

Amid the rhetoric, a profound threat to capitalism

AVNER MANDELMAN

MAY 9, 2009

Avner Mandelman is president and chief investment officer of Giraffe Capital Corp. and the author of *The Sleuth Investor*.

amandelman@giraffecapital.com

They say a bell never rings in the market. This is not strictly true. Every now and then one does ring - usually two or three times, as in theatre intermissions - to announce a bull or a bear run is nearing its end. Well, U.S. President Barack Obama's recent speech regarding Chrysler was just such a bell.

What did Mr. Obama say? He said he stands with the unions against Wall Street hedge fund bond investors for insisting on their legal rights in a bankruptcy.

I am not sure if you grasp how momentous this is. A U.S. president effectively said the law be damned, the sanctity of commercial contracts be damned, if such constructs cause pain to unions.

Would you buy a U.S. industrial bond in such an environment? No, and neither would I, nor would most other rational bond buyers. Thus in this one act the U.S. President nearly guaranteed that the U.S. stock and bond markets, before year-end, would plunge until the administration realizes that capital cannot be coerced, Soviet-style, into keeping unproductive enterprises going.

It is not yet Hugo Chavez nationalizing foreign oil companies, or Fidel Castro nationalizing United Fruit, or Vladimir Putin robbing BP of its assets, but it is close. From now on, bond investors who up to now could rely on the courts to stand behind their bond indentures could be forced to fight the President of the United States.

To their credit, the bondholders insisted they'd fight for their property rights - but of course they don't have much chance against the President.

In fact, in his action Mr. Obama brought to mind Canada's own former prime minister Pierre Trudeau, who, in the seventies, also centralized economic decision making.

Mr. Trudeau's national energy program (NEP) is to this day anathema in Western Canada. Yes, it was much smaller than Mr. Obama's trillions of dollars printed to "save the economy" (and union jobs): Mr. Trudeau's program provided only a few billion dollars in credits - financed by tax hikes - to avert an energy crisis, which may have existed mainly in the minds of Club of Rome members. Those billions of dollars helped promote oil drilling in the polar ice caps, and helped increase inflation, as well as western resentment.

But there are at least three other parallels between Mr. Obama and Mr. Trudeau: First, both have been hailed as healers of national rifts - Mr. Obama, between black and white, being both; and Mr. Trudeau, between Canada's two solitudes, French and English, being both.

Second, both Mr. Obama and Mr. Trudeau used classical rhetoric to win audiences over to their plans. In this, both leaders took advantage of North Americans' astonishing ignorance of rhetorical techniques, which makes North American residents peculiarly vulnerable to structured language's hypnotic power.

(As an aside: In the 1980s, when I was research director on Bay Street, I had all my analysts take a simple course on rhetorical delivery, both written and spoken; and in one firm all six analysts became ranked No. 1 in their fields.)

Finally, the third similarity: Mr. Obama is, and Mr. Trudeau was, essentially a liberal activist who, using rhetorical techniques, centralized power. In the case of Mr. Trudeau, it cost Canada some economic wealth and alienated the West; in the case of Mr. Obama, the cost is only beginning. When the president of the largest mercantile power on earth effectively says the sanctity of contracts is not for the courts to uphold, and the mesmerized populace (and media) meekly assent, all commercial contracts thereby become devalued, and the market for such contracts - for what are stocks and bonds but that? - must eventually tank.

I'll therefore repeat what this column noted on Feb. 28: The market, just like in 1938, would likely stage a 40- to 50-per-cent rebound from the then-6,600 Dow's fair-value level, before likely going into a two-year funk. The rebound is two-thirds there, and you can forget the "likely": Mr. Obama just ensured the funk would be upon us before year-end.

From here on, the Dow could rise another 1,000 to 1,200 points - say about 15 per cent more. Enjoy it, but don't get taken by Mr. Obama's hypnotizing rhetoric. I'd use the last few hundred Dow points to lighten up. And if you own non-government bonds, be equally wary, because Mr. Obama will have no compunction taking your money and handing it to the unions that helped elect him. Can you hear the bell ringing?