



AUSTRIAN ECONOMICS AND THE EVERYTHING BUBBLE

CHARLOTTE MISES MEET-UP
AUGUST 2023

What is Austrian Business Cycle Theory?

Theory of the credit boom/bust cycle

Artificially low interest rates and increases in credit and money supply will cause a boom that results in malinvestment, and which must ultimately be followed by a bust:

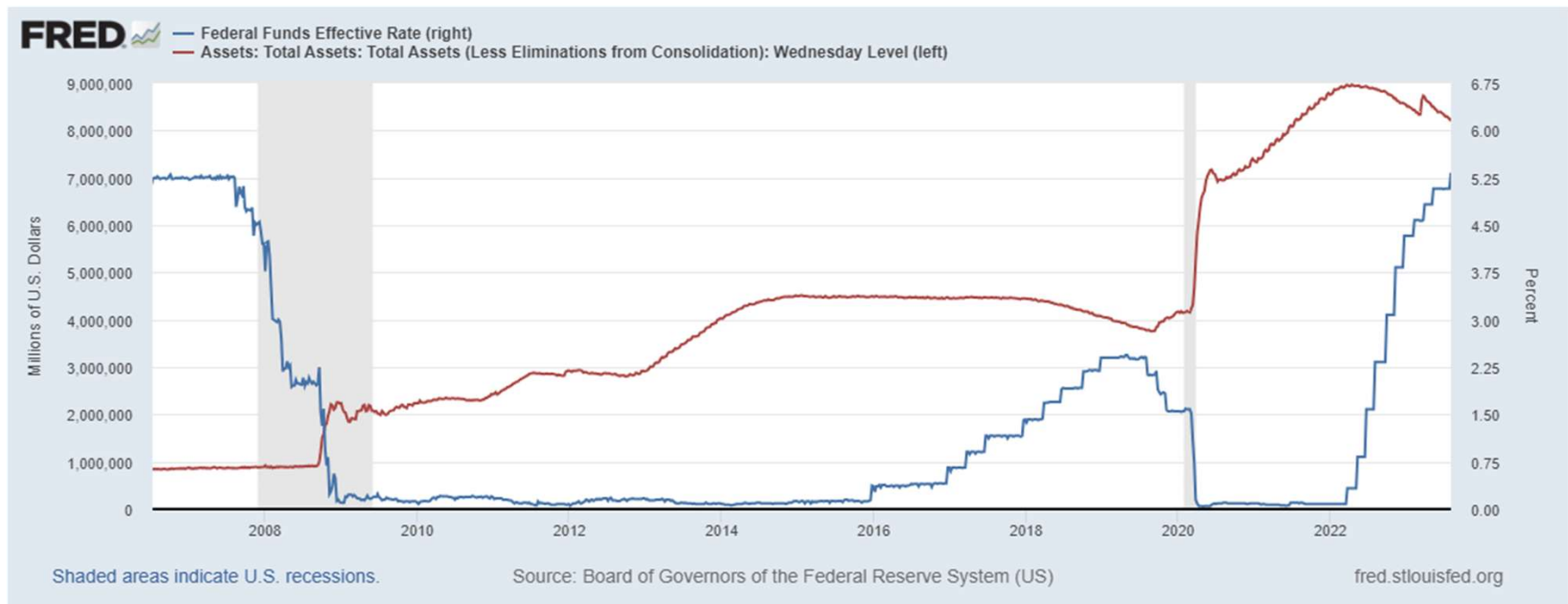
*“However, the boom can’t last. Just because commercial banks decide to lend out money – even though households haven’t engaged in more savings – and cut interest rates, their actions don’t actually create more [real goods]. If the economy had originally been in a long-run equilibrium at the higher interest rate, it is now embarked on **an unsustainable trajectory** at the artificially lower rate.¹*

Eventually a credit crunch arrives, typically with an accompanying recession / depression, during which the malinvestments of the boom are liquidated and re-allocated.

¹Murphy, Robert P, (2021) *Understanding Money Mechanics*. Mises Institute

What does ABCT tell us about markets in 2023?

Developed economies have recently seen enormous increases in central bank balance sheets and the lowest interest rates in human history.



Where did this new money go this time around?



Private equity, venture capital and cash-burning firms



Ultra-long term and negative-yielding sovereign bonds



Crypto and non-fungible tokens (NFTs)



Commercial office and residential real estate



Special purpose acquisition corps (SPACs) and Wall Street Bets

Many venture capital, SPACs and other cash-burning firms have crashed.

Company	Business	2019-2022 Net Income	Equity Drawdown from Peak
Doordash	Food Delivery	-\$3.0B	-66.1%
WeWork	Office Space	-\$14.5B	-98.2%
Peloton	Exercise Equipment	-\$3.3B	-94.7%
Carvana	Auto Sales	-\$3.8B	-86.4%
Lordstown Motors	Auto Manufacturing	-\$800M	-99.2%
Canopy Growth	Cannabis	-\$4.0B	-99.0%

Ultra-long term bonds have plunged in value.

Austria's Century Bonds Have Cost Investors Dearly

The plummeting value of the 100-year debt illustrates how the fixed-income environment has changed.

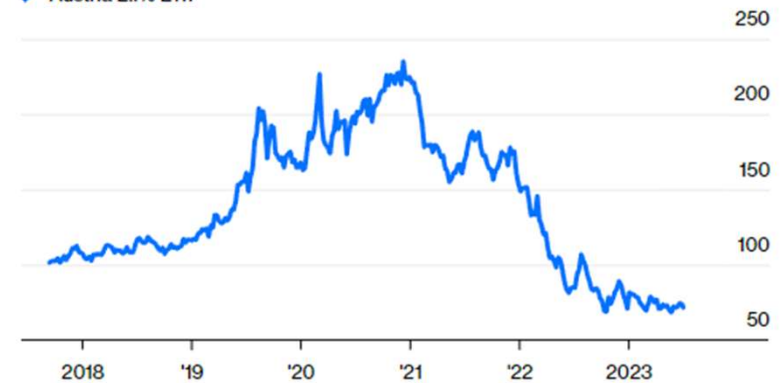


Austria secured super cheap ultra-long funding with its 100-year bonds. Investors haven't fared so well. Photographer: Thomas Kronsteiner/Getty Images Europe

Hold Onto Your Hats

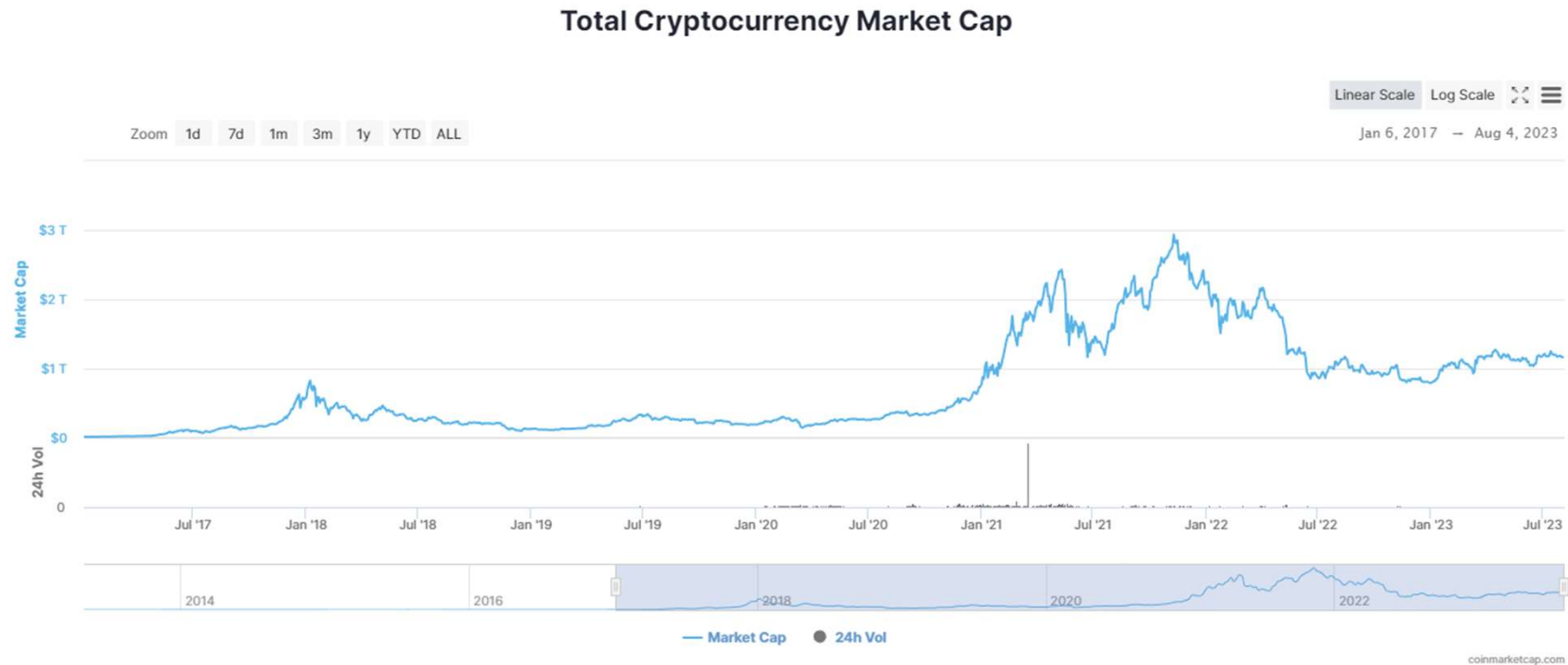
The Austrian century bond has plummeted in value since late 2020

▲ Austria 2.1% 2117



Source: Bloomberg

Market cap of cryptos have fallen sharply from peak but still above pre-2021 levels.

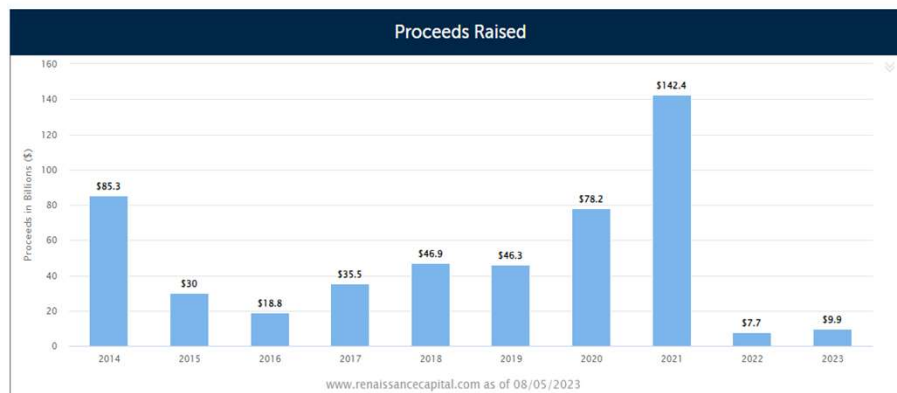


The above graph shows the total market cap of all [cryptoassets](#), including [stablecoins](#) and [tokens](#).

Source: CoinMarketCap.com

Private Equity is extending and pretending.

IPO market has shut down...



Source: Renaissance Capital

So “creative” exits are increasing

08/03/2023 08:00:00 [BN] Bloomberg News

Private Equity Deal Drought Spurs Firms to Raise Cash Creatively

- Private equity rushing to extend the life of investments
- Secondary market opening up new ways for firms to get cash

By Allison McNeely, Laura Benitez and Silas Brown

(Bloomberg) -- For years private equity firms had a simple way to keep investors happy: sell assets and share the proceeds. As the golden era of easy dealmaking and cheap debt ends, they're having to get more creative.

Private equity deal volumes have almost halved in the US since the end of 2021, according to PitchBook, and buyout groups are scrambling to extend the life of investments and maintain the flow of money to their backers.

With the cash paid out to investors from selling assets falling 67% from its second-quarter 2021 peak, firms are hunting for other options. Executives at one financial advisory firm, who asked not to be identified discussing confidential matters, said the firm has been flooded with calls from funds asking about strategies that might prop up returns and capital.

The commercial office sector is deeply distressed.

- 30 story Class A office tower
- Sold for \$66M in 2015
- Sold for \$24M in 2023 (64% drop)
- Short sale – equity owners wiped out

1 South Street,
Baltimore



- 22 story Class A office tower
- Appraised at \$300M in 2019
- In default, expected sale price of ≈\$60M (80% drop)

350 California
Street, San
Francisco

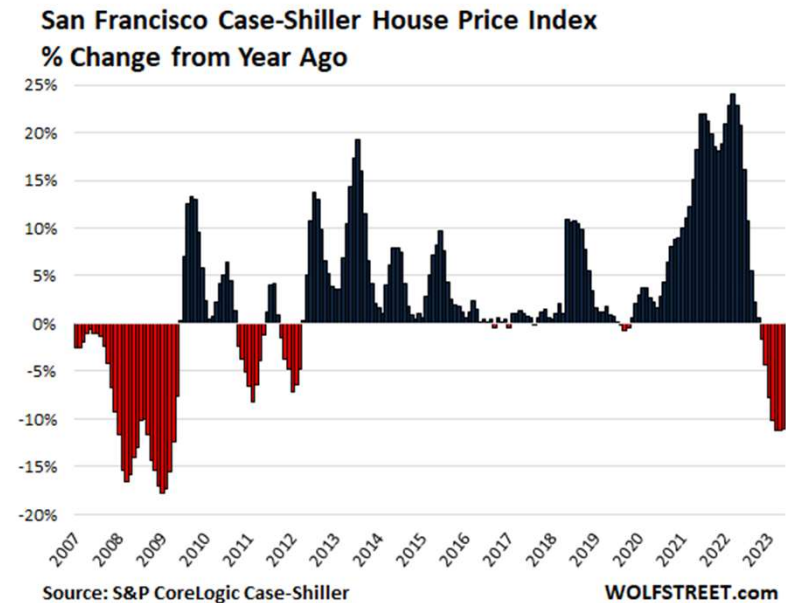
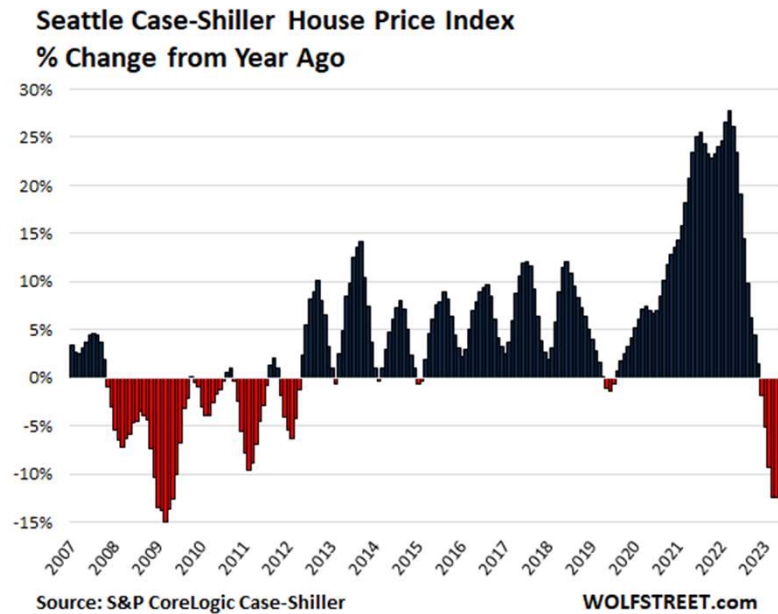


- 54 story 2.4M sq ft Class A office tower
- Blackstone purchased stake valuing it at \$1.5B in 2018
- Sold in 2023 at valuation of \$1B (-33%)

One Liberty
Plaza, NYC

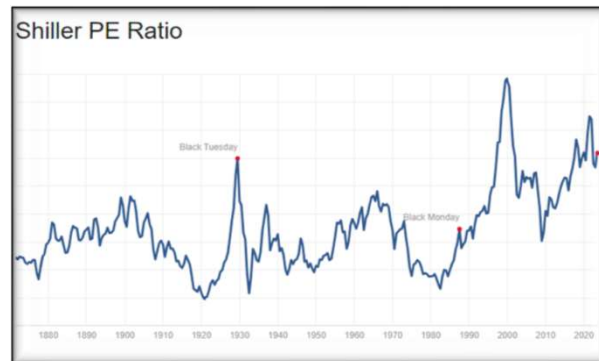


Residential real estate prices are dropping in some cities.

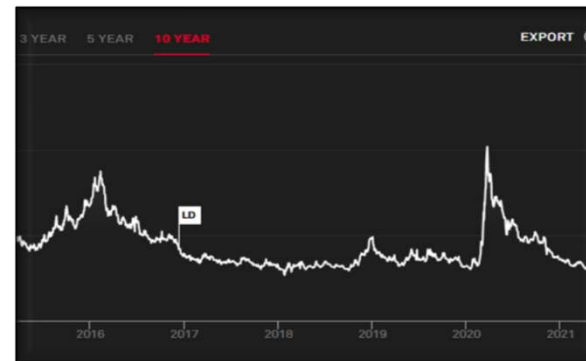


Many asset classes and sectors are still elevated.

S&P 500 Cyclically Adjusted P/E



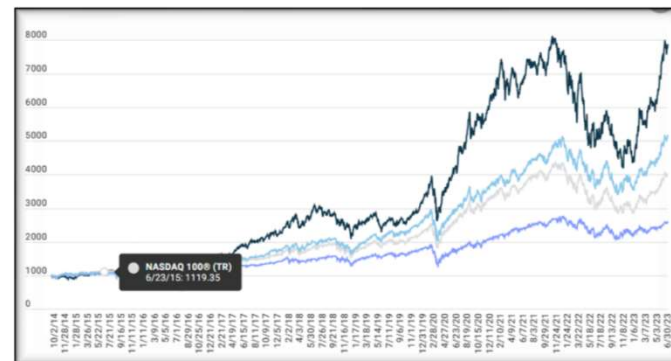
High-Yield Bond Spreads



US Home Prices – CS National



Mega-Cap Tech Stocks – FANG+



Sources: Multpl.com, S&P, Tradingeconomics.com, ICE

What can we do in this environment?

Government liabilities will be paid for through a combination of higher taxes and higher inflation.

Fed may have to choose between saving US Treasurys and saving the US dollar.

Focus on after-tax, real (net of inflation) returns.

Results are highly path-dependent. Don't bet on a particular long-run outcome, because the short-run path to get there could be quite different.

Bridgewater's "All Weather" framework suggests balancing exposure to four quadrants:

- Rising and falling economic growth
- Risk and falling inflation

Notably leaves out key financial (real estate, farmland, infrastructure) and non-financial assets (small business ownership, marketable skills, personal relationships/networks).

		Growth	Inflation
Market Expectations	Rising	25% of risk Equities Commodities Corporate Credit EM Credit	25% of risk IL Bonds Commodities EM Credit
	Falling	25% of risk Nominal Bonds IL Bonds	25% of risk Equities Nominal Bonds

Source: Bridgewater Associates