

14.1 Economic and Political Warning Signs

Source: <https://www.nytimes.com/2019/01/22/business/dealbook/world-economic-forum-klarman.html>

Background: In Greek mythology, Cassandra, the daughter of King Priam and Queen Hecuba of Troy, was cursed by the God Apollo to make accurate prophesies about the future that no one would believe. Seth Klarman, a capitalist and billionaire investor who manages the Baupost Group, which includes the huge endowments of Harvard and Yale Universities, may be the 21st centuries version of Cassandra. In a 22-page 2018 year end report to investors, Klarman warned that widespread social tensions, rising debt levels, and receding American leadership on the world stage were creating an expanding political and social divide that could end in a global economic calamity. The letter was later distributed at the January 2019 meeting of the World Economic Forum in Davos, Switzerland attended by many business and national leaders. In the letter Klarman made dire predictions about world unrest and the global economy. One thing he did not discuss was the impact of climate change. Examine excerpts from Klarman's letter, analyze his predictions, answer questions 1-4, and write your own letter to world economic and political leaders.

Questions

1. Why is Seth Klarman in a position to have his warnings taken seriously by global capitalist leaders?
2. Why does Klarman believe "It can't be business as usual"?
3. What warning signs does Klarman see in the global political economy?
4. Why is Klarman worried that his analysis of the economic and political future might be ignored?

A. "It can't be business as usual amid constant protests, riots, shutdowns and escalating social tensions . . . As the post-World War II international order continued to erode, the markets ignored the longer-term implications of a more isolated America, a world increasingly adrift and global leadership up for grabs."

B. "Social frictions remain a challenge for democracies around the world, and we wonder when investors might take more notice of this . . . Social cohesion is essential for those who have capital to invest . . . It is not hard to imagine worsening social unrest among a generation that is falling behind economically and feels betrayed by a massive national debt that was incurred without any obvious benefit to them."

C. "The seeds of the next major financial crisis (or the one after that) may well be found in today's sovereign debt levels . . . There is no way to know how much debt is too much, but America will inevitably reach an inflection point whereupon a suddenly more skeptical debt market will refuse to continue to lend to us at rates we can afford. By the time such a crisis hits, it will likely be too late to get our house in order."

D. "Individuals, professional investors and financiers are prone to project their own recent experiences into the future. So when adversity is absent, investors become complacent. They assume good times will continue, and they grow careless about risk, perceiving it through rose-colored lenses . . . More and more people are choosing to only seek out information from those who share their views . . . Technology and social media have made it increasingly easy to do so."