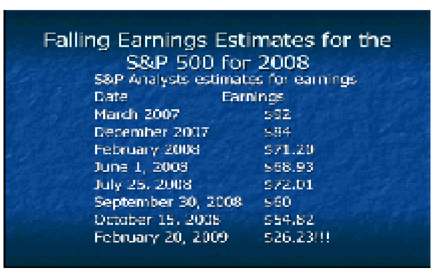
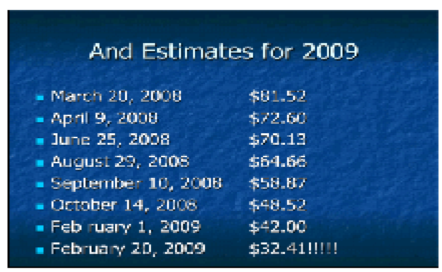
February 2009

<u>What Do Experts Know?</u>

The commissioner of the U.S. Office of Patents, in urging President William McKinley in 1899 to close down the patent office, said, “Everything that can be invented has been invented”. In 1901, Wilbur told Orville, “Man will not fly for fifty years.” The Wright brothers flew on December 17, 1903. In August 1941, Captain W.T. Pulleston, the former chief of US Naval Intelligence, stated: “The Hawaiian Islands are over-protected; the entire Japanese Fleet and Air Force could not seriously threaten Oahu.” Said Secretary of the Navy Frank Knox on December 4, 1941: “No matter what happens, the U.S. Navy is not going to be caught napping.” Three days later, Pearl Harbour and Oahu were bombed. An 1865 review of *Alice’s Adventures in Wonderland* in *Children’s Books* said of Lewis Carroll’s work: “We fancy that any real child might be more puzzled than enchanted by this stiff overwrought story.” *The Southern Quarterly Review* was a little more courtly in its review of Herman Melville’s classic in 1851: “Moby Dick is sad stuff, dull and dreary, or ridiculous. His Mad Captain … is a monstrous bore.” Louis B. Mayer, cofounder of MGM, was told by one of his senior executives not to bid for the rights for *Gone With the Wind*: “Forget it, Louis, no Civil War picture ever made a nickel.” A Universal Studio executive dismissed two actors at the same meeting, telling the first, “You have no talent”, and the second, “You have a chip on your tooth, your Adam’s apple sticks out too far, and you talk too slow.” The first actor was Burt Reynolds and the second was Clint Eastwood, the movies’ two biggest box-office draws in the 1970s (these examples come from a book by renowned contrarian David Dremen, *Contrarian Investment Strategies*).





In John Mauldin’s latest newsletter he produces a table (see above) showing how the so called experts have had to revise their forecasts of the S&P500 earnings.

So by now you are asking what is Berman trying to say. My point is actually quite simple. When President Obama gets up and says that he will create 3 million jobs, or reduce the government budget deficit by the end of his term, or Secretary Geitner or Chairman Bernanke try and convince you that they have got a handle on the situation or any other so called expert speaks with an authority that comes across as fact then you need to keep the above examples in mind and be a little circumspect; by the way that includes me and my forecasts.

The problems we are currently facing cannot be fixed with solutions that inevitably will cause further problems. The current Keynesian approach to solving our current problems combined with an enormous dose of quantitative easing (new form of Monetarist approach) is doomed to failure much like the Monetarist approach that brought on the current mess. A hero of mine, Ludwig Von Mises, the Austrian Schools leading figure of the last century had some prophetic words when he wrote in an essay in 1936 entitled, *The "Austrian" Theory of the Trade Cycle*, …. *attempts to artificially lower the rate of interest which arises on the market, through an expansion of credit, can only produce temporary results, and that the initial recovery will be followed by a deeper decline which will manifest itself as a complete stagnation of commercial and industrial activity. The economy will not be able to develop harmoniously and smoothly unless all artificial measures that interfere with the level of prices, wages, and interest rates, as determined by the free play of economic forces, are renounced once and for all.*

It is not the task of the banks to remedy the consequences of the scarcity of capital or the effects of wrong economic policy by extension of credit. It is certainly unfortunate that the return to a normal economic situation is delayed by the pernicious policy of shackling commerce, by armaments and by the only too justified fear of war, not to mention the rigidity of wages. But it is not by banking measures and credit expansion that this situation will be corrected. Much of the solution lies in embracing the fact that the economy functions in what the "Austrians" describe as the trade cycle. The problem with most of the policy decision makers over the last 50+ years is the failure to adopt tough love and face the reality that no economic policy produces growth without a period of contraction to adjust for the excesses during the growth phase (there is no exception Mr. Greenspan).

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