

Twitter Thread by Peter Young (The Austrian)



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@TheAustrian3



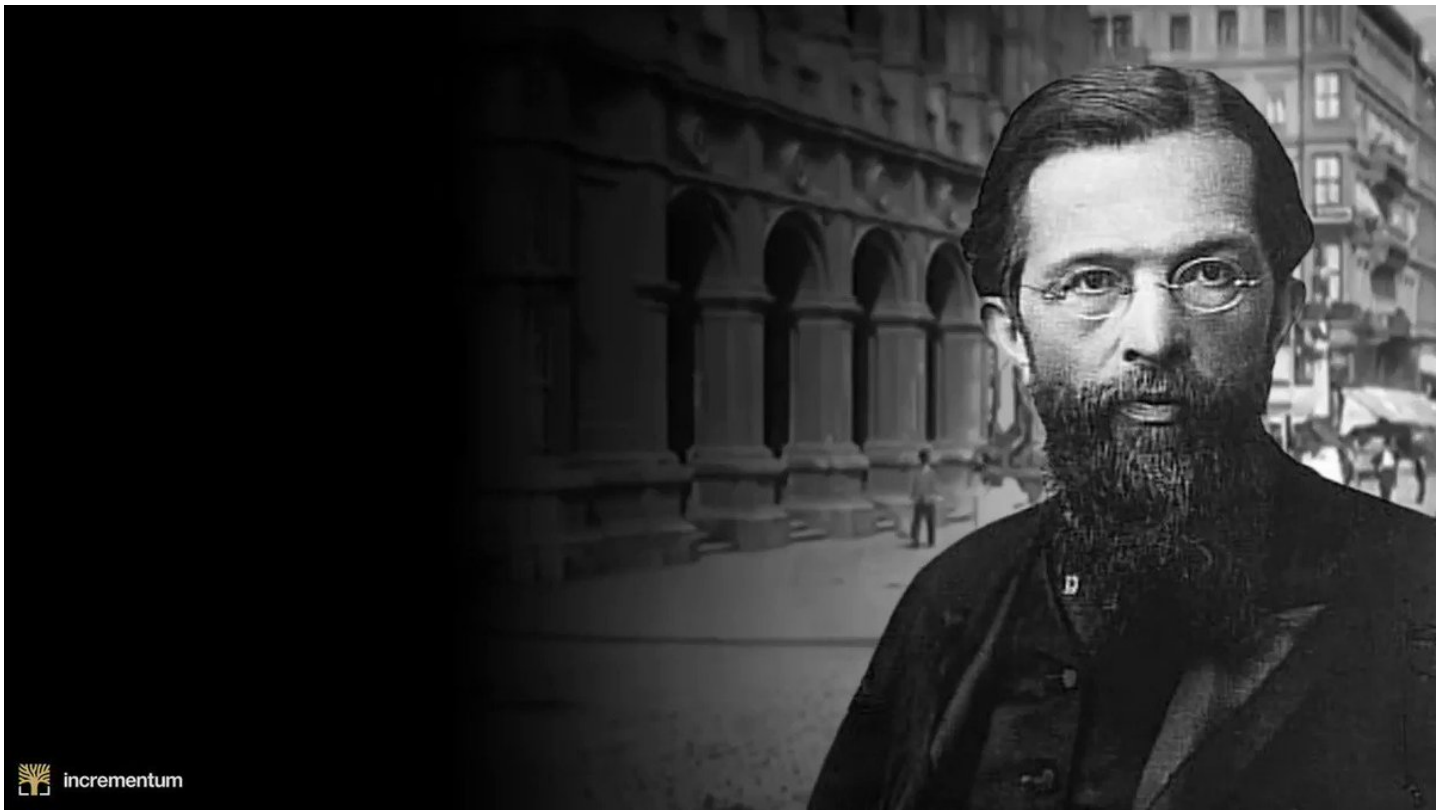
The insights of the Austrian School of Economics will prove invaluable to investors navigating the distorted global economy of 2021.

This 18-tweet thread walks you through the definitive guide "Austrian School for Investors" by @scholarium_at, @RonStoeferle and @MarkValek.■



1/ The roots of the Austrian School can be traced back to its founder Carl Menger, whose 1871 book Principles of Economics provided a new foundation for economic theory and solved the age-old "Paradox of Value".

From Menger's work we can derive 4 pillars of Austrian Investing.



2/ 1: The Subjective Theory of Value recognises that value is not determined by any inherent property of a good, nor by the amount of labor necessary to produce it, but by the importance an acting individual places on it for the achievement of their desired ends.

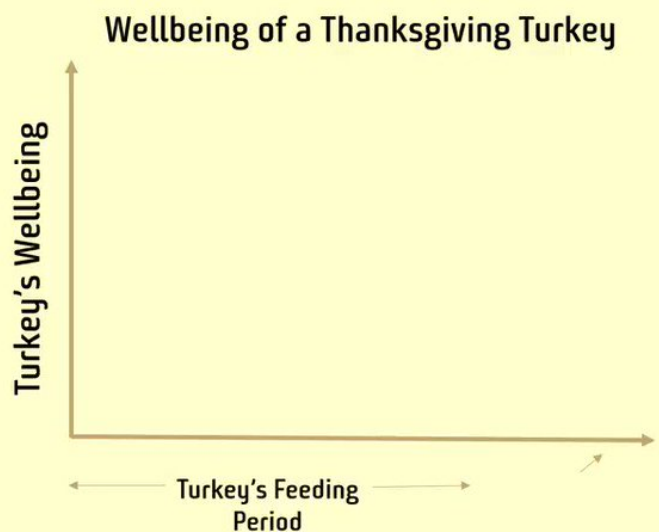


1/ SUBJECTIVISM



Prices are determined by subjective valuation of an uncertain future.

We cannot use past price trends to extrapolate confidently into the future.



3/ 2: The Law of Diminishing Marginal Utility recognises that as more units of a homogenous good are acquired, the utility derived from each additional unit declines.

This wide-ranging insight helps explain important economic phenomena such as the historical emergence of money.



2/ MARGINALISM



4/ 3: Methodological Individualism is the principle that economic phenomena result from the actions of individuals.

Collective magnitudes like “the people” cannot act, & therefore cannot be treated as ultimate causes.

Austrians are cautious in their use of economic aggregates.



3/ INDIVIDUALISM



“Methodological individualism, far from contesting the significance of collective wholes, considers it as one of its main tasks to describe and to analyze their becoming and their disappearing, their changing structures, and their operation. [...] It merely means that definite actions of individuals constitute the collective.”


Ludwig von Mises, Human Action




5/ 4: Causal Realism entails basing economic explanations on the notion of cause and effect grounded in human action.

Austrians reject posited functional relationships between abstract statistical constructions such as CPI, GDP or unemployment.

[@saifedean](#) explains■




4/ CAUSAL REALISM




"It is the action of humans that shapes economic outcomes, not the aggregate measures constructed in government statistical offices.

This is not to say that all statistical measures are worthless noise, as there can be value to be had from examining these aggregates as close approximations of economic phenomena.

The Austrian objection is in treating these statistical artifacts as causal factors and assuming the relationships can be extrapolated into the future predictively."



Saifedean Ammous, Principles of Economics

 **incrementum**

6/ These four pillars provide us with a framework for thinking about economics.

Underpinning each is an acknowledgement of a fundamental fact about economic life: that humans act under conditions of scarcity.

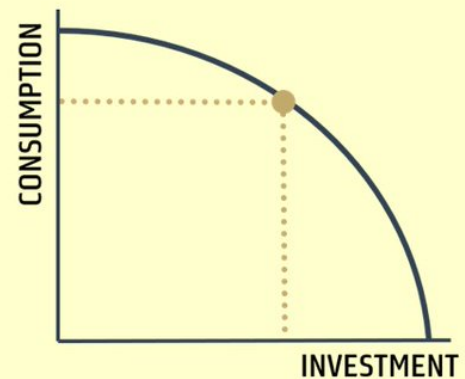
When we employ resources there is always the need to make trade-offs.

SCARCITY MAKES TRADE-OFFS NECESSARY

Due to scarcity there are always trade-offs to be made when making economic decisions.

This includes trade-offs between consumption and investment.

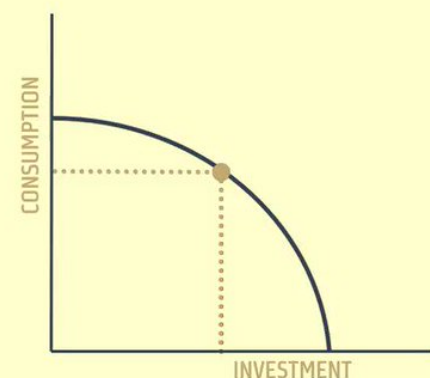
At any given time, the combination can't move beyond the curve known as the Production Possibilities Frontier (PPF).



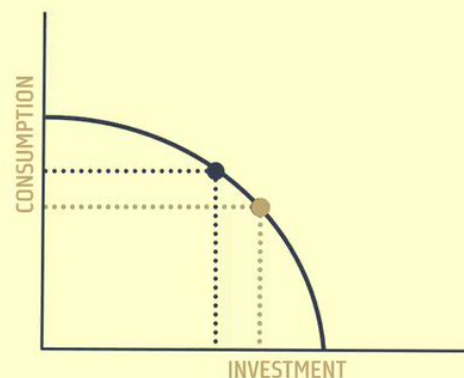
7/ Scarcity is key to understanding the relationship between consumption, investment and economic growth.

Given that resources are finite at any given time, if we want to increase investment and thereby increase the rate of growth, we need first to reduce present consumption.

ECONOMIC GROWTH INCREASES WITH INVESTMENT



MODERATE CONSUMPTION,
MODERATE INVESTMENT SCENARIO



LOW CONSUMPTION, HIGH
INVESTMENT SCENARIO

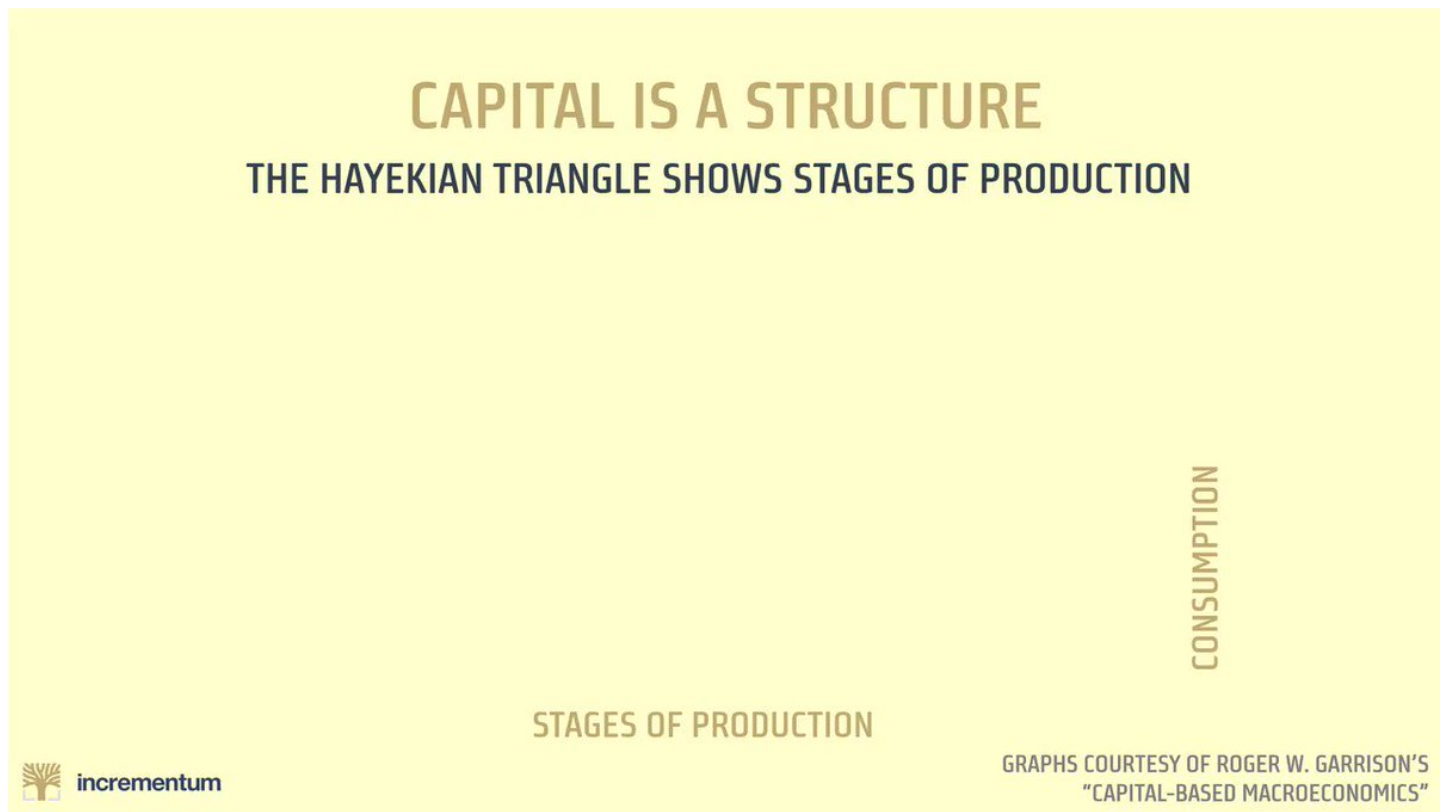


GRAPHS COURTESY OF ROGER W. GARRISON'S
"CAPITAL-BASED MACROECONOMICS"

8/ "Capital" is another concept important for understanding economic growth.

Unlike Keynesians, Austrians recognise that a nation's capital is a structure made up of distinct goods tailored to specific production stages.

Capital isn't amorphous, nor is it the same as "money".



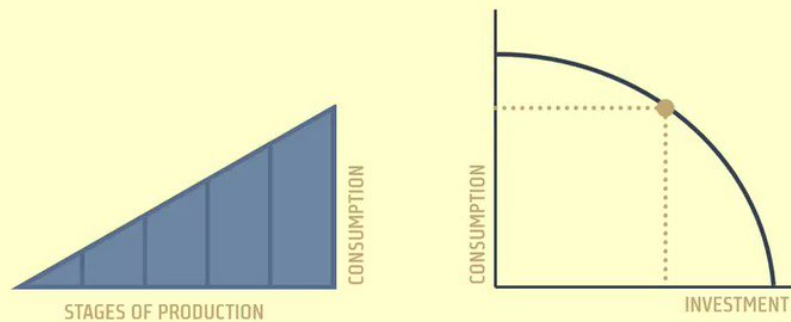
9/ In a free market, interest rates play an important role in coordinating economic activity.

They help society find the right balance between consumption and investment.

But investors today live in a world where rates are heavily distorted by central bank intervention.

THE EFFECT OF SAVING ON THE CAPITAL STRUCTURE

COORDINATED BY INTEREST RATES

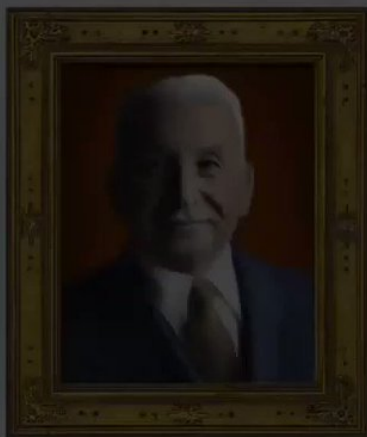


GRAPHS COURTESY OF ROGER W. GARRISON'S
"CAPITAL-BASED MACROECONOMICS"

10/ This intervention leads to the periodic booms and busts that are definitive of modern economies.

For investors looking to make sense of this phenomenon, Austrian Business Cycle Theory (ABCT) provides an explanation.

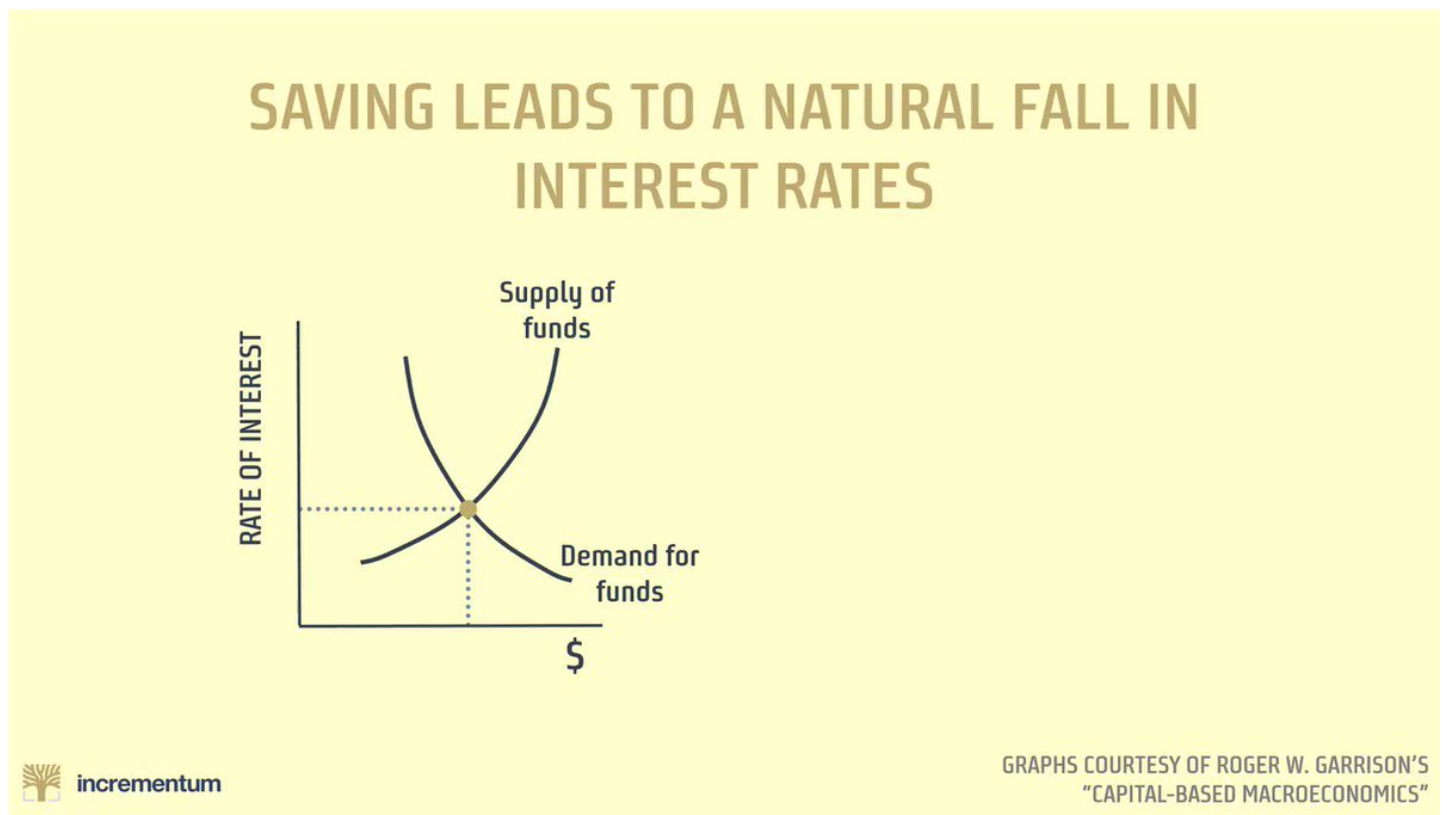
[@BobMurphyEcon](#) explains■



Austrian Business Cycle Theory

11/ In a free market, greater saving leads to a natural fall in interest rates, since more resources have been set aside for production.

For entrepreneurs, low interest rates are a signal that sufficient resources have been made available to undertake projects profitably.

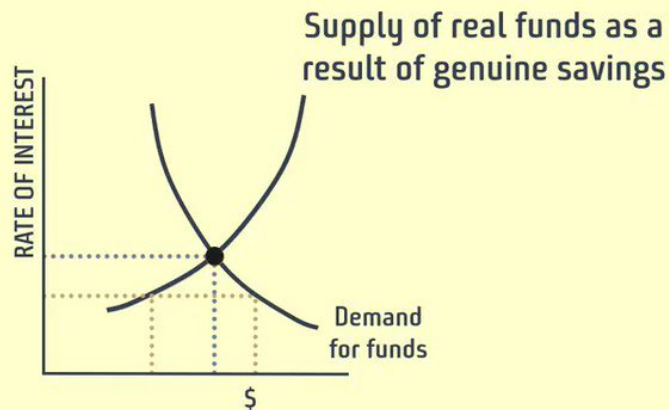


12/ But when central banks manipulate interest rates the crucial coordinating function they play is broken.

Authorities typically intervene to lower interest rates below their natural level by lending new money into existence.

This sends conflicting signals to the market.

MANIPULATION OF INTEREST RATES SENDS CONFLICTING SIGNALS TO THE MARKET

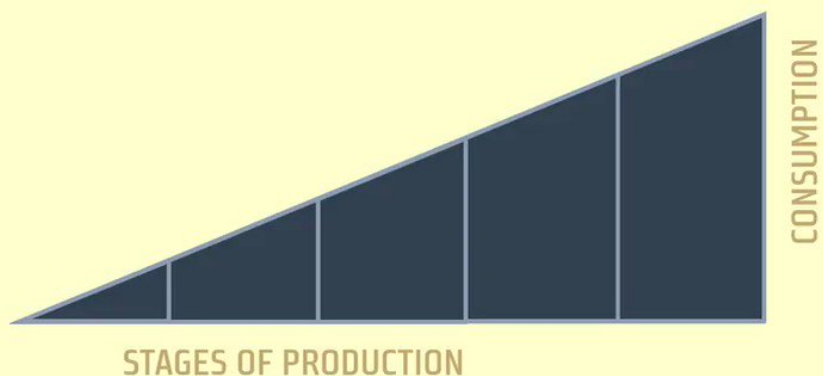


13/ It leads to:

>overinvestment in unprofitable projects as entrepreneurs are misled about the state of the economy. (We call these projects "malinvestments")

>overconsumption of consumer goods (and stimulation of late-stage production) due to decreased incentives to save.

ARTIFICIALLY LOW INTEREST RATES LEAD TO MALINVESTMENT



14/ Since early and late-stage production cannot be stimulated simultaneously, economic dislocation results.

It reveals itself in a recession: a "cluster of errors" where investors discover the resources needed to complete projects are insufficient.

@CaitlinLong_ explains■



15/ Whilst timings are notoriously hard to predict, understanding the character of cycles is key to protecting investments.

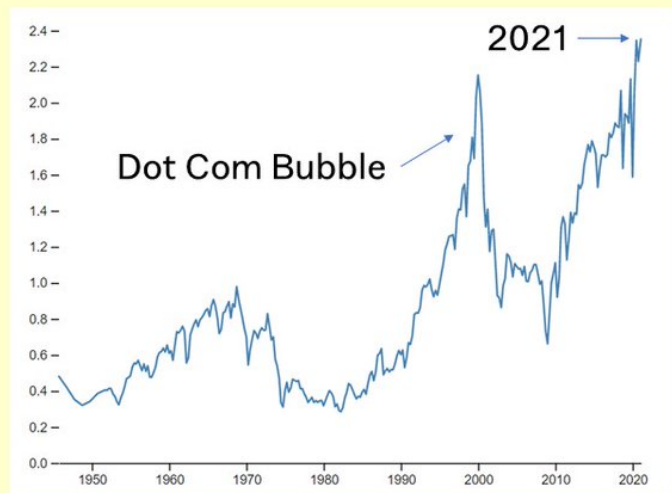
Metrics such as the Misesian Stationarity Index (Tobin's Q) and Rothbard-Salerno True Money Supply can help us gauge where we are in the cycle.

MISESIAN STATIONARITY INDEX

The Misesian Stationarity Index can – with certain limitations – measure the effects of an artificial monetary expansion.

It is calculated by dividing the total market cap of companies by their estimated replacement value, and can be seen as a measure of how overvalued the stock market is.

In 2021 it stands at an all time high.



FOR MORE ON THE MISESIAN STATIONARITY INDEX
SEE MARK SPITZNAGEL'S "THE DAO OF CAPITAL"

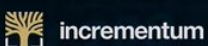
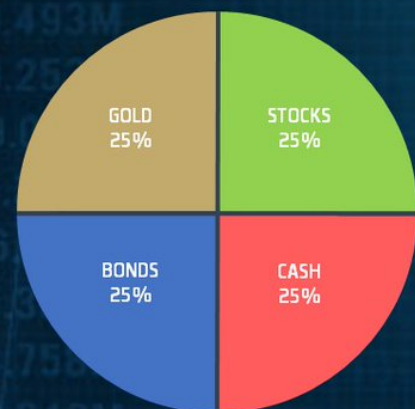
16/ Several prominent investment strategies have been influenced by ABCT.

They include Harry Brown's "Permanent Portfolio" which balances gold, cash, stocks and bonds to manage risks of the four scenarios for inflation and growth that are brought about by business cycles.

THE PERMANENT PORTFOLIO

Harry Browne's "permanent portfolio" has become a traditional investment strategy for those seeking to weather the four inflation scenarios that result from business cycles:

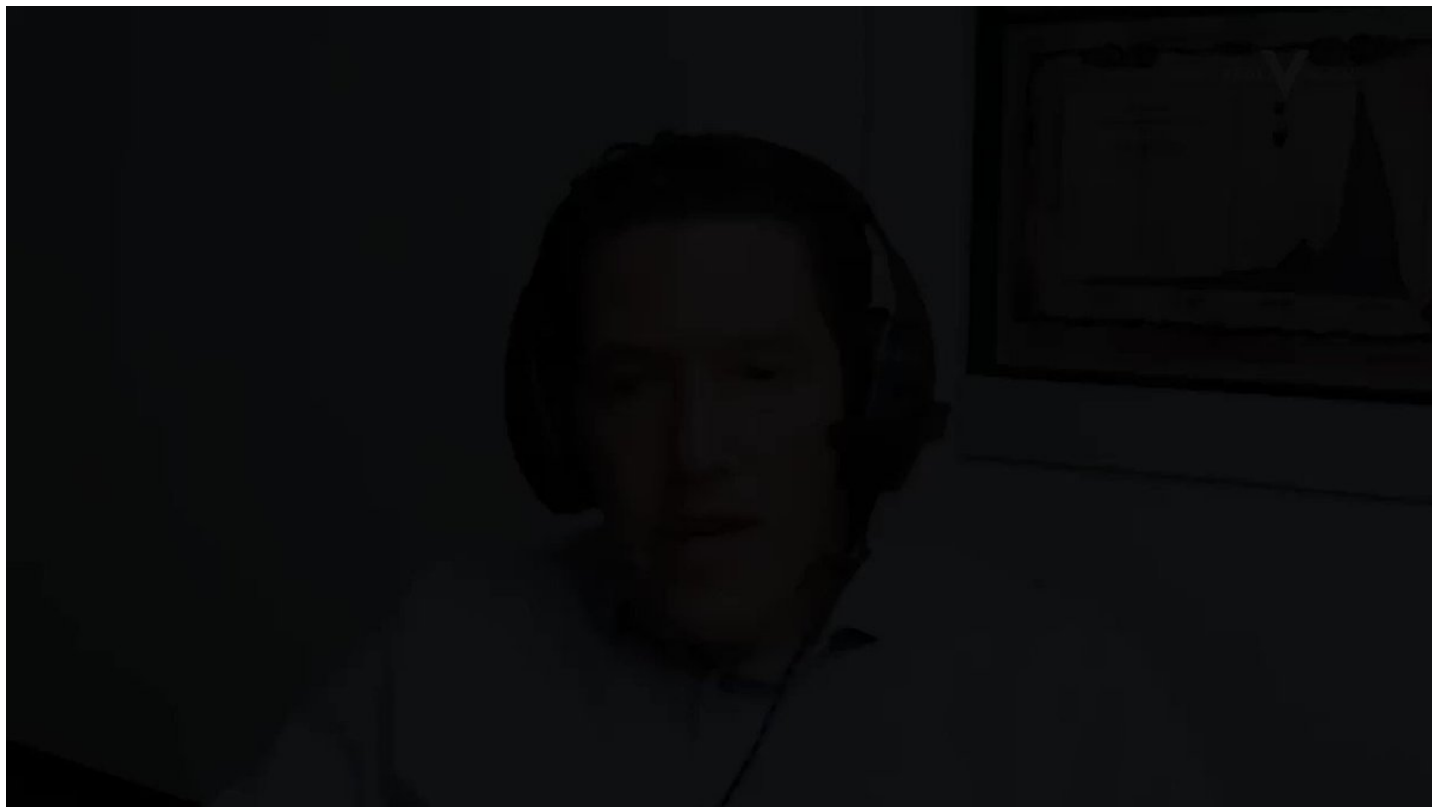
1. Inflationary growth (favorable for stocks and gold)
2. Disinflationary growth (favorable for stocks and bonds)
3. Deflationary stagnation (favorable for cash and bonds)
4. Inflationary stagnation (favorable for gold and cash)



17/ The recent rise of digital currencies like bitcoin has garnered intense interest from Austrians.

There are risks around its development, but Austrian theory suggests that bitcoin's attributes make it well suited to grow in use as a store of value.

@MarkValek explains■



18/ The Austrian School provides a sound theoretical foundation for our engagement with economic reality.

It equips us with the tools we need for navigating the uncertainty of a distorted world.

Its insights help us recognize patterns so we can invest wisely and act ethically.

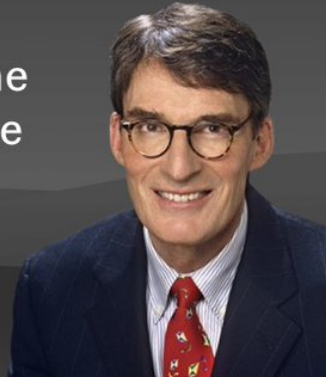
THE MODEST ROLE OF GOOD ECONOMIC THEORY

"When you have a theory to work from, you avoid stumbling around in the dark over chairs and night stands.

You can begin to visualize in the dark, which is where we all work. The future is always unlit. But with a body of theory, you can anticipate where the structures might lie. It allows you to step out of the way every once in a while."



JAMES GRANT
"AUSTRIAN" INVESTOR

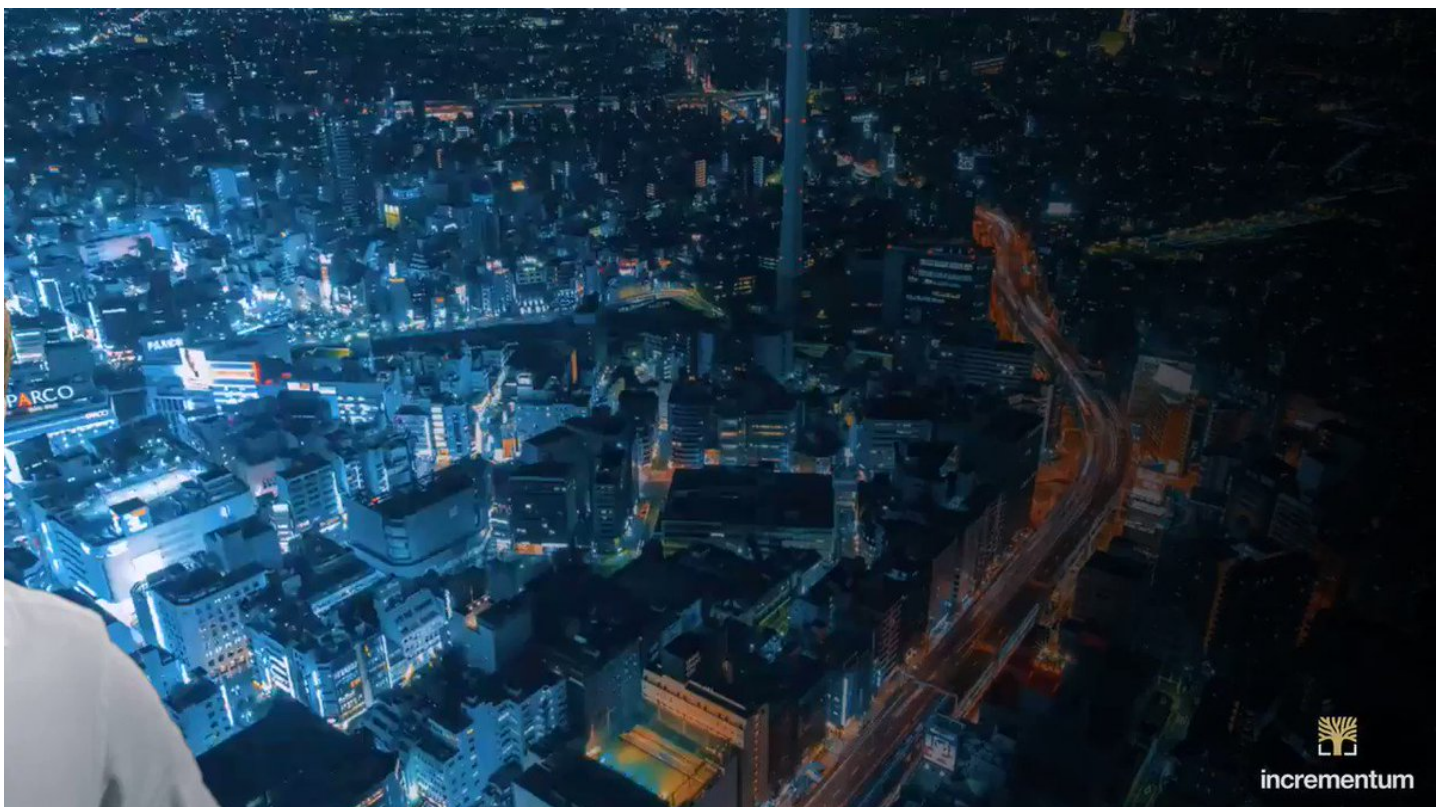


Thank you for reading.

This thread was produced by [@TheAustrian3](#) as a partnership with "Austrian" investment firm Incrementum.

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You can find out more about Incrementum here: <https://t.co/9ybj09lgMq>



RESOURCES/1

Austrian School of Investors by [@scholarium_at](#), [@RonStoeferle](#) and [@MarkValek](#), on which this thread was based, is available on Amazon here: <https://t.co/4Q8HRCSZob>

Resources by tweet number:

5: Principles of Economics by [@saifedean](#): <https://t.co/fmBcyu08Dm>



RESOURCES/2

7-14: Roger Garrison ABCT presentations: <https://t.co/TP5YM94UjQ>

11: Bob Murphy explains ABCT: <https://t.co/A554TKiOmL>

15: [@RaoulGMI](#) & [@CaitlinLong](#) interview: <https://t.co/v9tPsqQ1g5>

18: [@RealVision](#): [@AshBennington](#) & [@MarkValek](#): <https://t.co/lb0dcqMzhv>

Another excellent explanation of Austrian Business Cycle Theory is given in this 8 minute talk by [@ThomasEWoods](#): <https://t.co/lvpdA8EN4B>

For those looking for a deeper dive, this explanation of ABCT by Roger Garrison is recommended: <https://t.co/NmfHAjeg4g>

His slides, which were the inspiration for my business cycle graphics above, can be viewed here: <https://t.co/TP5YM94UjQ>

