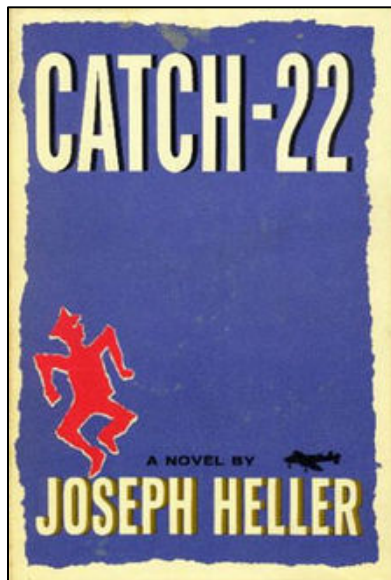


## "Catch-22"



Four times during the first six days they were assembled and briefed and then sent back. Once, they took off and were flying in formation when the control tower summoned them down. The more it rained, the worse they suffered. The worse they suffered, the more they prayed that it would continue raining. All through the night, men looked at the sky and were saddened by the stars. All through the day, they looked at the bomb line on the big, wobbling easel map of Italy that blew over in the wind and was dragged in under the awning of the intelligence tent every time the rain began. The bomb line was a scarlet band of narrow satin ribbon that delineated the forward most position of the Allied ground forces in every sector of the Italian mainland.

For hours they stared relentlessly at the scarlet ribbon on the map and hated it because it would not move up high enough to encompass the city.

When night fell, they congregated in the darkness with flashlights, continuing their macabre vigil at the bomb line in brooding entreaty as though hoping to move the ribbon up by the collective weight of their sullen prayers. "I really can't believe it," Clevinger exclaimed to Yossarian in a voice rising and falling in protest and wonder. "It's a complete reversion to primitive superstition. They're confusing cause and effect. It makes as much sense as knocking on wood or crossing your fingers. They really believe that we wouldn't have to fly that mission tomorrow if someone would only tiptoe up to the map in the middle of the night and move the bomb line over Bologna. Can you imagine? You and I must be the only rational ones left."

**In the middle of the night Yossarian knocked on wood, crossed his fingers, and tiptoed out of his tent to move the bomb line up over Bologna.**

— Joseph Heller, *"Catch-22"* (1961)

**A visitor to Niels Bohr's country cottage, noticing a horseshoe hanging on the wall, teased the eminent scientist about this ancient superstition. "Can it be true that you, of all people, believe it will bring you luck?"**

**"Of course not," replied Bohr, "but I understand it brings you luck whether you believe it or not."**

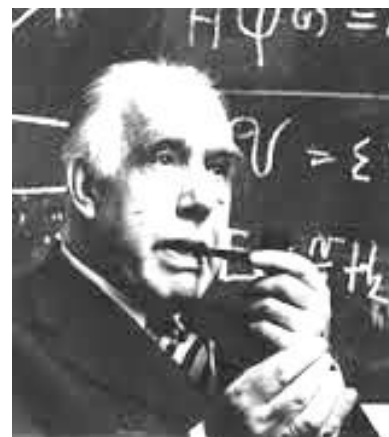
— Niels Bohr (1885 – 1962)

**Here's an easy way to figure out if you're in a cult: If you're wondering whether you're in a cult, the answer is yes.**

— Stephen Colbert, *"I Am America (And So Can You!)"* (2007)

**I won't insult your intelligence by suggesting that you really believe what you just said.**

— William F. Buckley Jr. (1925 – 2008)



**A new type of superstition has got hold of people's minds, the worship of the state.**

— *Ludwig von Mises (1881 – 1973)*

**The cult is not merely a system of signs by which the faith is outwardly expressed; it is the sum total of means by which that faith is created and recreated periodically. Whether the cult consists of physical operations or mental ones, it is always the cult that is efficacious.**

— *Emile Durkheim, "The Elementary Forms of Religious Life" (1912)*

**At its best our age is an age of searchers and discoverers, and at its worst, an age that has domesticated despair and learned to live with it happily.**

— *Flannery O'Connor (1925 – 1964)*

**Man is certainly stark mad; he cannot make a worm, and yet he will be making gods by dozens.**

— *Michel de Montaigne (1533 – 1592)*

**Since man cannot live without miracles, he will provide himself with miracles of his own making. He will believe in witchcraft and sorcery, even though he may otherwise be a heretic, an atheist, and a rebel.**

— *Fyodor Dostoyevsky, "The Brothers Karamazov" (1880)*

**One Ring to rule them all; one Ring to find them.**

**One Ring to bring them all and in the darkness bind them.**

— *J.R.R. Tolkien, "The Lord of the Rings" (1954)*

**Nothing's changed.**

**I still love you, oh, I still love you.**

**Only slightly, only slightly less**

**Than I used to.**

— *The Smiths, "Stop Me If You've Heard This One Before" (1987)*

So much of education, I think, relies on reading the right book at the right time. My first attempt at *Catch-22* was in high school, and I was way too young to get much out of it. But fortunately I picked it up again in my late 20's, after a few experiences with *The World As It is*, and it's stuck with me ever since. The power of the novel is first in the recognition of how often we are stymied by *Catch-22's* – problems that can't be solved because the answer violates a condition of the problem. **The Army will grant your release request if you're insane, but to ask for your release proves that you're not insane.** If X and Y, then Z. But X implies not-Y. That's a *Catch-22*.

Here's the Fed's *Catch-22*. If the Fed can use extraordinary monetary policy measures to force market risk-taking (the avowed intention of both Zero Interest Rate Policy and Large Scale Asset Purchases) AND the real economy engages in productive risk-taking (small business loan demand, wage

increases, business investment for growth, etc.), THEN we have a self-sustaining and robust economic recovery underway. **But the Fed's extraordinary efforts to force market risk-taking and inflate financial assets [discourage productive risk-taking in the real economy](#), both because the Fed's easy money is used by corporations for non-productive uses (stock buy-backs, anyone?) and because no one is willing to invest ahead of global growth when [no one believes that the leading indicator of that growth – the stock market – means what it used to mean](#).**

If X and Y, then Z. But X denies Y. Catch-22.

There's a Catch-22 for pretty much everyone in the Golden Age of the Central Banker. Are you a Keynesian? Your Y to go along with the Central Bank X is expansionary fiscal policy and deficit spending. Good luck getting that through your polarized Congress or Parliament or whatever if your Central Bank is carrying the anti-deflation water and providing enough accommodation to keep your economy from tanking. Are you a structural reformer? Your Y to go along with the Central Bank X is elimination of bureaucratic red tape and a shrinking of the public sector. Again, good luck with that as extraordinary monetary policy prevents the economic trauma that might give you a chance of passing those reforms through your legislative process.

Here's the thing. **A Catch-22 world is a frustrating, absurd world, a world where we domesticate despair and learn to live with it happily. It's also a very stable world.** And that's the real message of Heller's book, as Yossarian gradually recognizes what Catch-22 really IS. There is no Catch-22. It doesn't exist, at least not in the sense of the bureaucratic regulation that it purports to be. **But because everyone believes that it exists, then [an entire world of self-regulated pseudo-religious behavior](#) exists around Catch-22.** Sound familiar?

**We've entered a new phase in the Golden Age of the Central Banker – the cult phase, to use the anthropological lingo.** We pray for extraordinary monetary policy accommodation as a sign of our Central Bankers' love, not because we think the policy will do much of anything to solve our real-world economic problems, but because their favor gives us confidence to stay in the market. I mean ... does anyone really think that the problem with the Italian economy is that interest rates aren't low enough? Gosh, if only ECB intervention could get the Italian 10-yr bond down to 1.75% from the current 1.85%, why then we'd be off to the races! Really? But God forbid that Mario Draghi doesn't (finally) put his money where his mouth is and announce a trillion euro sovereign debt purchase plan. That would be a *disaster*, says Mr. Market. Why? Not because the absence of a debt purchase plan would be terrible

for the real economy. That's not a big deal one way or another. **It would be a disaster because it would mean that the Central Bank gods are no longer responding to our prayers.** The faith-based system that underpins current financial asset price levels would take a body blow. And that would indeed be a disaster.

**Monetary policy has become a pure signifier – a totem.** It's useful only in so far as it indicates that the entire edifice of Central Bank faith, both its mental and physical constructs, remains "efficacious", to use Emile Durkheim's path-breaking sociological analysis of a cult. All of us are Yossarian today, far too rational to think that the totem of a red line on a map actually makes a difference in whether we have to fly a dangerous mission. And yet here we are sneaking out at night to move that line on the map. All of us are Niels Bohr today, way too smart to believe that the totem of a horseshoe actually bring us good luck. And yet here we are keeping that horseshoe up on our wall, because ... well ... you know.

The notion of saying our little market prayers and bowing to our little market talismans is nothing new. "Hey, is that a reverse pennant pattern I see in this stock chart?" "You know, the third year of a Presidential Administration is really good for stocks." "I thought the CFO's body language at the investor conference was very encouraging." "Well, with the stock trading at less than 10 times cash flow I'm getting paid to wait." Please. I recognize aspects of myself in all four of these cult statements, and if you're being honest with yourself I bet you do, too. **No, what's new today is that all of our little faiths have now converged on the [Narrative of Central Bank Omnipotence](#). It's the One Ring that binds us all.**



I loved this headline article in last Wednesday's *Wall Street Journal* – "[Eurozone Consumer Prices Fall for First Time in Five Years](#)" – a typically breathless piece trumpeting the "specter of deflation" racing across Europe as ... oh-my-god ... December consumer prices were 0.2% lower than they were last December. Buried at the end of paragraph six, though, was this jewel: "Excluding food, energy, and other volatile items, core inflation rose to 0.8%, up a notch from November." Say what? You mean that if you measure inflation as the US measures inflation, then European consumer prices aren't going down at all, but are *increasing* at an *accelerating* pace? You mean that the dreadful "specter of deflation" that is "cementing" expectations of massive ECB action is *entirely* caused by the decline in

oil prices, something that from the consumer's perspective acts like an *inflationary* tax cut? Ummm ... yep. That's exactly what I mean. The entire article is an exercise in Narrative creation, facts be damned. **The entire article is a wail from a minaret, a paeon to the ECB gods, a calling of the faithful to prayer.** An entirely successful calling, I might add, as both European and US markets turned after the article appeared, followed by Thursday's huge move up in both markets.

When I say that a Catch-22 world is a stable world, or that the cult phase of a human society is a stable phase, here's what I mean: **change can happen, but it will not happen from within.** For everyone out there waiting for some Minsky Moment, where a debt bubble of some sort ultimately pops from some unexpected internal cause like a massive corporate default, leading to systemic fear and pain in capital markets ... [I think you're going to be waiting for a loooong time.](#) Are there debt bubbles to be popped? Absolutely. The energy sector, particularly its high yield debt, is Exhibit #1, and I think this could be a monster trade. But is this something that can take down the market? I don't see it. There is such an unwavering faith in Central Bank control over market outcomes, such a universal assumption of god-like omnipotence within this realm, that any internal market shock is going to be willed away.

So is that it? Is this a brave new world of BTFD market stability? Should we double down on our whack-a-mole volatility strategies? For internal market risks like leverage and debt bubble scares ... yes, I think so. But while the internal market risk factors that I monitor are quite benign, mostly green lights with a little yellow/caution peeking through, **the external market risk factors that I monitor are all screaming red.** These are Epsilon Theory risk factors – political shocks, trade/forex shocks, supply shocks, etc. – and they've got my risk antennae quivering like crazy. I've been doing this for a long time, and I can't remember a time when there was such a gulf between the environmental or exogenous risks to the market and the internal or behavioral dynamics of the market. The market today is Wile E. Coyote wearing his latest purchase from the Acme Company – a miraculous bat-wing costume that prevents the usual plunge into the canyon below by sheer dint of will. There's absolutely nothing internal to Coyote or his bat suit that prevents him from flying around happily forever. It's only that rock wall that's about to come into the frame that will change Coyote's world.



My last three big Epsilon Theory notes – [“The Unbearable Over-Determination of Oil”](#), [“Now There’s](#)

[Something You Don't See Every Day, Chauncey](#)", and ["The Clash of Civilizations"](#) – have delved into what I think are the most pressing of these environmental or exogenous risks to the market: the "supply shock" of collapsing oil prices, a realigning Greek election, and the realpolitik dynamics of the West vs. Islam and the West vs. Russia. I gotta say, it's been weird to write about these topics a few weeks before ALL of them come to pass. Call me Cassandra. I stand by everything I wrote in those notes, so no need to repeat all that here, but a short update paragraph on each.

First, Greece. And I'll keep it very short. **Greece is on.** This will not be pretty and this will not be easy. [Existential Euro doubt](#) will raise its ugly head once again, particularly when Italy imports the Greek political experience.

Second, oil. I get a lot of questions about why oil can't catch a break, about why it's stuck down here with a 40 handle as the absurd media Narrative of "global supply glut forever and ever, amen" whacks it on the head day after day after day. And it is an absurd Narrative ... very Heller-esque, in fact ... about as realistic as "Peak Oil" has been over the past decade or two. Here's the answer: **oil is trapped in a positive Narrative feedback loop.** Not positive in the sense of it being "good", whatever that means, but positive in the sense of the dominant oil Narrative amplifying the uber-dominant Central Bank Narrative, and vice versa. **The most common prayer to the Central Banking gods is to save us from deflation, and if oil prices were not falling there would be no deflation anywhere in the world, making the prayer moot.** God forbid that oil prices go up and, among other things, push European consumer prices higher. Can't have that! Otherwise we'd need to find another prayer for the ECB to answer. By finding a role in service to the One Ring of Central Bank Omnipotence, the dominant supply-glut oil Narrative has a new lease on life, and until the One Ring is destroyed I don't see what makes the oil Narrative shift.

Third, the Islamist attack in Paris. Look ... **I've got a LOT to say about "je suis Charlie", both the stupefying hypocrisy of how that slogan is being used by a lot of people who should really know better, as well as the central truth of what that slogan says about the Us vs. Them nature of The World As It Is,** but both are topics for another day. What I'll mention here are the direct political repercussions in France. The National Front, which promotes a policy platform that would make Benito Mussolini beam with pride, would probably have gotten the most votes of any political party in France *before* the attack. Today I think they're a shoo-in to have first crack at forming a government whenever new Parliamentary elections are held, and if you don't recognize that this is 100 times more

threatening to the entire European project than the prospects of Syriza forming a government in Greece ... well, I just don't know what to say.

There's another thing to keep in mind here in 2015, another reason why selling volatility whenever it spikes up and buying the dip are now, to my way of thinking, picking up pennies in front of a steam roller: **the gods always end up disappointing us mere mortals.** The cult phase is a stable system on its own terms (a social equilibrium, in the parlance), but it's rarely what an outsider would consider to be a particularly happy or vibrant system. There's no way that Draghi can possibly announce a bond-buying program that lives up to the hype, not with peripheral sovereign debt trading inside US debt. There's no way that the Fed can reverse course and start loosening again, not if forward guidance is to have any meaning (and even the gods have rules they must obey). Yes, I expect our prayers will still be answered, but each time I expect we will ask in louder and louder voices, "Is that all there is?" Yes, we will still love our gods, even as they disappoint us, but we will love them a little less each time they do.

And that's when the rock wall enters the cartoon frame.



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