The Butterfly Effect Will Level the Market

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It all happens at the margin.

Elections are won or lost at the margin. The swinging few percent can make or break a political career.

On any given day, less than 1% of shares on issue change hands. The price at which the 1% exchange their holdings affects the po

Only a few houses in your area need to sell to establish a valuation benchmark for future sales.

The same principle applies to the economy.

An economy doesn't need to collapse to create hardship…it only has to contract at the margins.

Greece shrank by a few percent and its citizens took to the streets.

Nobel Prize-winning monetary economist Milton Friedman said, '*Inflation is always and everywhere a monetary phenomenon in the*

Ideally, central bankers would also like to see inflation at the margin…around 2% per annum. The gradual erosion of buying power i

However, in recent years, inflation has been less Kim Kardashian (always and everywhere) and more Scarlet Pimpernel (they seek

Central banks have rapidly increased the quantity of money — trillions in newly minted currencies — yet the inflationary effects they

There's certainly been inflation in asset prices — as evidenced by historic highs in select share and property markets.

However, broader based inflation is proving more difficult to manufacture from the printing presses.

Those institutions with monopolistic pricing power — governments, councils, power suppliers — have taken full advantage of their p

Which is why the employees of these monopolies continue to enjoy wage increases that exceed those in the private sector.

According to March 2017 data from the Australian Bureau of Statistics (emphasis is mine): '*Through the year, the Private sector rise*

How screwed up is a system that rewards the parasite more than the host? Anyway, that's a discussion for another day.

With non-discretionary spending (the bills we must pay to keep the lights on, our names on the title, and our car on the road) on the

For some households, that means doing what most of us would find unthinkable…disconnecting power.

On 8 July, *The Weekend Australian* published the following line: 'Energy bill pain: surge in cut-offs'.

‘*Australia is entering the “realm of third world countries” with residential power disconnections rising by as much as 140 per cent*

‘*Australian Energy Regulator figures reveal almost 60,000 households are on electricity hardship payments and another 151,862*

These cut-offs are at the margin, but it’s a margin that’s increasing. Pretty sad for a country that is hailed as an economic miracle.

And for the rest of us, it gives at the discretionary margin.

In a monetary statement on 4 July, the Reserve Bank of Australia acknowledged the problem facing Australian households (emphas

The RBA is slightly downplaying our debt situation. Household debt is at record high levels. If there was a debt Olympics, we’d win g

Discretionary spending under pressure

With wage stagnation on one side and rising non-discretionary spending on the other, the vice is tightening.

In the middle is discretionary spending — the cost we can exercise some control over.

The squeeze is on.

On 8 July, *The Weekend Australian* published another interesting line: ‘Health cover at “tipping point”’. Here’s an excerpt from the ar

‘…[Medibank Private CEO] *Mr Drummond, fresh from a tour of European and US health systems, said* ***affordability concerns were***

*“**The issue is more about the financial shape of Australian consumers relative to their debt burden**,” he said. “We are at a*

‘…*“You can push things under the carpet or take an approach that you need to make some changes now.”*’

People are choosing to either reduce, cancel or neglect to take up private health insurance. The shrinking dollars in the discretionary

Households are, collectively, under pressure. This, in turn, puts pressure back on the ‘monopolies’. A vicious cycle.

The debt-funded economic growth we pursued — to achieve a record recession-free run — is now coming back to seriously bite us.

Debt burdens raise affordability concerns? No kidding. Why does this predictable outcome come as a surprise?

When your strategy for economic growth is to actively encourage the bringing forward of future consumption, what else do you expe

The aforementioned article went on to provide an insight into the structural problems associated with private health insurance (emph

‘…*Mr Crombie* [the Australian Managing Director of Bupa’s health insurance arm] *said the industry had hit a “tipping point”, and*

‘*Under Australia’s risk equalisation and community rating system,* ***young people need to pay for insurance to balance the cla***

‘*“**Whatever participation growth you have, if you look under it, the only growth is in the over 65s**,” Mr Crombie said.*’

Does this structural problem sound familiar?

The age pension operates on the same basis.

Growth in the over-65s age bracket, and less participation from the younger generations, means future age pension payments are fa

For political reasons, any changes to social security will be done incrementally at the margin. Continual tinkering with the assets and income test. The inclusion of the family home. In time, the system will morph into a user-pays model…use your own assets first before being eligible for a taxpayer-funded retirement income.

There's very few guarantees in this life, but it's a dead-set certainty that, within the next decade, age pension access is going to be much more restrictive. Demographics have baked this outcome into the cake.

The structural flaws in our economic model — too much debt, too little participation, and too many households with stagnant incomes — are starting to publicly reveal themselves.

What we've created is an economy where debt is always and everywhere.

And it's not isolated to the Lucky Country.

This morning, I received an article from *ValueWalk*, titled 'US Debt To GDP Hits A Record Level But China Catching Up Quickly'.

Here's an extract (emphasis is mine):

> '…*By 2016* [China's] *debt had increased to $22 trillion and the current rates* [indicate] *it will hit $50 trillion by 2020****. In the first q***

> '…*However, it's not just China that's building a worrying level of debt. According to a June 29 report from Moody's "leverage of* ***t***

Debt is now an economic retardant.

Once upon a time, debt-funded consumption produced inflation. Now that we've reached the mature stage of this ill-fated growth strategy, we may well find an equal and opposite effect takes hold…deflation.

Inflation favoured debt — gradually reducing the dollar value of debt.

Deflation favours cash — gradually improving the buying power of a dollar.

Things happen at the margins.

All it takes is enough households to decide to change their habits, and our miracle economy falls into a severe recession.

The warning signs are starting to appear in the mainstream press.

Take heed and you'll be more than marginally better off.

Regards,

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Vern Gowdie has been involved in financial planning in Australia since 1986. In 1999, *Personal Investor* magazine ranked Vern as o

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