is uncertain, though again, one can certainly point out that we are in a precious metals bull market, even despite the recent difficulties of gold.

This particular pro-metals market started early in the 2000s and may well continue until we reach a precious metals "mania" of sorts as we saw in the 1970s. The only way to puncture something like that in the short term is to raise interest rates, which will certainly confirm the suppositions on which Daniels and others have positioned their hedge fund.

We're certainly a ways away, but an interest rate increase affecting the dollar reserve system has a certain inevitability about it. At some point, those expecting it will likely see their expectations confirmed – Daniels and his colleagues among them.

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Danny B • 9 days ago
Dear Bell, quite a while back, I posted the vid of the FED doing a Star Trek shtick. Very strange. Apparently, the FED felt the need to speak again and create another vid. Her it is; http://www.youtube.com/watch?v...

And here is what Mish had to say about it;
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Roger D. McKinney • 12 days ago
"I don't think that understanding Austrian business cycle theory is an important prerequisite for successful investing the vast majority of the time."

Great interview, but I disagree somewhat with the quote. I don't have the investing experience the author has, but I see the ABCT as providing good guidance for timing entry/exit in the market. I also have a book out on the subject, Financial Bull Riding, published by Laissez Faire Books. For a description visit my blog at rdmckinney.blogspot.com

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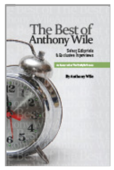

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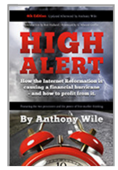

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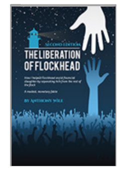

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