Interviews

**02/10/2016 - Felix Zulauf talks Financial Repression & Warns of What is Ahead**



FRA Co-founder Gordon T. Long recently interviews Felix Zulauf, Founder and President at Zulauf Asset Management AG.

FELIX ZULAUF has worked in the financial markets and asset management for almost 40 years. He started his investment career as a trader for a large Swiss Bank and received training in research and portfolio management thereafter with several leading investment banks in New York, Zurich and in Paris. Felix joined Union Bank of Switzerland (UBS), Zurich, in 1977 and held several positions over the years including managing global mutual funds, heading the institutional portfolio management unit and at the same time acting as the global strategist for the UBS Group. After two years with a medium-sized Financial Organization as a member of the executive board, he founded his wholly owned Zulauf Asset Management AG in 1990, allowing him to independently practice his own individual investment philosophy.

Mr. Zulauf focused on macro and strategic issues within the firm. In spring 2009 Zulauf Asset Management was split in two parts and Felix Zulauf fully owns the split-off Zulauf Asset Management AG focusing on some advisory activities to selected family offices and institutions including a US based global macro fund. Felix Zulauf always believed that the world economy and the financial markets move in cycles. That has helped him avoiding all the major casualties in the financial markets since the 1973/74 bear market in equities. He has been a member of Barron’s Roundtable for over 20 years.

**QUESTION: How would you define Financial Repression?**

**FELIX ZULAUF:** “Financial Repression is an attempt by the government and central banks to reduce free market forces and the freedom of individuals to do what they would do if they had the free choice.  It is compounded by market manipulations such as money printing, regulations, and distorting the interest rate; which are the best capital allocator there is and much better than any committee or central bank. Government authorities force capital to be allocated wherever they want capital to be allocated and not where the market would allocate it. It is the beginning of an era that will lead to decisive decline of prosperity and individual freedom.”

**QUESTION: What type of economist would you consider yourself?**

**FELIX ZULAUF:**“I am closer to the Austrian School. It is important to know that economies and financial markets do not progress in a linear way. They are cyclical; there are expansions and contractions and recessions have the job to remove the excessive build up in expansions. Bear markets have the same job, to reduce excess in boom markets. This is a very natural action and reaction process.”

**QUESTION: You wrote the following – could you elaborate on it:**

**FELIX ZULAUF:***“At some point in time we have to get rid of the debt that we have. Obviously central banks are trying to do that by financial repression. The consensus among the investment community is that financial repression will work. I’m not so sure. Financial repression means that they put interest rates below the inflation rate, and by doing that the debt-to-GDP level of the different segments in an economy, the households, governments, etc., drops down over time. I’m not sure that policy will be successful, but for some more years they will try that. If it doesn’t work, then we will go into other things such as currency reforms, confiscation .. It’s very hard to imagine the world will solve its problems in a conventional way. More likely we will see more government controls on capital flows as things get out of control over time.”*

Central banks have used mechanisms to reduce the level of debt ration within the economy. They have tried these mechanisms for many years and it hasn’t worked. You have seen some deleveraging in parts of the world economy, but in total the world economy has leveraged more.  Debt to GDP is the highest level it has been in modern history and therefore this route the central banks have taken has failed.

**QUESTION: Where are we in the possible outcomes you warned us of?**

**FELIX ZULAUF:**If it unfolds in a free market mechanism fashion then it would lead to massive bankruptcies but I doubt the authorities will allow this to play out be cause it can lead to a systemic collapse. I think eventually there will be another burden on taxpayers and there will be attempts to confiscate some of the wealth out there through whatever means they can think of to bring down and finance the debt. The bottom line is in the future we will be less wealthy.

**QUESTION: How will the leverage failure unfold?**

**FELIX ZULAUF:**I don’t know if there is a way to escape. Even if you made all the right decisions and came out a winner and were able to preserve your capital, they would most likely tax you on whatever gains you make. Ideologically, we are in a very highly socialist environment.  You have to have a certain diversification as an investor and you have to make sure you’re in the right jurisdiction.

**QUESTION: How can the fed raise rates into a economy where broad fires are burning especially in credit markets?**

**FELIX ZULAUF:**Quantitative easing does not work. You cannot fix the problems rampant in today’s economies by printing mass amount of money. You have to solve problems from a political and economic angle but not by printing money. I don’t expect any further rate hike by the Fed, they are attempting normalize but it won’t work because the economy is soft. They have tried and I think it is becoming more and more apparent to them that money printing does not work. Rather than money printing I think they have adopted a bond yield target. Central banks are tired of QE, they realize they have to leave some pressure on the economy, politicians, and entrepreneurs move forward and make the necessary decisions. I don’t think this is a good message to the financial markets, because it means the financial markets have to suffer more pain until the central banks come in and attempt to fix the system again.

**QUESTION: What does the BOJ’s recent announcement of NIRP signal?**

**FELIX ZULAUF:**With the world economy growing at such low rates, we have a risk of running into systemic growth again. I suspect the Chinese will eventually let the currency go and then you have another deflation hit the world economy, this is when you run into another systemic crisis.

Letting the currency go and letting the currency find its own equilibrium will lead to a central bank crisis. This affects pricing power and when pricing power is affected it trickles down to profit margins, and therefore corporate earnings are going to decline.

Abstract written by, Karan Singh

Karan1.snigh@ryerson.ca