

Contents

Foreword by Russell Napier	xiii
Acknowledgements	xvii
About the Authors	xix
List of Tables, Figures and Charts	xxiii
Introduction	1
Appetiser	1
Structure of the book	2
Language and jargon	2
Academic theories	3
Modern Portfolio Theory	3
The Efficient Markets Hypothesis	4
Forms of investment analysis	4
Fundamental analysis	4
Monetary analysis	5
Technical analysis	5
The intuitive approach	6
What the book is going to say	6
PART I THE LIQUIDITY THEORY	9
1 Types of Trades in Securities	11
1.1 Liquidity trades and portfolio trades	12
1.2 Information trades and price trades	12

viii	Contents	
1.3	'Efficient prices'	12
1.4	Expectations of further rises or falls	13
2	Persistent Liquidity Trades	15
2.1	Demand for money	15
2.1.1	Transactions demand for money	15
2.1.2	Savings demand for money	16
2.1.3	Interest rates and the demand for money	16
2.2	Supply of money	16
2.2.1	Printing-press money	16
2.2.2	Fountain-pen money	17
2.2.3	Interest rates and the supply of money	17
2.3	Monetary imbalances	17
2.4	Excess money in the economy	18
2.5	Summary	19
3	Extrapolative Expectations	21
3.1	Sentiment	21
3.2	Intuition	21
3.3	Decision-taking inertia	22
3.4	Crowds	23
3.5	Fundamental and monetary forces in the same direction	23
4	Discounting Liquidity Transactions	25
4.1	Speculation	26
4.2	Timing	26
4.3	Short-term risk versus profits in the longer term	26
	Appendix: Speculation and market patterns	27
5	Cyclical Changes Associated with Business Cycles	37
5.1	Introduction	37
5.2	Direct and indirect effects of money on asset prices	38
5.2.1	Money, business cycles and inflation	38
5.2.2	Business cycles and fundamental factors: the 'indirect effect' on asset prices	38
5.2.3	The combination of the indirect and direct effects	39
5.3	Strategy	39
5.4	Timing	40

	Contents	ix
5.5 Sequences		41
5.6 Triggers		42
6 Shifts in the Savings Demand for Money		43
6.1 The peak of a business cycle		43
6.2 Running down bank deposits		44
Appendix 6A: Some bond arithmetic		46
Appendix 6B: Government bond markets		47
PART II FINANCIAL BUBBLES AND DEBT DEFLATION		49
7 Financial Bubbles		51
7.1 Detection of a bubble		51
7.2 Phases		52
7.2.1 Chronically dangerous		52
7.2.2 The burst		52
7.2.3 Acutely dangerous		52
7.3 Crosschecks		53
8 Debt Deflation		55
8.1 The cure for debt deflation		56
8.1.1 Money supply policy		56
8.1.2 Fiscal policy		57
Appendix: Ignorance of Irving Fisher's prescription		58
PART III ELABORATION		59
9 Creation of Printing-press Money		61
9.1 The UK in more detail		63
9.2 Four policies		64
10 Control of Fountain-pen Money and the Counterparts of Broad Money		65
10.1 Control of bank lending		65
10.1.1 The teaching in textbooks		65
10.1.2 How central banks operate in practice		66
10.2 Bank capital		66
10.3 The UK in more detail		67

x	Contents	
	10.4 The ‘counterparts’ of changes in broad money	68
	10.5 Relationship between the counterparts	68
11	Modern Portfolio Theory and the Nature of Risk	71
	11.1 Summary	71
	11.2 Expected yield	72
	11.3 Risk	74
	11.3.1 Risk and the circumstances of the investor	77
	11.3.2 Variation in risk – life assurance funds	77
	11.3.3 Investment managers’ personal risk	78
	11.3.4 Unacceptable risks	79
	11.4 Exploiting skewness	79
12	Technical Analysis and Crowds	81
	12.1 Trends and trading ranges	81
	12.2 Crowd behaviour	82
	12.3 Information	82
	12.4 Trends and momentum	83
	12.5 Approaching a turning point	83
	12.6 Turning points	84
	12.7 Further reading	84
13	The Intuitive Approach to Asset Prices	87
	13.1 Intuition that is a reflection of monetary forces	87
	13.1.1 Biased reaction to news	87
	13.1.2 Technical reactions	87
	13.1.3 Market-makers	89
	13.1.4 Bulls and bears of the core market-makers	89
	13.1.5 Summary	91
	13.2 Intuition that is not a reflection of monetary forces	91
	13.3 Forced selling	92
14	Forms of Analysis	93
	14.1 Different languages	93
	14.2 Macroeconomic models	93
	14.2.1 An hydraulic model	93
	14.2.2 Large electronic computer models	94
	14.3 Disequilibrium	95
	14.4 Intended and actual transactions	96

	Contents	xi
14.5 Accounting identities		96
Appendix: Direct Estimates of Supply and Demand for Credit in the US		97
PART IV EVIDENCE AND PRACTICAL EXAMPLES		101
15 The UK Markets Prior to 1972		103
15.1 UK money supply and a combined capital market price index, 1950–72		104
15.2 UK money supply and the equity market, 1927–72		104
16 The US Equity Market 1960–2002		109
17 Two Forecasts		113
17.1 Health warning		113
17.2 Prediction of the October 1987 crash		113
17.3 Prediction of the top of the US equity market in April/May 2000		114
17.4 Postscript		116
18 Debt Deflation, Practical Experience		119
18.1 The US in the 1930s		119
18.2 Japan in the 1990s and early 2000s		119
PART V MONITORING DATA		121
19 Monitoring Current Data for the Monetary Aggregates		123
19.1 Erratic data		123
19.2 Which aggregate?		123
19.3 A target aggregate		125
19.4 An expert approach		125
19.5 Timing of the availability of data		127
19.5.1 Timing of publication		128
19.5.2 Whiplashes		128
19.6 Understanding the current behaviour of the market		128
Appendix 19A: Monetary targets in the UK		129
Appendix 19B: Distortions to monetary data in the UK		130
Appendix 19C: Velocity of circulation		131
20 Monitoring Data for the Supply of Money		139
20.1 Printing-press money		139
20.2 Fountain-pen money		140

xii	Contents	
	20.3 The counterparts of broad money	140
	20.4 Forecasts	141
	20.5 Management information	141
	20.6 Discernible trends	142
	20.7 The public sector's borrowing in foreign currency and from abroad	142
	21 The Different Sectors of the Economy	145
	Conclusions	147
	Conclusion for industrialists	147
	Conclusion for policymakers	147
	Conclusions for investors	147
	Glossary	149
	References	157
	Index	159