

Ray Dalio Is Kinda, Sorta, Really Wrong, Part 2

By John Mauldin | June 14, 2019



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Last week we started a mini-series in the form of an open letter responding to a series of essays by Ray Dalio, the founder of Bridgewater Associates. I [wrote](#) that he was kinda, sorta wrong in [Why and How Capitalism Needs to Be Reformed, Parts 1 and 2](#) but really, really wrong in [It's Time to Look More Carefully at 'Monetary Policy 3 \(MP3\)' and 'Modern Monetary Theory,'](#) in which he basically endorsed MMT. Today I continue my response.

As I noted, Ray has done us all a service by pointing out some rarely-mentioned elephants in the room (some tinged with pink). We discuss various parts but seldom the entire creature. By that, I mean the rapidly growing potential for “progressive” control of both Congress and the White House. This stems from frustration over differences between haves and have nots, between the protected and unprotected, combined with a fascination for government solutions to our society's perceived ills.

Last week, I basically agreed with Ray's analysis of US income and wealth disparity. It obviously exists. The question is what, if anything, can we do about it? I think this is an important conversation, not just between two people but throughout the entire nation. The answers will make a huge difference to both our society and our children's futures. Not to mention our own futures.

And if the response from my readers is any indication, you are also passionate about this conversation. Last week's letter generated many long, thoughtful reader comments. Clearly, it is not just Ray and I who are worried about the country's future direction. I find that encouraging. A national conversation is precisely what we need in these serious times.

So let's pick up where we left off last week.

Dear Ray,

...As you can see, I really agreed with almost all of Part 1 of your essay. In Part 2, I begin to see things a little differently, especially your suggested actions.

I am going to quote somewhat liberally from Part 2, primarily some portions you put in bold thus highlighting those points. They are worth repeating before we jump into the discussion.

Contrary to what populists of the left and populists of the right are saying, these unacceptable outcomes [income and wealth inequality, and ideological partisanship/populism] aren't due to either a) evil rich people doing bad things to poor people or b) lazy poor people and bureaucratic inefficiencies, as much as they are due to how the capitalist system is now working.

I believe that all good things taken to an extreme become self-destructive and everything must evolve or die, and that these principles now apply to capitalism. While the pursuit of profit is usually an effective motivator and resource allocator for creating productivity and for providing those who are productive with buying power, it is now producing a self-reinforcing feedback loop that widens the income/wealth/opportunity gap to the point that capitalism and the American Dream are in jeopardy. That is because capitalism is now working in a way in which people and companies find it profitable to have policies and make technologies that lessen their people costs, which lessens a large percentage of the population's share of society's resources.

Those companies and people who are richer have greater buying power, which motivates those who seek profit to shift their resources to produce what the haves want relative to what the have-nots want, which includes fundamentally required things like good care and education for the have-not children. We just saw this exemplified in the college admissions cheating scandal.

As a result of this dynamic, the system is producing self-reinforcing spirals up for the haves and down for the have-nots, which are leading to harmful excesses at the top and harmful deprivations at the bottom. More specifically, I believe that:

- 1. The pursuit of profit and greater efficiencies has led to the invention of new technologies that replace people, which has made companies run more efficiently, rewarded those who invented these technologies, and hurt those who were replaced by them. This force will accelerate over the next several years, and there is no plan to deal with it well.*
- 2. The pursuit of greater profits and greater company efficiencies has also led companies to produce in other countries and to replace American workers with cost-effective foreign workers, which was good for these companies' profits and efficiencies but bad for the American workers' incomes.*

That brings several thoughts to mind.

First, I agree technology and globalization are clearly impacting jobs in the US but it isn't a recent thing. It has been happening since the First Industrial Revolution. At one point, almost 80% of the population was organized around some form of agricultural activity. Today it is less than 2%. Obviously, that has been a dramatic change but it also happened over at least 10 generations. And while we romanticize the family farm, it was damn hard work. It was also wrenching for people to go from working on a farm to an urban factory. There was plenty of political turmoil and pushback over those changes.

Globalization also started long ago, prior to 1930, and Republicans of that time dealt with it inadequately passing Smoot-Hawley and beginning a trade war that led to the Great Depression. They also misunderstood and misused Federal Reserve policy.

As you note, the pace of technological change is only going to accelerate. Within 10 to 15 years, a significant portion, if not a majority, of the people who currently earn their living as truck or taxi drivers will find themselves replaced by self-driving trucks and cars. That is just one of many technologies which will reduce the need for direct human employment. Our own money management and investment industry won't escape, either. Many of our customers may be unable to justify the cost of our expensive personal services when software can do it faster, better, and cheaper.

Few industries will be untouched. And there is no point in trying to be King Canute and hold back the tide. Any country that tries to save "their" jobs from technological change will soon find itself a backwater, struggling to compete as the world moves forward ever faster.

Financial Repression

While you correctly note that quantitative easing and easy money simply boosted asset prices and increased wealth and income inequality, you later argue that we need better-coordinated monetary and fiscal policies. I think monetary policy run amok bears a significant, if not primary, responsibility for the financial disparity (along with crony capitalism, but more on that later...)

Beginning with Greenspan, we have now had 30+ years of ever-looser monetary policy accompanied by lower rates. This created a series of asset bubbles whose demises wreaked economic havoc. Artificially low rates created the housing bubble, exacerbated by regulatory failure and reinforced by a morally bankrupt financial system.

And with the system completely aflame, we asked the arsonist to put out the fire, with very few observers acknowledging the irony. Yes, we did indeed need the Federal Reserve to provide liquidity during the initial crisis. But after that, the Fed kept rates too low for too long, reinforcing the wealth and income disparities and creating new bubbles we will have to deal with in the not-too-distant future.

This wasn't a "beautiful deleveraging" as you call it. It was the ugly creation of bubbles and misallocation of capital. The Fed shouldn't have blown these bubbles in the first place.

The simple conceit that 12 men and women sitting around the table can decide the most important price in the world (short-term interest rates) better than the market itself is beginning to wear thin. Keeping rates too low for too long in the current cycle brought massive capital misallocation. It resulted in the financialization of a significant part of the business world, in the US and elsewhere. The rules now reward management, not for generating revenue, but to drive up the price of the share price, thus making their options and stock grants more valuable.

Coordinated monetary policy is the problem, not the solution. And while I have little hope for change in that regard, I have no hope that monetary policy will rescue us from the next crisis.

Further, this financial repression that keeps rates far below their natural level punishes savers and rewards borrowers. This makes it especially hard for those in the lower- and middle-income brackets, not to mention retirees, to earn a return from their savings without having to take unhedged market risk.

The Referees Suck

Michael Lewis has just finished a seven-part podcast called [Against the Rules](#). He begins by talking about referees, specifically the referees who toil at NBA games. Later episodes deal with the “referees” in financial markets, courts of law, civil society, and government.

The first podcast discusses how the NBA has completely reformed the entire process of refereeing NBA games. Every play in every game is reviewed real-time from an NBA studio with 110 screens that sees every play from many different angles. When a referee in any NBA game asks for a replay, other referees in Secaucus, New Jersey call up the play, revisit it in slow motion and from different perspectives, and then make a final call within 30 seconds. Sometimes the ruling on the floor stands, sometimes it is overturned—in either case accompanied by loud crowd reactions.

Because every play is now reviewed and referees after the game get to see where they made mistakes, the game has improved significantly. Referees now see their own biases and learn how to deal with them. The game has never been judged more accurately than it has been the last few seasons.

The interesting thing is that there has been almost no recognition of this improvement by fans or players. The elite players are frustrated they no longer get away with what they had in the past or what other great players did in decades gone by. Think Larry Bird and the extra step or two he took on his drives to the basket. It doesn't happen today. Today's players are generally held to a clear standard, whether rookie or all-star, and the all-stars don't like it. They think they deserve that extra step or a little grace in the judgment call. Not happening anymore.

But the tone of the fans is also increasingly negative. To listen to the roar in the arenas around the country, you would think we are at an all-time low in the judgment of referees.

Small confession: Before I recently moved to Puerto Rico, I had been a 35-year Dallas Mavericks season ticket holder. I have done more than my fair share of yelling at refs. Sometimes, sitting next to minority owners for the team, I was encouraged to yell at the refs. They cited research showing part of the home-court advantage came from abusing the refs. More than a few of us were delighted by Mark Cuban turning red faced as he yelled at the refs from the floor. It was just part of the game.

And yet, Michael Lewis says this is part of the increasing coarsening of the culture. It is not just in sports that we yell, “Refs, you suck!” There is a general feeling that the system is rigged and the referees no longer fair. It's not just in sports but also in the law, government, markets, in all the areas of life where we need outside judges to level the playing field. Nearly all of us have had our children angrily tell us, “That's not fair!” Ref, you suck.

We resort to lawyers at the drop of a hat, looking for arcane rules to solve problems that used to be solved in more civil and less expensive ways. We take to the streets condemning those who disagree with our sense of fairness and justice as part of a system that needs to be changed, if not brought down. Ref, you suck.

Donald Trump and Bernie Sanders both said in the last election that the system was rigged. Trump clearly struck a sympathetic chord in enough voters to become president. Sanders is still arguing that the tax system or the electoral system is rigged. So are many of his fellow candidates. Ref, you suck.

One of the things you and I can agree on is that populist sentiments are not designed to produce compromise and solutions. Trump, and many of his associates, see problems in immigration or globalization or China or big government while the left increasingly sees income and wealth disparity as a core problem, along with climate change, racism, and a host of other issues.

But the overarching theme on both left and right is that the “referees” are no longer fair or impartial. There is a general distrust of those who are protected by circumstances and wealth by those who consider themselves unprotected. More and more of our fellow citizens feel that they are in the unprotected category and that the referees suck. They no longer trust the leaders of either party to solve problems. They increasingly prefer to throw a wrench in the system rather than look for a solution or compromise.

Ray, I have read and reread your Part 2, and especially your recommendations about what to do. I admire your optimistic, idealistic outlook. Even though I consider myself one of the most optimistic people I know, compared to your recommendations it seems I am cynical if not (sadly) skeptical.

You talk about the need for bipartisan commissions and solutions. Obama appointed Simpson and Bowles to lead a [bipartisan commission](#) on fiscal reform back in 2010. The commission couldn't even pass its own findings because those on the left thought it unfairly reduced Social Security and Medicare and those on the right were against raising taxes.

That was in 2010. Congress is far more partisan today. The national debt is also \$10 trillion more.

While a bipartisan commission sounds evenhanded and thoughtful, in today's climate, where so few people trust the leadership and the elites, any bipartisan compromise would be shot down either from the left or the right or both. Likely both. If Trump were to propose a bipartisan commission to deal with the national deficit and entitlement spending, do you seriously think it could get any cooperation or trust from the left? Or that the right-wing members could convince their fellow partisans that a compromise was fair?

Margaret Thatcher once famously said, “First you win the argument, then you win the vote.” Putting together a working majority to deal with the problems we have is going to be a long, arduous process of winning the argument. And sadly, I am afraid it may take a full-blown crisis or series of crises to resolve the argument. I would very much prefer that not to be the case. But the cynical realist in me says the country is not ready for compromise and bipartisan stewardship.

Next week will be part three of this series. We still have the rest of Ray's suggested solutions to deal with, before we get to the problems of using Modern Monetary Theory as part of the solution. But we will get there.

Boston, New York, and ???

I am enjoying the beautiful weather here in Puerto Rico. At the end of the month, Shane and I will fly to Boston to be with our good friends Steve Cucchiaro and (his future bride) Jama to help celebrate their wedding. Then Shane goes to California for a week while I meet with my Mauldin Economics partners in Boston, and then take the train down to New York for a few days of meetings and media. Then on July 4 I fly to...? Well, I'm not sure. The next destination is up in the air as no meetings have been confirmed. Hopefully I will know by this time next week. Then I will meet up with Shane and we will go back to Puerto Rico.

People often ask me for book recommendations, so here's one I really liked. [The Art of Currency Trading](#) is a comprehensive, one-stop guide for anyone who seeks to master foreign exchange markets and achieve sustained trading success. Fellow Maine fisherman Brent Donnelly is one of the smartest currency traders anywhere. He is the king of cross currency trades. He writes a 1-2 page letter every morning explaining what is happening. I don't trade currencies, but I've found that understanding them gives me better insight into global macro trends. This is a must-read for those who anyone who does anything with currencies. It will likely become the new go to book on currencies.

And with that I'll hit the send button. Let me wish you a great week. And apologize to all of the NBA referees who I have screamed at over the years. Oh well...

Your thinking about our collective future analyst,



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