



Matthew Piepenburg, 10/15

The Character of Debt, A Debt of Character

History is an exceptional teacher of psychology, philosophy and alas: economics. Indeed, the areas overlap wonderfully. Great leaders—be they of countries, armies or industries—understand this. That is, they understand that the lessons of the past serve as sources of wisdom, perspective and foresight. In particular, yesterday’s lessons train the eye to look more clearly at tomorrow. History shapes our lens with the necessary skepticism, courage and individuality that comes only from taking the time to hear her lessons. Lessons, of course, nourish knowledge, and knowledge, in turn, creates confidence. Lastly, and most importantly, from confidence comes character. *Character*. It’s an evasive, opaque term today. Almost an abstraction. Like so many of the words tossed around by advertising drivel or media spin (i.e. “freedom,” “ethics,” “guidance,” or “security”), character’s very meaning is often lost, distorted, or co-opted for immediate sales and propaganda rather than long-term applicability. Far worse (and we all *feel* this), the knowledge and confidence that precedes character is increasingly lacking upon the once sacred fields of American society—from Donald Trump politics to Larry Summers education, Gordon Gecko finance to Daniel Steel fiction, or Paris Hilton Hollywood to Bill O’Reilly journalism. Mediocrity (even stupidity) and fame have supplanted maturity and greatness. We live, as the poet Octavio Paz remarked, in an age of mud.

The financial industry, which increasingly promotes sales and self-interest over education and candor, is no exception to this mediocrity. Having spent over 25 years navigating its finest circles (from Ivy League facades and Goldman Sachs credentials to conversations with countless hedge fund *wunderkinder*), my own conclusion is that most of Wall Street’s so-called experts have very little knowledge, and by extension, very little, well... character. This lack of character, of course, is admittedly easy to overlook when one is otherwise seduced by the Faustian calls of an industry synonymous with easy fortunes. I certainly was not immune to the promised dollar signs. Wall Street is a siren for armies of young, bright minds looking to find the fastest route to a beach house in the Hamptons, a third car for the weekends and that special Christmas bonus from bank X, Y or Z. Cadres of well-armed MBA’s, JD’s and BA’s from the best schools look to the markets and their gatekeepers as a kind of supernal space where the American Dream lies just within one’s grasp. But here’s the rub: there can be no American Dream without character, and in the long term, the very industry that promises this dream is the same industry that is slowly destroying it—for it is an industry that lacks the very character needed to save it.

The evidence of America's sad economic decline is all around us, yet because of this collective lack of knowledge—of history—we are missing the parallels, the lessons, the signs and hence the warnings. For those still curious enough to look beyond Cramer TV or the Ken and Barbie economists at CNN, however, these signs are painfully obvious and worth repeating, especially in the face of the historically overwhelming distortion of truth and facts that so characterize the modern financial environment.

In order to illustrate this distortion of financial risk, I sometimes turn to military headlines to drive the point home. Recently I visited the battlefields of Gettysburg with my son. I go there often, as the ground is a reminder of so many insights, so many lessons—in particular the notion that pride cometh before the fall. Fought in July of 1863, this battle effectively ended the war for an over-confident Confederacy as the army of Northern Virginia lay bleeding on the hayfields of Pennsylvania. General Lee—like Longstreet—had to have known that very day that the American Civil War was over. Nevertheless pride, stubborn bravery and an admirable Johnny-Reb loyalty pushed the war deeper for two more years and countless more had to die unnecessarily in the name of false hope and an inability to accept the unthinkable. The same was true of the German army in the winter of 1943 at Stalingrad. Their defeat there sealed Germany's fate, yet lunacy, supported by propaganda, false reporting and unwillingness to accept the unacceptable similarly drove that horrific war on for another 2 years and another unnecessary death toll.

The same is true for America's economy and stock market. That is, the signs of our inevitable defeat are already past. Our economic and stock market Gettysburg and Stalingrad have already been lost. What is left now is the stoic anticipation of economic surrender. The astounding levels of debt, money printing, zero-bound interest rate promiscuity and derivatives market leverage have already killed fair market price discovery or any hint of sober risk analysis. Yet the same pride, lunacy, false reporting/hope and dishonesty which kept proud yet doomed armies marching past their expiration date is keeping our tired economy and markets temporarily lulled into accepting fiction and battle cries over reality and the honor to admit a well-deserved defeat.

Well-deserved? Defeat? Is it not un-American to harbor such pessimism about our economic "recovery"? Is it not uncouth to predict an end before the white flag becomes official? Seemingly, yes. But let's clarify, brush aside the emotion and—like honest, tired generals in the smoke of battle—call it like it is. And here are the cold facts: We did this to ourselves. We must accept the coming collapse because our debt is too high, money supply too inflated, and productivity and employment too low to ever turn the tide and avoid a catastrophic recession.

I have unpacked each of the foregoing elements in greater detail in other papers. Here, the topic is simple. It's about debt, and frankly, that's about all one really needs to know, for behind every market crisis is a debt crisis with a guilty smile.

So the hard-nose fact is this: our country has passed its debt point of no-return. Let's abstain from all the complex, sordid and highly relevant details about yield curves, credit spreads, PE ratios, junk bond risk, CPI fictions etc. and repeat this very simple fact: debt tells the entire story. We can pretend, extend and declare victory (as Obama did in the recent State of the Union Address with as much fated hubris as Bush did from an aircraft carrier in 2003), but we can't escape raw math, common sense and the law of markets any more than a weatherman in a dingy can escape the law of nature as a tidal wave forms.

What *is* un-American, however, is for government officials and agencies (such as the Bureau of Labor Statistics), elite banks, and market pundits to distort truth, lie and promulgate false hope to gather assets and sustain fiction rather than take brave responsibility for self-inflicted wounds.

Some of these wounds we know well, from the repeal of Bretton Woods in 71 (nod to Nixon) to the repeal of Glass Steagall in 99 and the deregulation of derivatives in 2000 (nod to Larry Summers, of which I've written extensively). *We* created the fiat currency; *we* printed 3.5 trillion dollars in a blink (thus destroying our currency *long-term*); *we* accumulated an additional 8 trillion of new debt (more in seven years than in the prior 219 combined); *we* kept interest rates at 0 for 81 months and counting (thereby harboring the oldest sin in Wall St: the fast money "carry trade"); *our* government declares unemployment at 5.2% when the reality is closer to 20%; *our* government places inflation at less than 2% when the truth is far, far worse. The foregoing numbers, by the way are staggering, but like the death count of the Holocaust or the battle of Verdun, they slowly become just an abstraction, a figure too large to grasp and hence almost too big to matter. Pause to re-read them. These facts and figures cannot be un-done. In short, a country, like a family, a marriage, a business or an individual is not immune from this simple truth: if you live only on debt and produce next to nothing in income, eventually the game ends. The battle is lost. America—like Germany, France, Russia, Argentina, or even Zimbabwe before it—is no exception to such self-inflicted economic wounds no matter how unthinkable the pain or how "elite" or backwards the nation. History and markets confirm this over, and over, and over...

And so again, let's just look at one simple indicator in this otherwise layered tornado of confusing and complex indicators of economic Gettysburgs—let's just look at debt. Privately, and despite a few kids driving undeserved Teslas in Silicon Valley, the real American citizen is hardly thriving. Instead, the average Joe is living on debt, just like his Uncle Sam. Specifically, Americans are sitting on \$13.5T in mortgage debt, \$1T in credit card debt, and \$1.1T in auto loan debt (much of it sub-prime) and \$1.3T of student loan debt. These trillions matter. Trillions. These debt levels are extraordinary. Add on top of that 46 million Americans are on food stamps (the invisible food lines) and notwithstanding the 5% unemployment creative writing given to us daily by the BLS (whose job reports are mostly about low wage, part-time jobs), full-time employment among those aged 24-54 is the lowest in history. In short, we are broke, unemployed and in debt. And that's just the private sector. Since 08, the private debt crisis in America became a public debt crisis when we handed the multi-trillion-dollar unresolved sub-prime hot potato to our national balance sheet rather than actually solve anything. Growing at a rate of \$1.6B a day, we have an \$18.3T national debt and 200T in unfunded liabilities. Again, pause to re-read those numbers. They are immoral. They are completely unsustainable, more so than the Confederacy after Gettysburg or the Third Reich after Stalingrad.

But like any dying army, they march on lies and false hope. The easiest and perhaps most important lie in today's market is the fantasy that the Fed has your back. Really? The same Fed that declares we are in a "recovery" but is terrified to raise the Fed Funds Rate a measly 25 basis points above zero (when the historical average is 5.7%?) Why the fear? To those who understand markets rather than TV anchorpersons, the answer is obvious: because the market is too weak, the economy and government are too broke and the Fed fears a rate hike—even a minuscule one—is enough to send the bond market into a substantive and figurative nosedive, creating a contagion effect into a stock market that is already

at bubble levels 35% higher than the S&P of 2008. The Fed then tells the public they simply want to hit “target inflation” of 2% before they raise rates. That inflation target is even more of a lie than our so-called “unemployment target” of less than 6%. But I find the inflation lie the most disturbing of all—and the most symbolic for a very simple reason, and one which I hope readers take away from these pages and remember at the next water-cooler debate on America. That is, the real veterans of Wall Street know that inflation is far higher than the fiction of 1.8% reported by the BLS. But even the average American feels this inflation at the tuition bill or the grocery store or the dentist, doctor or pharmacy. It’s obvious that inflation is falsely reported. And it’s equally obvious why. Because if the BLS/FED were honest about inflation, that would mean our sacred Treasuries (the means by which the US debt economy survives), which yield about 2% in nominal dollars, would yield at least a *negative* 3% in real, *inflation-adjusted dollars*. In short, because the truth about inflation is so bad, the reaction from the top is to just, well: lie. It’s that simple. And a negative US Treasury would be the pin in the proverbial bubble of the debt-soaked “recovery” that has artificially inflated US stock and bond markets to nose-bleed levels. It’s that simple. Inflation is a lie, the recovery is a lie, the employment numbers are a lie and the valuation of our markets is a lie.

So when will the white flag go up? When will the bubbles pop? The moment we gain a little character as a nation, accept reality and stop believing the lie.