HOLLYWOOD AND THE LONG TERM CONSENSUS

A great deal of the investment process at a fund requires an investment professional to pour over annual reports, quarterly updates and economic releases, there is another part to investment management, and that is to imagine how the world could be in the long term – say ten, twenty or even thirty years out. Here is where spreadsheets and company forecasts have very little to offer. In fact, when it comes to long term forecasting, consensus is almost always spectacularly wrong.

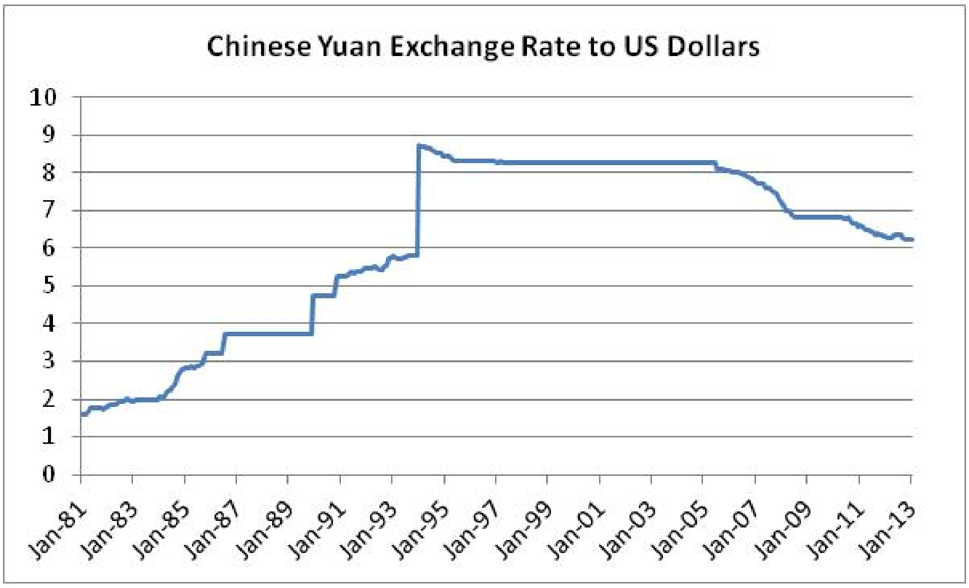
But what is the long term consensus? Most people in the investment profession are extremely hesitant to give long term forecasts, and even then they will often hedge their views. However, there is another source of long term consensus views that I am particularly keen on - it is plots of big budget Hollywood films. The making of a big budget film is by nature consensual. Scripts are written and rewritten numerous times, with directors and producers making constant amendments. Furthermore, once a film is finished it is shown to various test audiences to make sure of its acceptability to as many people as possible. The 1993 Sean Connery film, "**Rising Sun**", with its undertone of Japanese corporate control of the US, was released when the Japanese threat to US industry was already in decline. The 1984 film "**1984**" was released when the threat from the totalitarian regimes of the communist bloc already looked to be in decline. The 2000 Dennis Quaid Film, "**Frequency**", a movie where due to an unusual solar activity, characters are able to talk to people 30 years earlier. One subplot has a character getting rich by telling his younger self to buy Yahoo stock. The movie release marked the top in the tech bubble nearly to the day.

Hollywood films that are set in the future are ever easier to ridicule. So often their predictions are so wildly off the mark, it almost seems rude to pay them any consideration. Can it really be true that 1982's "**Bladerunner**" is set in 2015 – a mere two years away? Or that the original "**Terminator**" film, released in 1984, suggested that computers would achieve spontaneous artificial intelligence in the near future? Or the 1981 film, "**Escape from New York**", predicting that by 1988, due to an uncontrollable rise in crime, Manhattan would be converted into a massive maximum security prison. While extreme, all these futures were based on the recent past carrying forward. The 60s and 70s saw introductions of the personal computer, and also the ongoing cold war struggle. Crime in New York seemingly rose without check during 1970s. For the script writers and producers of this film they were just following a simple natural extrapolation, and one that the majority of cinema goers would be able to agree with. That they were playing into a consensus view was the point.

Every now and then, a Hollywood film set in the future will give you some idea of financial trends. Most memorable for me was the film, "**Back to the Future II**", when Marty McFly and Doc Brown travel from 1985 into the future to 2015. Doc gives Marty fifty dollars, and tells him to go buy a Pepsi. No one seemed to question it – but as we sit here in 2013, Pepsi is going to have to push through some pretty chunky price increases to make this future a reality. The interesting thing for me is that for Pepsi to go from being around 50c in 1985 (when the film was based) to 50 bucks implies a compound inflation rate of roughly 16.6%. Oddly enough the early 1980s coincided with a top in the yields on long date bonds in the US at around 16%. Investors that realised that a can of Pepsi was unlikely to rise that much have made a killing in the fantastic bond bull market ever since.

Recent Hollywood films have begun to see a slightly different future. The 2004 film, "**I, Robot**", set in 2035 Chicago, has the protagonist paying $23.50 for a beer. Sources tell me a beer in a Chicago bar is currently more like five dollars. The compound inflation implied here is 5%. Again this is in line with 30 year bond yields at the time of the film's release in the US, and this was also released pre financial crisis. Since then, expectations of inflation have moved lower.

"**Looper**", was released in 2012 and is set in 2044. The writers envisage an America of rampant crime and drug taking, where the preferred form of payment is in gold and silver. The hero eventually moves to China, where he happily exchanges his savings from precious metals to the Chinese yuan. Both these films are giving quite extreme views on the future. One of 5% inflation a year, the other of complete breakdown of society and trust in the US dollar, which would imply rampant inflation.



Of course "Looper" is extrapolating forward recent history that has seen both the Chinese yuan and gold rising consistently against the dollar. While gold has inexorably risen against the US dollar until relatively recently, the 80 and 90s were bear markets for gold. The Chinese yuan while rising for the last ten years has yet to reverse its depreciating trend of the 80s. Given the very high level of wage inflation in China, and signs of capital outflow, it seems possible that Hollywood has managed to time a top in markets yet again.

My view is that neither “Looper” nor “I,Robot” will be correct in the implicit financial predictions. When I first lived in Japan, my favourite restaurant charged a flat 300 Japanese yen for all dishes. This same restaurant, 20 years later still charges a flat 300 yen for all it dishes. Could it be possible that we are heading for a prolonged period of flat to mild deflation in the US and other western markets? My view is yes, we are coming to the end of a wildly inflationary era. We have seen many commodity prices rise 10 fold over ten years. We have seen a sustained fall in the value of the US dollar against all but the weakest currencies, and have seen a sustained period of fiscal and monetary easing. Despite all of this, inflation in the US has stubbornly stayed below 2%. We now have fiscal tightening, combined with a much more mixed outlook for the Chinese economy – to my mind the worst of the deflationary pressure lies ahead. Contrary to these movies, I think the US dollar will be stronger than expected, and commodity prices weaker. I hope Hollywood script writers have not become better forecasters.

INFORMATION

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