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"Money for Nothing"

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Experience is both a powerful and painful learning tool. Aging, while full of experiences, can also be very humbling. Recently, I asked a young analyst at work if she were "up" for lunch. She responded that she was "down" for it. I learned that what was "up" is now "down." The other week, I mentioned to our summer intern that I was going to a Pearl Jam concert at Fenway Park, and he responded, "Who are they?" Not surprisingly, they were both equally unfamiliar with Dire Straits' "Money for Nothing," the classic rock song written in 1986. After all, neither were born until the 1990s. Co-written and sung by Mark Knopfler, the song's lyrics sarcastically refer to the work ethic and lifestyles of rock musicians questioning the value of their work ("Now that ain't workin' that's the way to do it. Play the guitar on the M.T.V."). Today, the lyrics could just as easily be applied to central bankers ("now look at the yo-yo's, that's the way you do it"). The way in which they do it may be creative, and is getting more creative with each subsequent move they make. But, in the end, it is about printing money and what we thought was "up" is really "down." The world as we knew it is turned upside down with lenders paying to lend and borrowers paid to borrow. Really!

While of still uncertain origins, the concept of money has existed since 5,000 BC according to archeologists' findings. Of course, before the invention of money, barter allowed for the exchange of goods and services, but money forever transformed the nature of commerce. To the extent that it was a store of value, money facilitated trade between parties with divergent interests and needs across different time periods and locations. A farmer with too many apples to sell on a given day did not have to accept that day's local oranges in return. He could receive money in exchange and buy bananas whenever he wanted, from whoever he wanted, or none at all. The number of bananas he could purchase depended on the price, set by free market supply and demand. Higher prices were understandably associated with product shortages and lower prices with gluts. Higher demand led to higher prices while weaker demand led to discounting. It was all so logical!

Suddenly, a person with extra money could lend to an individual in need of money in return for more money in the future. The concept of interest rate was thus born as compensation for the use of someone else's money. Since money was a form

of deferred consumption, a holder could choose the most advantageous time to exchange it for goods and services. As money tends to be fungible, it served as satisfaction of an obligation at the time and choosing of the money holder. It all seems so sensible!

Fundamentally, both parties had to be confident that money would be a store of value as well as an acceptable means of exchange. Trust was, and is, at the core of any successful currency. Gold was used to back currency in the good old days. Its value ensured by its relative scarcity. It is by no accident that the production of gold has been roughly in line with economic growth over the long term. There would never be an oversupply of gold in relation to goods and services, nor likely to be a shortage. The rise and fall in gold's demand and supply corresponds roughly to its value in trade. The math worked!

The gold standard proved too constraining for governments. As governments grew, they gradually replaced gold with paper money, substituting tangible scarcity with a promise to pay. With governments increasingly attempting to control economies through market participation, government spending outpaced gold supplies. Over time, they abandoned the gold standard in favor of a system of fiat currency. Such a system has very few natural predators. Only by pursuing beggar thy neighbor policies can the competitive devaluations be exposed. There are no winners, only losers.

With today's paper money it is essential that the issuing entity maintains confidence in its currency. In God we can trust but not necessarily Caesar. Just like the holders of the past, the holders of today's money ultimately must believe that they can exchange it for future goods and services. If, however, in the currency is thought to have diminishing purchasing power going forward, the holder is incentivized to consume. Negative interest rates are believed to stimulate loan demand and consumption by playing upon this expected behavior. Rather than save and get back less money in the future I should spend it today.

But holders are not forced to save in financial instruments. They can also hoard cash. This is especially true when cash perversely becomes a higher yielding instrument than a savings account. The financial institution receives compensation for safekeeping the cash. Is it smart to pay someone to store your savings? How safe is it really?

Experience teaches us never to say never. But who of us of a certain age and experience could have imagined an environment where money became free, or you had to pay to store or lend it? It makes cash very attractive, particularly if you maintain confidence in the issuer. Otherwise, gold if you don't.

Unfortunately, the very fact that money is free means it is losing its store of value and importance in trade. Simple supply and demand suggests that the reckless printing of money leads to oversupply and diminished value. The age of shortage has quickly and quietly become that of abundance. If successful, the central banks will manufacture inflation transferring more wealth from the creditor to the debtor, from investor to speculator, and from the saver to the consumer. If they fail, deflation is

inevitable. Markets will then reward prudence. Income will become scarcer. Debts will be repudiated and promises not kept.

Call me old-fashioned, but I preferred it when up was up and down was down. Experience tells me that a very painful lesson is about to be learned again. Notwithstanding the song's lyrics, there's no money for nothing.

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