ARC thinking notes for December 9, 2022

Subject: Inflation
Theme: Inflation enables fraud on a massive scale
Contrast: People don't see the connection between widespread fraud and "inflation," which they see as rising consumer prices.

Title: FTX and The Federal Reserve: What's the connection?

Hello everyone, welcome back to Finance Friday on the ARC-UK Youtube network. I am HardmoneyJim speaking today from beautiful Coronado California, where my family and I have come to escape the frigid Wyoming winter.

Here's a photo of my backyard in Jackson Hole last Wednesday morning just before we hit the road for the drive south.

And here is where we'll be spending most of the winter. Lots of sunshine and pretty warm, too. Quite a contrast!

OK, so that's my travelogue for today. Let's check out what's going on in the world of money creation and its consequences.

About a week ago, on November 30 to be exact, something caught my attention. I saw a news report that Sam Bankman Fried, also known as SBF, the CEO of the FTX crypto exchange and now one of the most famous frauds in all financial history, was, despite the sudden public bankruptcy and obvious fraud of his activities and his company, would still be a featured speaker at a New York Times financial conference called the New York Times Dealbook Summit.

I saw this New York Times promotion and noticed right away that he was sharing the stage with the former Chair of the Federal Reserve, Janet Yellen, along with several other luminaries. Seeing this criminal, Sam Bankman Fried, together with Janet Yellen, the former Fed chair and current treasury secretary, I immediately made a connection that I thought was worth sharing.

Because there is an important but not obvious connection between modern central bankers like Yellen and swindlers like Sam Bankman Fried, (whose name should be remembered as "Sam the Bankster Fraud"). And I am not claiming they are both swindlers or criminals; only one of them (SBF) I actually a crook. But there is a strong connection which we'll talk about today.

First, for those of you not very familiar with the FTX fiasco, I'll just mention a few points essential to this discussion. We are not going to delve into the particulars of what bad things SBF and his associates did. There are many places you can read about that, and it is still a developing story. What is important for this discussion is that SBF ran a financial exchange, an online marketplace, where you could trade crypto coins or fiat money of any kind with others on that exchange. FTX took in dollar deposits as well as crypto tokens and made a market in these items. Nothing wrong with that of course. But SBF was not content to run an honest exchange.

Among other antics, SBF offered to borrow his customers' coins so he could re-lend them to speculators, and he promised low-risk returns on those loans of up to 18%. So even if you believe his recent claim that FTX was undone by sloppy accounting and carelessness rather than intentional fraud, the fact is that FTX advertised itself specifically as a secure crypto exchange. If you attract customer money by saying that you have a well-run lending system when you really don't, and then you lose your customers' money, and then you say "oops we didn't mean to do it," then that's bad even if it's true. In other words, attracting customer money with lies and then losing it by accident is to me just as bad as attracting customer money with lies and then stealing it. It's fraud either way.

Right now it appears SBF stole something like 8 billion dollars in customer deposits (the number is still uncertain as we speak) and, by fraudulent lending and borrowing, and posting phony price quotes, he spent that money on everything from real estate in the Bahamas to making huge political donations, in addition to incurring huge trading losses. The latest reports are calling SBF the biggest fraudster in modern financial history – bigger than Jeffrey Skilling of Enron, bigger than Bernie Madoff, and bigger than Elizabeth Holmes of Theranos (who just got sentenced to 11 years in prison for her fraud).

SBF's fraud occurred over the last 2 to 3 years, coinciding with the greatest asset bubble ever experienced in the financial markets. I contend this is not a random coincidence

The Yellen SBF Connection

So, what *is* the connection between central bankers like Janet Yellen and frauds like SBF? The connection is *inflation*. Yellen and other central bankers enabled Sam Bankman-Fried. Janet

Yellen and other central bankers cause inflation, and SBF cashes in on it, at least until he is caught.

Here at HardmoneyJim we are all about money creation and its consequences, and here is a case where that perspective improves your understanding. You would never see the connection between inflation and fraud if you held the Fed's view of inflation, which, according to Bernanke and Yellen, and Powell is simply "rapidly rising consumer prices." If you accepted that definition, you would think: Oh, here we have inflation, consumer prices are rising, and in addition, just by coincidence, we have just had this big scandal surrounding the FTX cryptocurrency exchange. Those are just two newsworthy things that coincidentally happened at the same time.

But constant subscribers to this forum know better because we know that inflation is properly defined as excessive money creation caused by government action and that rising consumer prices are only one important consequence of that action. What may surprise you today is that big scams like the one just perpetrated by Sam the Bankster Fraud are also a result of the Fed's inflationary policies.

I am saying that money printing causes a decline in the moral standards of the culture and that this decline enables fraud on a broader scale than what otherwise might have occurred. I am not saying inflation, i.e., money printing is the only cause of financial fraud, but I do contend that inflation sets us up for bigger, more widespread fraud than what would have happened in a sound money environment.

More precisely, I think fraudulent money creation (inflation) is *both a cause and an effect* of declining standards of honesty, independence, and personal responsibility in our culture today. By "both a cause and an effect," I mean: when a government debases a currency, it is taking a first step in the process of moral debasement, but once the government has gone down that road, the monetary debasement itself encourages public behavior that further undermines the integrity and character of the average investor.

On this forum, we often discuss how the government, creates inflation, that is, how the currency debasement starts. But we have not discussed very much some of the secondary effects on the morals of the culture. So today we want to ask, how does inflation, properly understood as an undue increase in the stock of money, degrade the culture, right down to undercutting the personal character of the typical investor or even the typical citizen?

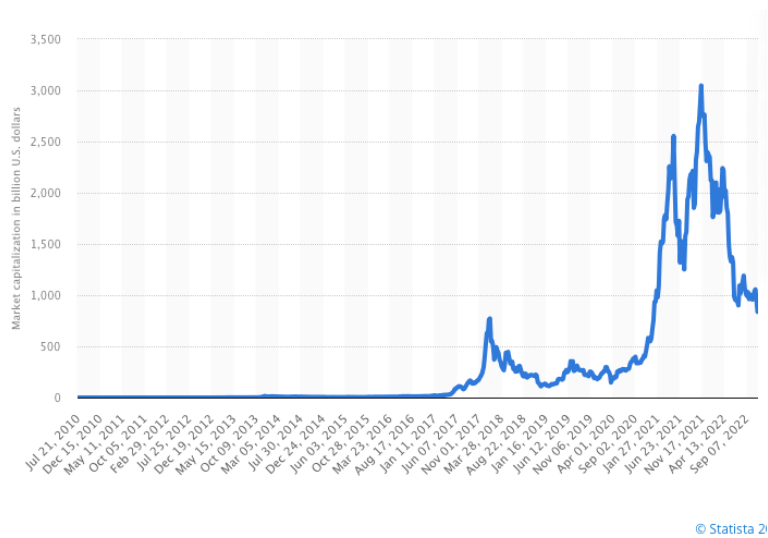
After we address that question, we will also want to talk about how you can avoid the ethical trap that inflation wants to put you in. We will discuss what practical things you can do to retain what I will call your "ethical sovereignty" in this era of unethical money production.

Who were the suckers?

To set the stage, let's focus not on SBF himself, but instead let’s look at the **millions of people who gave him their money**, the people who bought into his story, all those who believed his fraud.

Who were these people and why were so many people so easily duped into giving this guy their money?

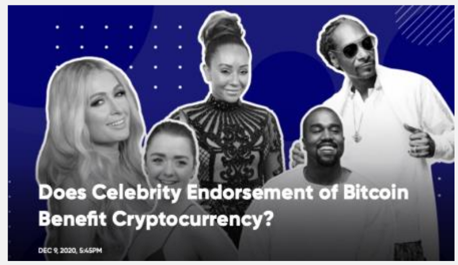
Don’t be tempted to think it was just the gullible little unsophisticated people who fell for SBF’s fraud. Yes, there were many small investors who sent real money to FTX, full of hope that they’d make a fortune trading crypto tokens. And some of these small investors lost their entire life savings. But there were many others caught up in the hype.



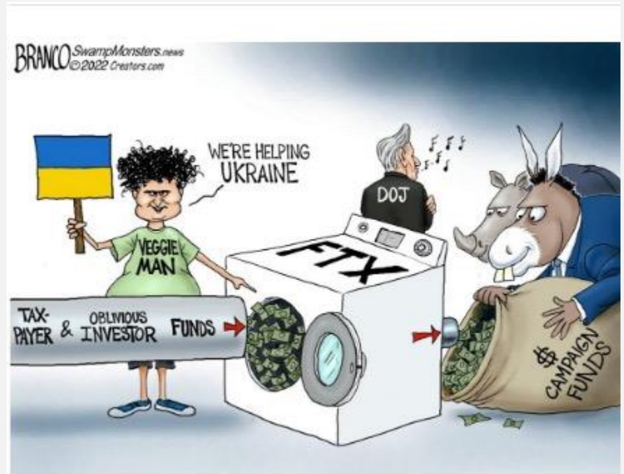
Here is an estimated market cap of all cryptocurrencies. In November 2021, just a year ago, it reached over $3 trillion. FTX was had been founded only two years earlier, in 2019. Clearly, FTX was riding a wave of unwarranted enthusiasm and overconfidence in the entire crypto currency story.

There were a lot of suckers and they fell into several categories.

“Fortune Favors The Brave”



First there were the celebrities. Matt Damon, Tom Brady, his former wife Giselle Whatsername, Larry David, LeBron James, Steph Curry, Mark Cuban, Snoop Dog. The list goes on. The Miami Heat’s stadium was named FTX Arena, and Cal Berkeley’s football field was until recently going to be called “FTX Field. “Fortune favors the brave” touted by Matt Damon was the slogan used to entice people to send in their money.



Then there were the politicians who shared many public presentations with SBF. These were high-profile politicians: Bill Clinton, Tony Blair, Barack Obama, and the list goes on. They were attracted to SBF by both the crypto myth and the money – SBF was reportedly the second largest donor to the Democrat party, at $40 million, second only to George Soros. (He also gave some money to Republicans. For example, Mitch McConnell reportedly got some money, but we are just not sure how much. The point is, SBF was trying to buy favors from politicians.)

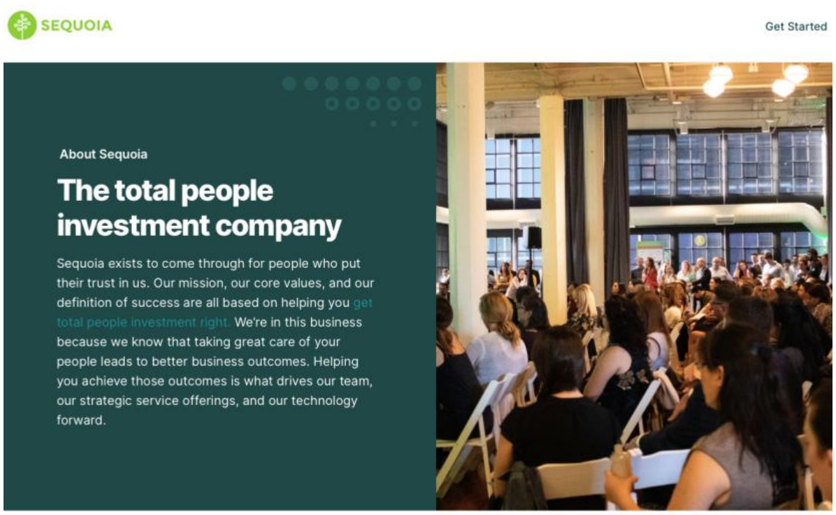
There are even allegations that the government of Ukraine invested money in FTX, some of which was then recycled back to the Democrat party to fund their mid-term electin campaign. I don't know if this is true, the point is we don't know where that Ukraine money went, and it sure looks like Vlodomyr Zelensky fell for the scam as well.

This one with Maxine Watters is especially shocking. Waters is the chair and ranking member of the House Financial Services Committee. She oversees financial services! She is a consumer advocate! You would think she would be circumspect about posing with a 30-year-old kid who claims to be reinventing financial services. Does she know anything? Will she believe anything as long as it gets her a campaign contribution? Her endorsement of SBF undoubtedly gave others confidence in SBF. Shouldn't she have been more careful?

There were also famous bureaucrats. Six months before bankruptcy, SBF even had a meeting with Gary Gensler, the head of the SEC, who was reportedly coaching SBF on how to advocate for a regulatory structure favorable to his business. What was Gensler's connection to SBF? He was formerly a student at MIT, where a professor he is friendly with is the father of Caroline Ellison, SBF's head trader and part-time girlfriend.

Here she is.

So we had celebrities and politicians and government officials all piling on, all buying into this fraud, all acting like true believers. But to me, the worst offenders and the biggest suckers were the professional investors. And among professional investors, we see the evasion, the loss of rational standards, and a wanton waste of good money by those who make a living investing the life savings of many average people, including the proverbial widows and orphans.



This is from the website of Sequoia Capital, a large and famous venture capital firm that invested $214 million into FTX. To illustrate how willfully gullible some of these professional investors were, let's look into a transcript of a Sequoia due diligence conference call with Sam Bankman Fried, a call designed specifically to smoke out the hype and empty claims of companies like FTX who are looking for investment funds.

So, after a zoom interview with Bankman-Fried, during which no financial documents were reviewed, these trained professional financial analysts at Sequoia lit up the Zoom chat function with the following comments. I'm quoting now from a research piece called Epsilon Theory by Ben Hunt:

"We had a great meeting with Sam, but the last question, which I remember Alfred asking, was, 'So, everything you're building is great, but what is your long-term vision for FTX?'"

That's when SBF told Sequoia about the so-called super-app: "I want FTX to be a place where you can do anything you want with your next dollar. You can buy bitcoin. You can send money in whatever currency to any friend anywhere in the world. You can buy a banana. You can do anything you want with your money from inside FTX."

Suddenly, the chat window on Sequoia's side of the Zoom lights up with partners freaking out.

> "I LOVE THIS FOUNDER"
>
> "I am a 10 out of 10"
>
> "YES!!!"
>
> "I sit ten feet from him, and I walked over, thinking, Oh, shit, that was really good. And it turns out that that f#@ker was playing *League of Legends* through the entire meeting."
>
> "We were incredibly impressed."
>
> "It was one of those your- hair-is-blown-back type of meetings."

"I LOVE THIS FOUNDER," typed one partner. "I am a 10 out of 10," pinged another. "YES!!!" exclaimed a third.

What Sequoia was reacting to was the scale of SBF's vision. It wasn't a story about how we might use fintech in the future, or crypto, or a new kind of bank. It was a vision about the future of money itself—with a total addressable market of every person on the entire planet.

"I sit ten feet from him, and I walked over, thinking, Oh, shit, that was really good," remembers Arora. "And it turns out that that f#@ker was playing *League of Legends* through the entire meeting."

"We were incredibly impressed," Bailhe says. "It was one of those your- hair-is-blown-back type of meetings."

I have been in many, many due diligence meetings, some with people trying to get my firm to invest our clients' money in snake oil. I did exactly this job for 20 years. And the way my firm operated, all of us, was to start with written disclosure by the firm in question, many pages of accounts and financial statements, then tear those documents apart before the meeting, then on the due diligence call we would grill the company CEO or his representative to uncover any possible flaw in their investment story. Our starting point was skepticism and doubt. We asked tough questions. The obsequious, adoring attitude displayed by these Sequoia analysts is worlds away from anything I ever experienced in a due diligence meeting.

SBF had them all buffaloed, all in awe. He just had to play video games while chatting up the analysts, making them think he was so smart and confident that he could multitask with a video game and a vision for a world currency at the same time.

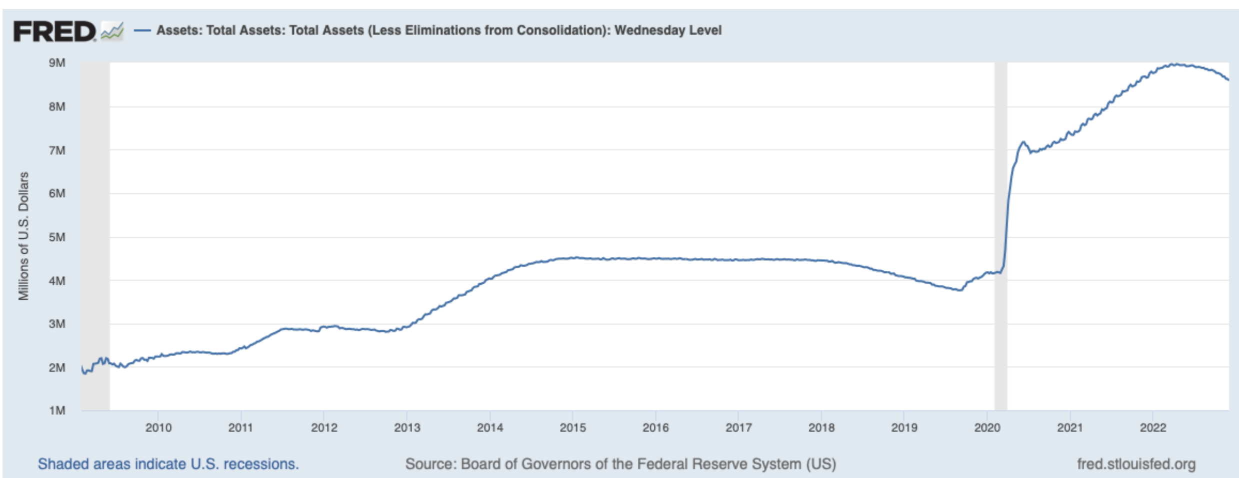
What made these people – clients, celebrities, politicians, and even professional investors – so gullible? How did inflation play a role this deception?

HOW INFLATION SETS US UP FOR FRAUD

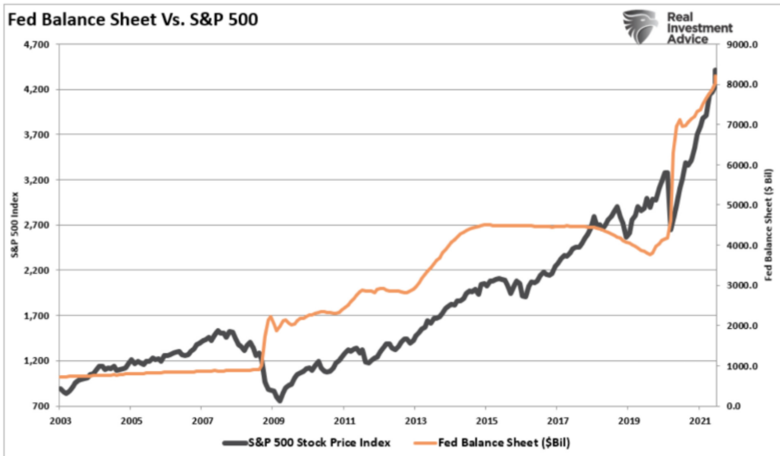
Let's go back about 13 years to the beginnings of quantitative easing to get a grasp of how inflation sets us up to swallow fraudulent schemes like FTX. Here is the explanation for QE by Ben Bernanke in his famous *Washington Post* Op-Ed of November 2010, "*What the Fed Did and Why.*"

"Lower corporate bond rates will encourage investment. And higher stock prices will boost consumer wealth and help increase confidence, which can also spur spending. Increased spending will lead to higher incomes and profits that, in a virtuous circle, will further support economic expansion."

Bernanke thought that by creating money to buy bonds he could lower interest rates, increase stock prices and increase spending which would somehow increase real wealth. He called this the "wealth effect." To him, it is a confidence game, a typical Keynesian notion based on psychology rather than the production of real goods and services.



He and his successors continued their QE program, with only a few brief interruptions, for 13 years. They created almost 7 trillion dollars of new money, most of which was spent in the stock and bond markets, causing asset prices to rise for years with only a few interruptions. They did not yet see a significant rise in the Consumer Price Index, so they assumed they were not causing inflation. They never explained why they think soaring asset prices is not inflation, but rising consumer prices is inflation. This chart from the Fed shows the Fed's assets accumulated over the QE period, basically from 2009 to 2022. Remember, for every dollar of new Fed assets, there is a dollar of new money created in the banks.



And here is the result in the stock market, which responded just as Bernanke expected. The orange line is Fed assets, or new money, read on the right scale. The black line is the value of the S&P500 stock index, read on the left scale. The Fed's monetary stimulus was not a one-time thing. QE, or money printing, became their only policy, and it went on for many years. Every time the stock market hiccupped, the Fed pumped more money into it.

And investors responded, and learned to depend on that flow of new money. Interest rates fell too low to support saving, so they learned to speculate in the stock market. The broad market went up over 500% during the 13 years of QE, at the same time interest rates plummeted to nearly zero, making ordinary saving impossible.

The biggest bubble of all was during the pandemic (see the far right side of the graph where the lines go almost vertical) when money printing took on new meaning. Money supply went up 40% on two years, house prices went up 30 to 40%, stocks soared to new heights, and the market cap of cryptocurrencies hit 3 trillion. This was the "everything bubble."

Now, what should we expect from investors, especially young investors, after years of this kind of monetary conditioning? Will they be careful, risk-averse savers or will they feel compelled to speculate in programs they do not understand? Do you think this kind of one-way market would attract hard-nosed analysts or would it attract feverish gamblers?

Just look at the stock market even today, after the Fed has started tightening (that is raising short-term interest rates) and the broad market is down 15% or so. Every time the Fed hints it might slow its tightening schedule, the market rallies 3 to 5%, responding to the prospect of more cheap money.

But the only reason the Fed would slow down its tightening program would be if they thought the economy was getting worse, getting closer to a recession. So a bad economy (slower growth, higher unemployment) is what the stock market seems to want because only a bad economy will make the Fed give us more printed money.

This means good news in the real economy is bad news for the stock market. Think how bizarre that is. Stock traders think a poor economy means a bull market for stocks. Good financial performance and a booming economy don't matter; in fact they are considered to be negative. It is all about the Fed and its next move. The market is addicted to liquidity, that is, to easy money, and to nothing else.

The veteran economist Jim Bianco summed it up in a Bloomberg interview on Dec. 6:

"In 2023, it's all about liquidity, and it's all about money. The hope [in the stock market] is the economy turns down, then the Fed pivots and cuts rates, and the market responds positively. This is the upside-down world we are in. **Fifteen years of quantitative easing, zero interest rates, negative interest rates, and forward guidance, have got the market to become like a liquidity junkie. It only wants cheap money, it only wants low rates, and that is all it responds to."**

Other veterans echo this analysis. "Nobody knows what anything is worth," said David Einhorn of Greenlight Capital in a recent interview. Einhorn, a multi-decade veteran, says most market participants don't know how to value a company anymore. Company valuation is a lost art. "Nobody's actually doing those calculations," he says.

So inflation, or money printing, creates an illusion of wealth that makes people believe they are rich. But printed money does not create new wealth. Some people get rich simply because of inflating asset prices, but at the level of the entire economy, there is no new wealth created. Just think, if the share price of a widget-maker goes up 10% because of money printing, has the ability of that firm to produce widgets increased? No, it just costs more dollars for an investor to buy the shares of the widget maker. The owner of widget stock gets richer relative to everyone else, but widget consumers and new potential widget investors are penalized.

So after years of Fed money printing, and higher share prices that have no relationship to the underlying financial fundamentals of the companies, what do people resort to? They resort to speculative trading, options trading, and derivatives trading which is more akin to gambling than investing because most of these new speculators don't know what they are doing.

Here is a quote from the late Henry Hazlitt to sum up this point:

"Inflation discourages prudence and thrift. It encourages squandering, gambling, and reckless waste of all kinds. It often seems more profitable to speculate than to produce. Inflation tears apart the whole fabric of stable economic relationships. Its inexcusable injustices drive men toward desperate remedies. It plants the seeds of fascism and communism. It leads men to demand totalitarian controls. It ends invariably in bitter disillusion and collapse."

[break for superchat]

Now I want to say just a bit more about the effects of inflation on the moral fiber of the culture. And here I want to quote from a source I have referenced before, from a 125-year-old monograph called "Fiat Money Inflation in France," by Andrew Dickson White. White wrote about the great inflation leading up to the French Revolution, and how inflation literally changed the character of the people of the country. The point of referring to this ancient account is to illustrate that fiat money inflation always has similar effects on the people and on their culture.

White first points out that Frenchmen were naturally very thrifty people, but inflation changed that.

"The great majority of Frenchmen now became desperate optimists, declaring that inflation is prosperity. Throughout France, there came a temporary good feeling. The nation was becoming inebriated with paper money. The good feeling was that of a drunkard just after his draught; and it is to be noted as a simple historical fact, corresponding to a physiological fact, that, as draughts of paper money came faster, the successive periods of good feeling grew shorter… "

"Still another difficulty appeared. There had come a complete uncertainty as to the future. Long before the close of 1791, no one knew whether a piece of paper money representing a hundred livres would, a month later, have a purchasing power of ninety or eighty or sixty livres. The result was that capitalists feared to embark their means in business. Enterprise received a mortal blow. [This sounds very much like Argentina today, as we saw in our November 12 podcast.]

"Demand for labor was still further diminished; and here came a new cause of calamity: …The business of France dwindled into a mere living from hand to mouth. This state of things, too, while it bore heavily upon the moneyed classes, was still more ruinous to those in moderate and, most of all, to those in straitened circumstances. With the masses of the people, the purchase of every article of supply became a speculation—a speculation in which the professional speculator had an immense advantage over the ordinary buyer…

"**Commerce was dead; betting took its place**."

"But these evils, though great, were small compared to those far more deep-seated signs of disease which now showed themselves throughout the country. One of these was the **obliteration of thrift from the minds of the French people**. … a loose luxury spread throughout the country. A still worse outgrowth was the **increase in speculation and gambling**. …at the great metropolitan centers grew a luxurious, speculative, stock-gambling body, which, like a malignant tumor, absorbed into itself the strength of the nation and sent out its cancerous fibres to the remotest hamlets. At these city centers abundant wealth seemed to be piled up: in the country at large there grew a dislike of steady labor and a contempt for moderate gains and simple living.

"<u>What a prospect for a country when its rural population was changed into a great band of gamblers!"</u>

"<u>Even worse was the **breaking down of the morals of the country at large**</u>, resulting from the sudden building up of ostentatious wealth in a few large cities, and from the gambling, speculative spirit spreading from these to the small towns and rural districts. From this was developed an even more disgraceful result,—the decay of a true sense of national good faith."

White documents the rise of betting instead of honest commerce; the obliteration of thrift; increase in speculative gambling; the breakdown of morals. Does this sound familiar, does it remind you of our own predicament?

So this is the progression of investment culture based on a monetary policy built on an illusion. It is a kind of magical thinking that ends up as mass self-delusion and dishonesty. Money printing and a misunderstanding of inflation leads many to think wealth creation is disconnected from the creation of real goods and real services. Because money if practically free, investors are temporarily allowed to believe things like windmills can power steel mills, or that we don't even need steel mills. The illusion of wealth masks the declining productivity of industry, and hides the creeping poverty among the working class. Unable to save or move up the ladder, but coddled by increasing government handouts (like Pandemic subsidies) that give them temporary relief, many simply give up on the virtues required to be productive members of an economy. This is the demoralization of the population that Hazlitt describes and that Andrew Dickson White describes. And I contend this social condition is behind the wide acceptance of the phony story that was FTX and Sam the Bankster Fraud. This mass hypnosis allowed his massive fraud to go undetected for years while he was making fools of depositors, celebrities, politicians, and professional investors.

WHAT IS THE LESSON? HOW CAN YOU AVOID THE PITFALLS OF AN INFLATIONARY, SPECULATIVE INVESTMENT CULTURE?

The first lesson is to always **remember that inflation is not rising prices, but government money printing.** Remember all the things money printing causes, not just rising consumer prices. Training yourself to think this way allows you to see many more results of inflation than just rising prices at the grocery store. Tracing as many connections as you can, you can see that printing money gives an enormous arbitrary advantage to the early recipients of the money; that this dilutes the real wealth of everyone else; that money printing encourages everyone to get in on the scam so they can plunder everyone else because that is what everyone else is doing to you! That is the kind of incentive inflation sets in motion.

So how do we restore the morality that inflation wants to take away from us?

The "civics" lesson is that **we need to choose better stewards of our money**. I would love to end the Fed entirely but I have little hope that will happen soon. At the very least, we need better, more knowledgeable, and more honorable politicians and financial regulators. (Again, I would prefer no regulators, but that will not happen any time soon.)

One immediate problem I see is that our better politicians need more knowledge of the monetary system and the money creation process. I've noticed that the politicians and economists who best understand the monetary system tend to be social engineers. They are the collectivist types, not the free market types. On the other hand, the free market advocates generally do not understand money and banking as well as their political adversaries. They are outnumbered by amoral technocrats.

So as citizens we have to first educate ourselves about money creation and its consequences. We have to understand the current system before we can reform it. As you know, that is what this podcast, HardmoneyJim, is all about. Then we need to vote for better politicians, who will hopefully appoint better regulators. That's what we can do at the level of public, political action.

But there is an equally important personal lesson for individual investors, a lesson we all need to keep in mind as we try to make our way through an inflationary world. I believe the **personal lesson to learn from the SBF fraud fiasco is to always practice personal integrity in your own investing.**

What do I mean by personal integrity in the context of investing? There is a saying that you can't cheat an honest man, which I take to mean, If you are honest with yourself, you are less likely to be fooled by a scam.

And how do you stay honest with yourself? You have to learn to **be comfortable with your own knowledge, and don't try to exceed it**. Learn all you can, of course, and increase your investment knowledge as best you can, but no matter how much you learn you will never know everything about investing; that is just impossible. In an inflationary world, the hype and the speculation around you will try to undermine your integrity, and convince you that you can get something for nothing. Don't succumb to it!

You must stay within your own rational intellectual boundaries. Just because others seem to be making a killing, don't try to imitate them in a second-hand way. **You cannot do better than your own mind,** that is, you can't do better than your own reasoning and judgment. Do not bite on a new investment idea just because someone else does. You must stay first-handed; you must make your own decisions.

Remember that ignorance about a particular aspect of investing is not stupidity. So don't think you are stupid for not being in on the latest investment fad, no matter how much your friends brag about the money they made. For example, if you do not know enough to own stocks, do not own stocks. (BTW, many and perhaps even most investors have no business buying or selling in the stock market, in my opinion.)

If you hire an investment advisor, or if you buy an investment fund, do it because the decision-makers are an extension of what **you already know or at least what you could know**. For example, if you are *capable* of understanding a conservative investment in a company's stock, but do not have time to research a portfolio of stocks in detail yourself, there is nothing wrong with farming out that research to a well-vetted, trusted advisor.

On the other hand, if someone tells you, they have a proprietary system of investing that can turn a 3% yield into a 9% yield with very little risk (like the LDI programs that scorched British pension funds in September, recall our discussion on that?) remember you are entering that world at your own risk, so don't be surprised if you pay a high price. So to summarize this point, do not invest in what you do not understand, and that goes for stocks, bonds, options, crypto, meme stocks, and anything else that is outside your understanding.

And do not worry about "FOMO," the fear of missing out, although it can be a tempting pull. I have a saying based on years of experience: In investing, the chance of a lifetime comes along about every three months. Keep your eyes open, and eventually, you will find a good investment prospect that is within your sphere of competence.

And finally, when evaluating an investment, **always start with true economic value, which means the product or service in question must be a win-win for all parties involved**. Real investment involves real production. This means all parties to a transaction must be better off after the transaction than before it. If you invest in a company that makes and sells widgets, both the buyers and the sellers of widgets should be happy with their activities. "Win-win" requires appropriate transparency and complete honesty in all transactions.

Let me give you an example of the opposite of win-win. After Bernie Madoff was caught and punished for fraud, many of his clients said they knew all along he was cheating, but they went along with it. Why did they? Because they thought Madoff was cheating the market, but not them! They knew his returns were too good to be true, but they assumed he was trading on tips from insider trading, not making money due to superior investment analysis. They thought he was merely violating "regulatory" rules, which would have put him in jail if he was caught, but until that happened, the clients thought they could reap the benefits. They assumed Madoff was their personal Robin Hood, stealing from the market somehow. They knew Madoff was cheating in some way, but they thought, Bernie would never cheat me. But stealing his client's funds was exactly what he was doing.

Now I suspect at least some of Madoff's clients were innocent, but any of them who believed he was making them money by cheating someone else, but not them, is naïve and cynical all at once. Their desire to get something for nothing got in the way of their rationality. If they had started with a "win-win premise, they could not have gotten involved with him.

So, if you are tempted to think you can legitimately make money by deceiving or cheating other people, well, you need to get your mind right. A real investment turns into genuine products and services that add real wealth to the world, i.e., something that improves living standards in some tangible way.

When your reason says no, you have to listen to it. Let me give you a couple of examples of what I have stayed away from, things I have said “no” to. I say this just to illustrate a rational investment process.

I have not invested in cryptocurrencies, even Bitcoin, the original crypto coin and possibly the best of the lot. I **do not** claim I am right about Bitcoin. Frankly, I would like to believe Bitcoin is a good solution to the ravages of fiat money, because we need a solution.

But I truly do not see how Bitcoin can solve the fiat money problem. If that is because I am simply not smart enough to understand how it solves that problem, so be it. Does bitcoin solve a genuine problem, or is it merely a solution in search of a problem? What does it actually accomplish for mankind? As I see it, we are 13 years in since Satoshi Nakamoto’s ingenious paper (you should read it by the way) and there is still no compelling use case for Bitcoin that I can see. If it does end up being used as money, then I will use it and happily benefit from it at that point. But how can it be valued at 60k one month and 16k a few months later? How do you explain that, when there is no real use (that I can see) for this admittedly ingenious database? I don’t invest in it because ultimately I trust my own mind as far as it will take me, but only that far.

Now some very smart people, people I respect, have told me with great conviction that Bitcoin should be worth at least 100k per coin, maybe even higher. Others have said blockchain technology will revolutionize payment systems. OK maybe, but even if that turns out to be true, how does that outcome connect to the current price of a bitcoin? Remember I am musing here, trying to illustrate my own thinking processes. The point is, I know better than to invest in complex schemes that I don’t understand. If Bitcoin is really a thing, sorry, I don’t get it, so I’ll pass on the opportunity.

The same thinking process would apply to scams like FTX. In general, **if you don’t understand how it works, stay away.** This little maxim alone will keep you safe from most inflation-fueled scams like BFX

Another example of investments I have avoided involves avoiding what I consider to be counterfeit ideas. To illustrate, would you invest in a scheme to sell religious relics to devoutly religious people? Think of how that could go wrong.

Personally, I will not invest in what I consider to be ideological fraud. For example, for 30 years I have watched the global warming/ climate change hype unfold. There were many times I could have profitably invested in windmills and solar energy companies. To be fair, there is a limited legitimate, specialized market for some of these energy applications, so they are not all scams.

But the problem is these heavily subsidized renewable energy industries are built on a huge lie, the propaganda that carbon dioxide is a harmful substance that will disrupt the climate so badly that civilization will suffer irreparable harm. So therefore we must all declare war on CO_2. And yet we know carbon dioxide is the building block of nearly all of life, that it helps plants grow bigger and faster while using less water, and that CO_2's incremental effects on atmospheric temperature diminish as its concentrations go up. We further know that in geological history there were many periods where the atmospheric temperature was much lower than today even though the CO_2 concentrations were much higher. So how can CO_2 be the main control factor for atmospheric temperature, much less for the entire climate? And yet the energy policies of virtually every government on earth assume this is true. Even worse, eliminating atmospheric CO_2 is the formal organizing principle of many political parties and of the anti-industrial ideology prevalent today.

I don't buy it, so I avoid schemes like carbon credits and carbons sequestration, even though there might be a lot of money involved in the short run. But I refuse to suspend rationality to make a buck.

The broad point is, don't worry about missing out on the latest investment thing. There are thousands of legitimate investments out there with the permanence, scarcity, and independence required of any good business venture. So keep your head, keep your integrity, be hard to convince, and don't succumb to FOMO. You won't always be right, but practicing rationality will lessen your vulnerability to the scam culture that breeds during inflationary times like our own.

That is probably a good place to stop. I hope you enjoyed our discussion on how properly understanding inflation can help you avoid the scams that often accompany an inflationary economy