

“Number Go Up” & The Ouroboros-Like Asset Inflation of the Post GFC Era

“Number Go Up” [is] one of the many memes that sprang up during a previous crypto surge, representing a similar vibe as “to the moon” or “hodl” – the idea that the faithful would keep buying in the belief that prices would continue to climb. ...

it seems a safe bet that at least some of the recent enthusiasm is an ouroboros-like construct: People are buying because they expect prices will keep rising. Prices keep rising because people are buying.

That mentality seems to have spread beyond the world of crypto. ...Both crypto and Nvidia – heck, even the S&P 500 – have taught investors that, indeed, “number go up.” -[Julie Hyman](#), “[Number go up is alive & well](#)”

Ouroboros: noun, a circular symbol that depicts a snake or dragon devouring its own tail and that is used especially to represent the eternal cycle of destruction and rebirth. In alchemy, the ouroboros is considered one of the oldest symbols representing the idea of eternity...One of the most highly desired but challenging aims for an alchemist was to discover a way to turn a base substance such as lead into gold...¹

The symbol dates back to Tutankhamun’s tomb in the 14th century BCE, but the ouroboros first went viral in the 3rd century AD. It was then that one of the few alchemists credited with **actually** being able to turn base metals into gold wrote the *Chrysopoeia of Cleopatra*. The title, translated, means “Cleopatra’s Gold Making.”

Considering the financial benefits of such knowledge, one can only imagine how the text, penned on a single page of papyrus, would be popular. ^{2,i}



The Chrysopoeia of Cleopatra, possibly 3rd century AD

¹ Merriam-Webster Dictionary & [Ancient symbols: The Ouroboros in Alchemy, Gnosticism and Hermeticism](#)

² We kid, we kid! We have absolutely no idea if this thing ever went viral! KCR cautions readers: learning about this image can lead you down some deep rabbit holes. We do not recommend the endeavor but have provided some of the links we followed to get this information in the end-notes.

The alchemist Cleopatra and her mentor, a giant in the field of alchemy, are credited by some as having invented the chemical instrument and heat bath, the bain-marie, discovering hydrochloric acid and inventing hermetic sealing. Hydrochloric acid is used in everything from batteries to bridges – and we may owe much of modern life to these accomplished alchemists.

But back to the possible investment merits of alchemy. How to use the four basic elements of fire, earth, water and air to turn cheap metal into gold. This incredible feat of financial innovation eludes us to this day. Based on the many articles we read, KCR offers our readers two possible explanations for why this science has been lost:

- 1) Roman Emperor Diocletian burned all the books that explained how to turn lead into gold to prevent the Egyptians from gaining enough wealth using the technique to challenge the Romans. Having located and burned all copies, the science was lost forever. **OR...**
- 2) The people who saw lead turned into gold were being deceived by the alchemists, and any perceived wealth-creation was simply an illusion doomed to eventually fail under any significant scrutiny

It turns out that financial innovation is, in many ways, timeless. Today's alchemists lean not on fire, earth, water, and air. Instead, today's financial alchemists use fiat money, debt, equity, and real estate to create wealth.

Our paper today quotes extensively from terrific work McKinsey did in 2021 and 2023 on asset values. Titled [The rise and rise of the global balance sheet: How productively are we using our wealth?](#) and [The future of wealth and growth hangs in the balance](#), their research offers a comprehensive review of the increasingly untenable disconnect between asset prices and GDP on a global level.

Here is a brutally insufficient summary of our conclusions from McKinsey's impressive body of work:

- 20+ years of asset inflation have created a wealth illusion ever further detached from fundamental reality
- There are many paths forward. Unfortunately, most involve pain that few people are prepared for
- The most appealing path forward requires society to halt speculative capital misallocation

KCR readily admits to confirmation bias. McKinsey's work lends significant empirical heft to our pieces on:

- the brutal headwinds facing corporate margins that are above levels last [seen in 1929](#)
- our relentless hammering of [market-cap to GDP](#) metrics championed by Warren Buffett
- the growing evidence that [bipartisan support](#) for labor and [anti-trust](#) are the klaxons of change being recklessly disregarded by investors

Had we seen McKinsey's work at publication in 2021, it would have helped us respond to those who grumbled about our relentless adherence to the lessons of history and our fervent belief that this time is not different.

Weighing in at over 200 dense pages of data-rich material, the McKinsey work is a "must read" in our view. But we recognize the works' complexity and our readers' time constraints make it unlikely many will get through them. Today's piece is "KCR-lite" and chart-rich. The pictures tell the stories better than we could.

This truly is a moment of "number go up." Every day this persists, the consequences of [capital misallocation](#) grow more severe. **But as always, epic capital misallocation creates significant opportunities for evidence-based investors willing to put even a small amount of their capital in "non-consensus" stocks.**

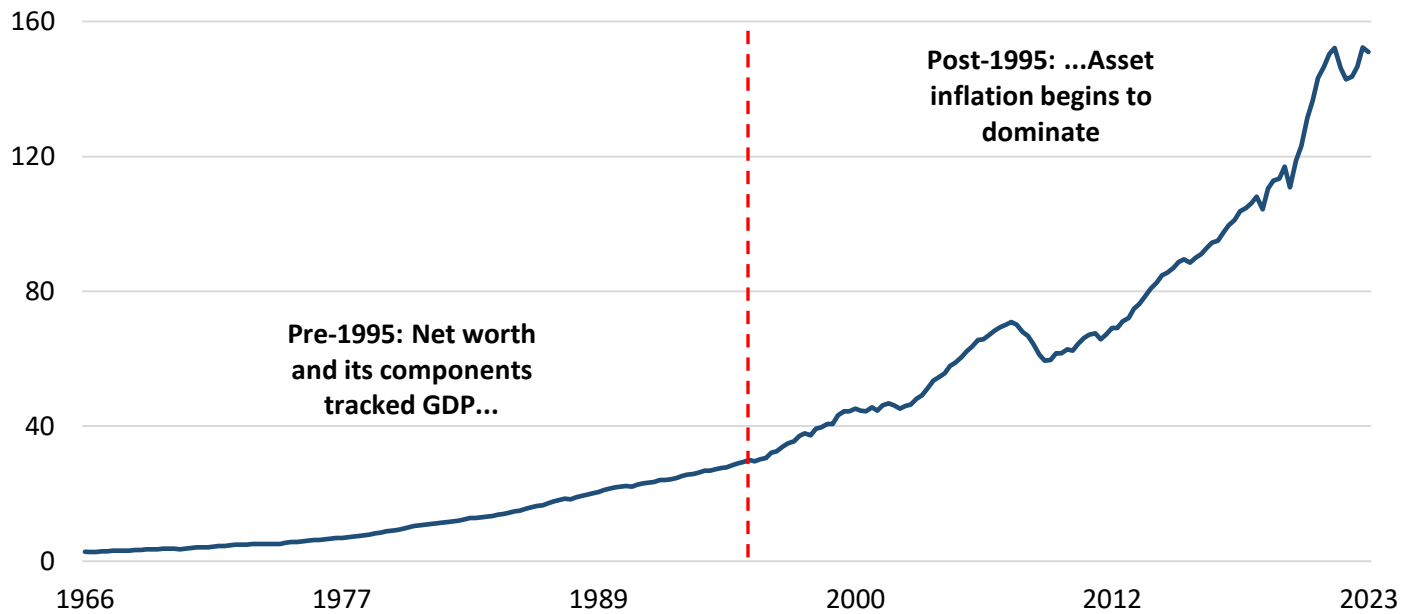
The stack of charts will begin with "net worth" and then move to the four basic elements that drive that figure: equity, real estate, debt, and profit margins. Each chart will be a pair – the nominal value of, say, net worth, and then that value scaled by US GDP. Any bolded text in the quotes from McKinsey is KCR's doing. Let us begin:

*"The past two decades stand in marked contrast to the post-World War II historical trajectory of global wealth (and debt) accumulation. Before the turn of the millennium, growth in global net worth largely tracked GDP growth. But then something unusual happened. **Around [1995]...net worth, asset values, and debt began***

growing significantly faster than GDP. In contrast, productivity growth among G-7 countries has been sluggish, falling from 1.8 percent per year between 1980 and 2000 to 0.8 percent from 2000 to 2018.”³

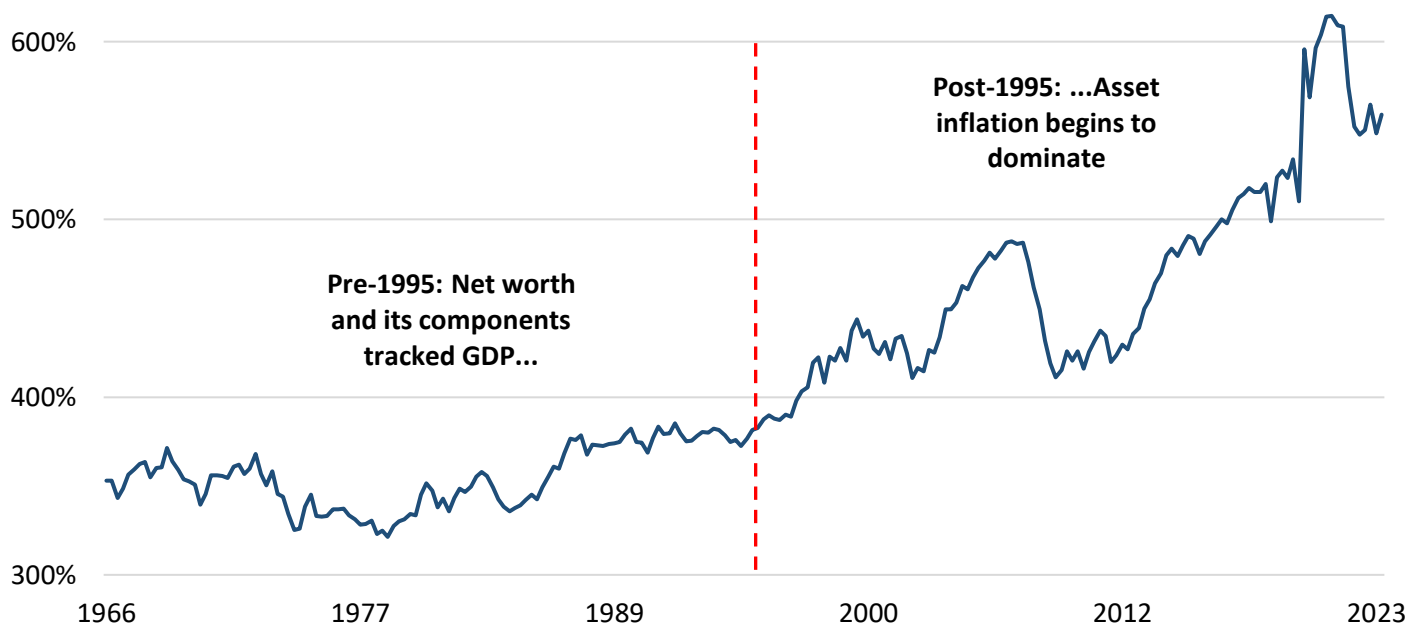
“Over the past several decades, there has been too little productive investment. In advanced economies, net investment has declined as a share of GDP. In the 2010s, this ratio was roughly 40 percent lower than before the 2008 financial crisis ... in the United States. ... growth in capital stock per worker dropped to the lowest rate in the post-World War II period. Public investment has also lagged...in infrastructure and affordable housing.”⁴

Net Worth (\$ Trillion)



Source: Kailash Capital Research, LLC, St. Louis Fed

Net Worth/ GDP



Source: Kailash Capital Research, LLC, St. Louis Fed

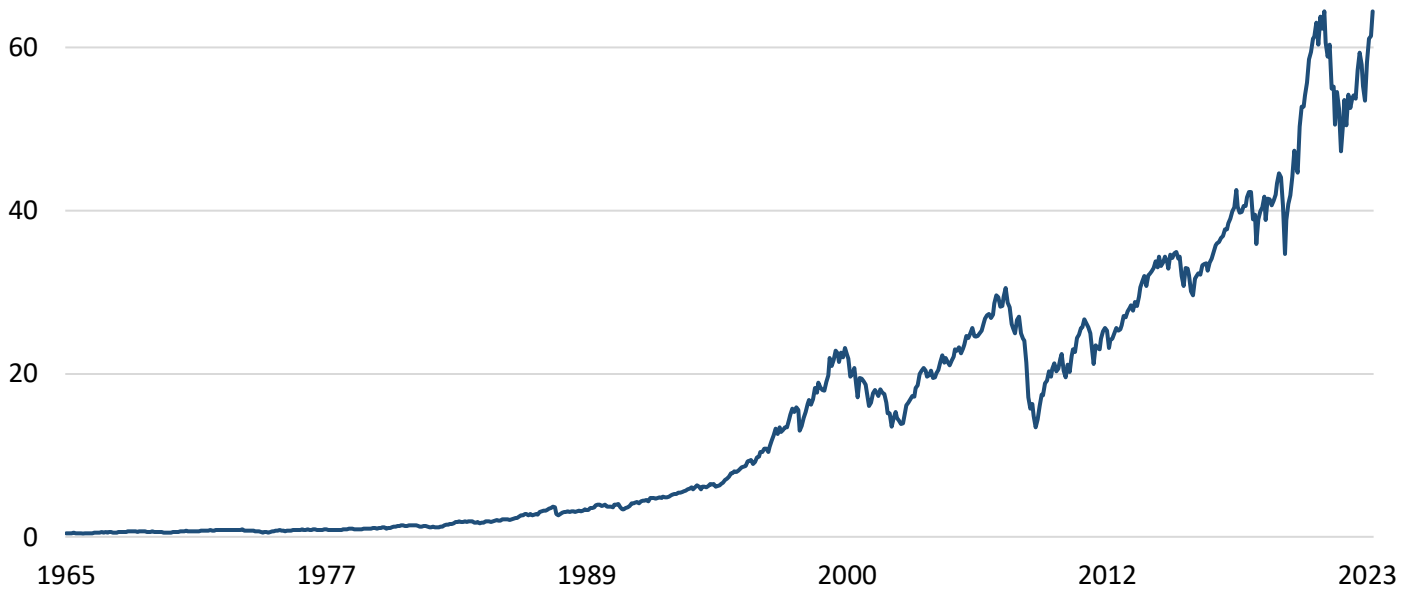
³ *The future of wealth and growth hangs in the balance*, McKinsey, p. 6

⁴ *IBID*, p 15

“Asset price inflation over the past two decades has created about \$160 trillion in ‘paper wealth’ [globally].⁵ Valuations of assets like equity and real estate grew faster than real economic output.⁶ Economic growth was sluggish, inequality rose, and every \$1.00 investment generated \$1.90 in debt.”⁷

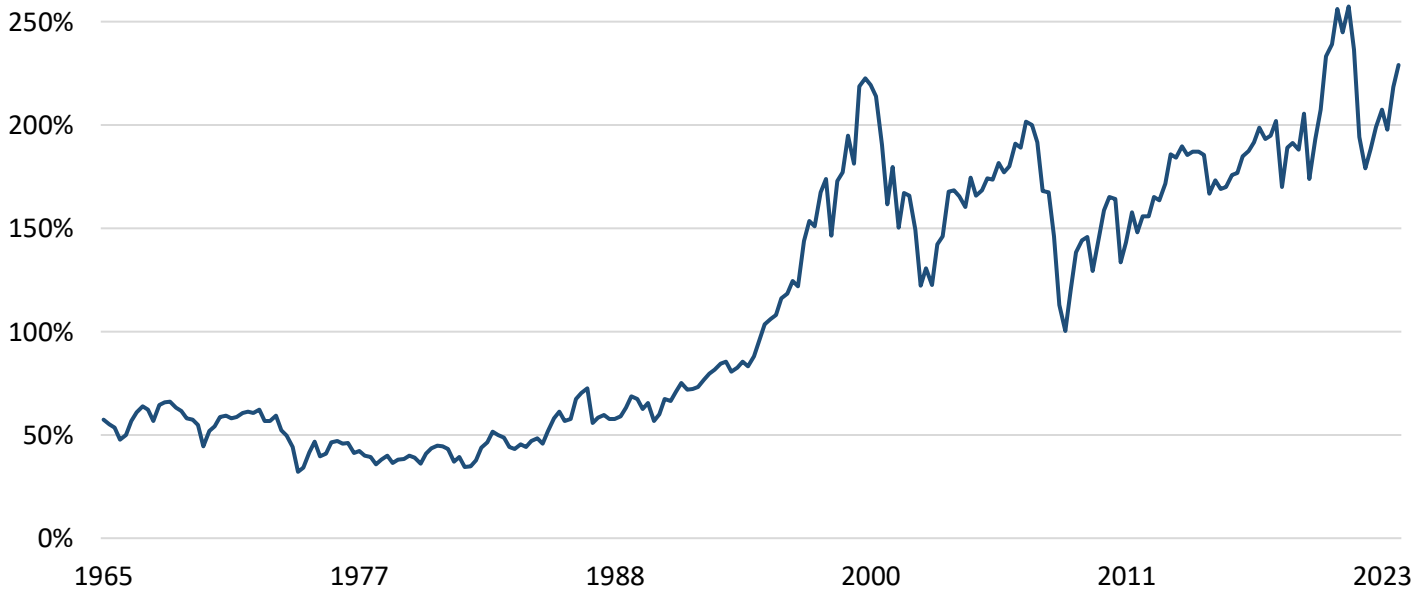
*“Taking the United States as an example, the four largest balance sheet items **outgrew GDP** by between 50 percent (real estate) and **200 percent (equity)** at market values relative to 1995 values.”*

U.S. Stock Market Cap (\$ Trillion)



Source: Kailash Capital Research, LLC; Data from 12/31/1965 - 2/29/2024

Total Market Cap/GDP



Source: Kailash Capital Research, LLC, St. Louis Fed

“Low interest rates encouraged borrowing ...an overhang of capital chased too few productive investment opportunities, and much of it flowed into real estate and equity, driving up prices...and paper wealth grew.”⁸

⁵ IBID, p. iv

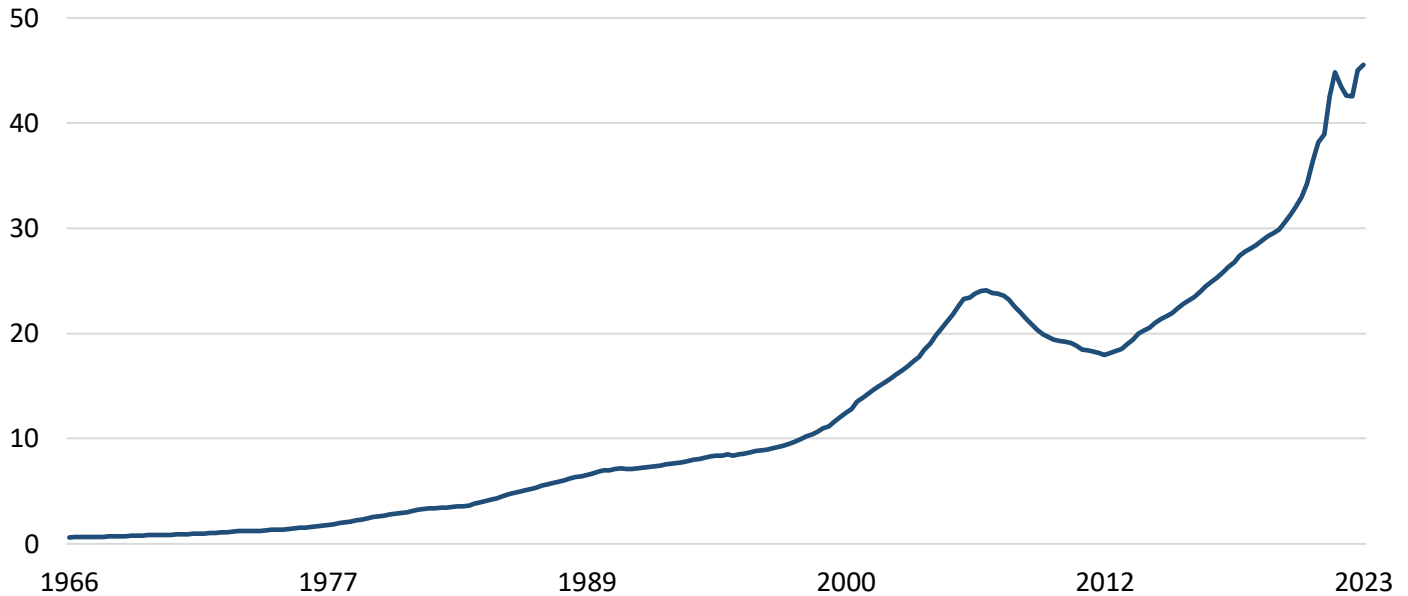
⁶ IBID, p. 7

⁷ IBID, p. iv

⁸ IBID, p. 9

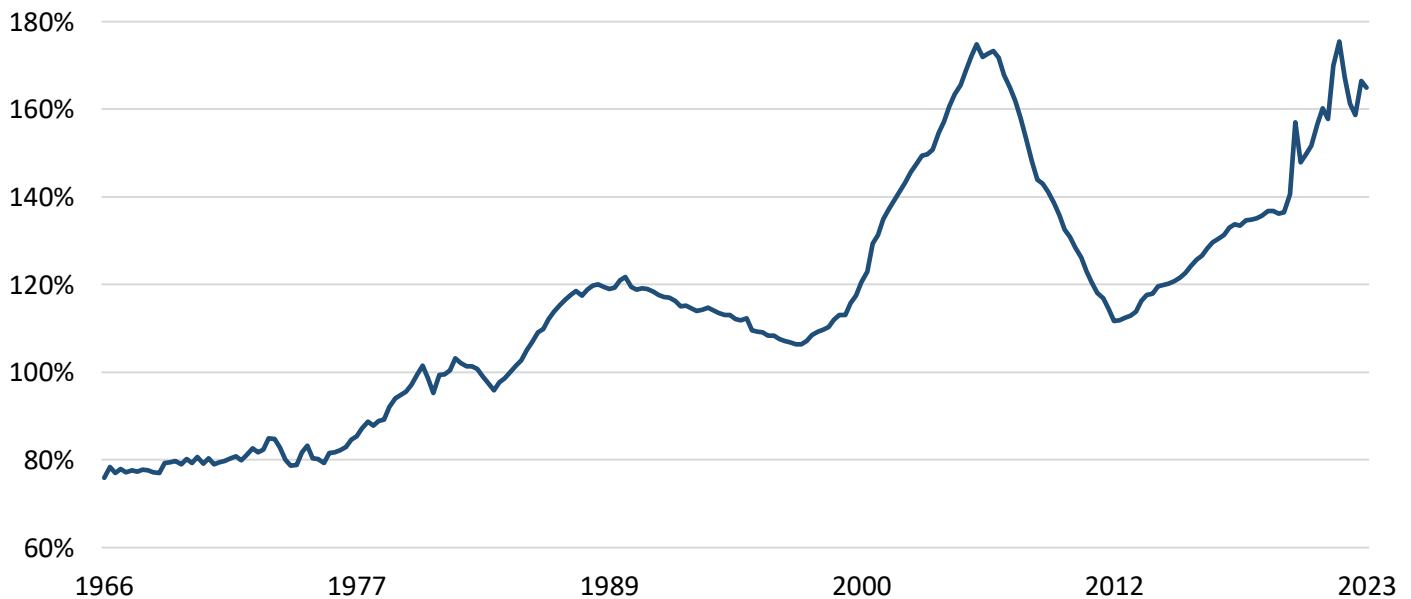
“There was a relative paucity of productive options for savers...and the price of existing homes and shares duly rose, GDP growth remained below its structural potential. Central banks kept interest rates low to stimulate economic activity...This was classic ‘secular stagnation.’”⁹ **“In the United States...the market value of real estate expanded 1.5 times faster than GDP from 1995 to 2021. While there was a significant correction after the global financial crisis, the rise quickly resumed. Declining real interest rates drove almost the entire increase.”**¹⁰

Real Estate (\$ Trillion)



Source: Kailash Capital Research, LLC, St. Louis Fed

Real Estate/GDP



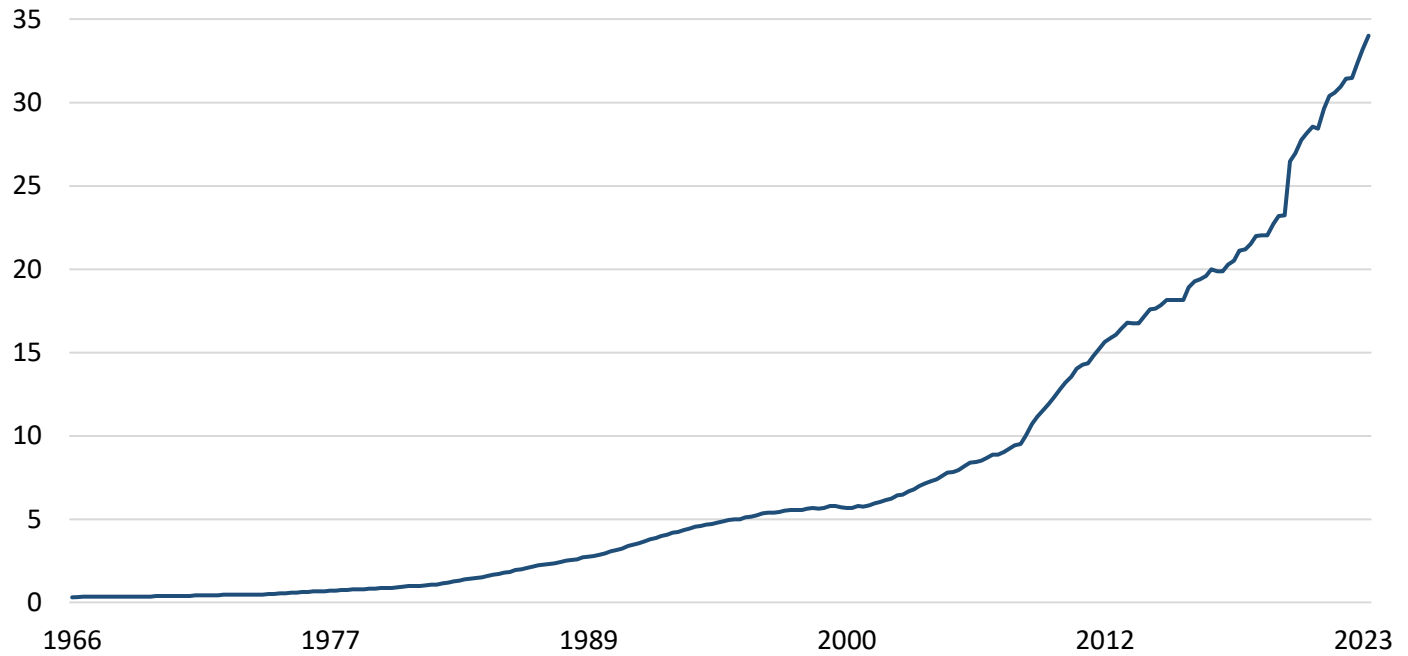
Source: Kailash Capital Research, LLC, St. Louis Fed

⁹ IBID, p. 14

¹⁰ IBID, p. 9

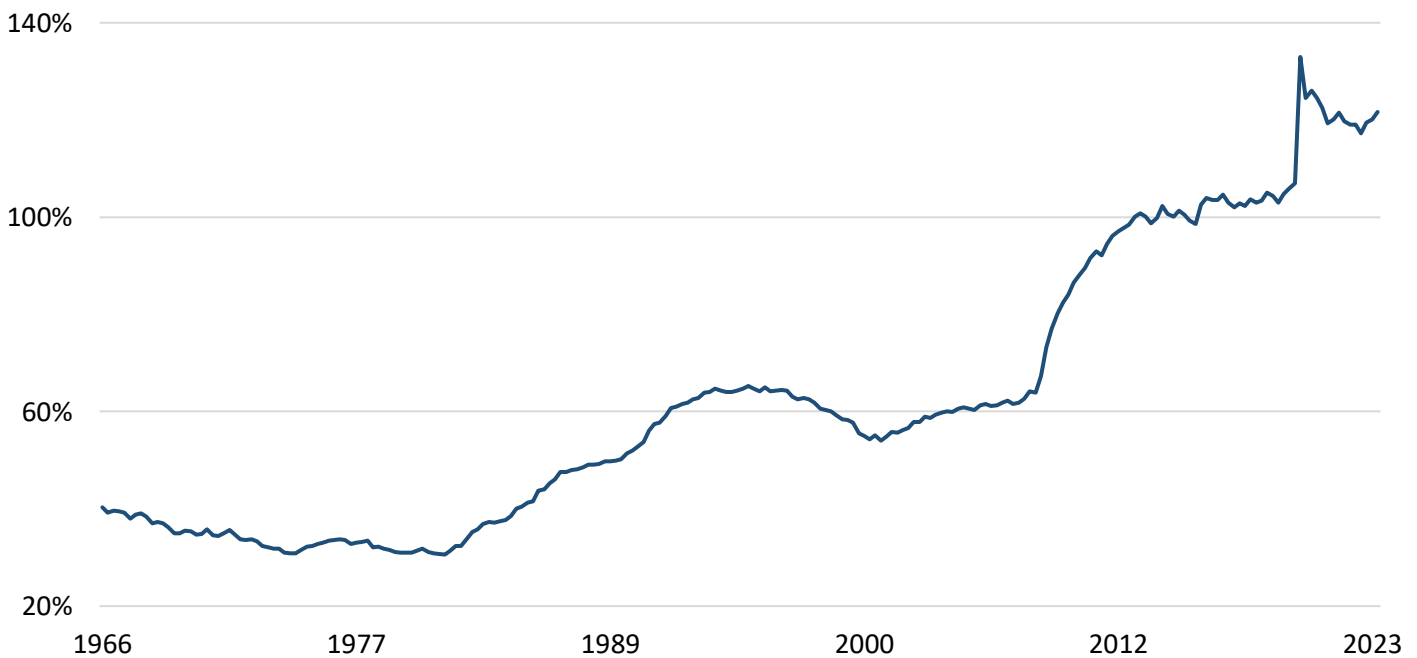
“In the United States, the [explosion in liquidity] unfolded in three waves....Loose mortgage lending before the great financial crisis in 2008 triggered the first wave....A second wave came with quantitative easing and thus the creation of central bank (or ‘outside’) money in response to the crisis. Finally, a third wave occurred with another round of quantitative easing [and financial support for households and firms] in response to the pandemic.”¹¹ During 2020 and 2021 global wealth relative to GDP grew faster than in any other two-year period in the past 50 years. **The creation of new debt accelerated to \$3.40 for each \$1.00 in net investment.**¹²

US Debt (\$Trillion)



Source: Kailash Capital Research, LLC, St. Louis Fed

US Debt/GDP



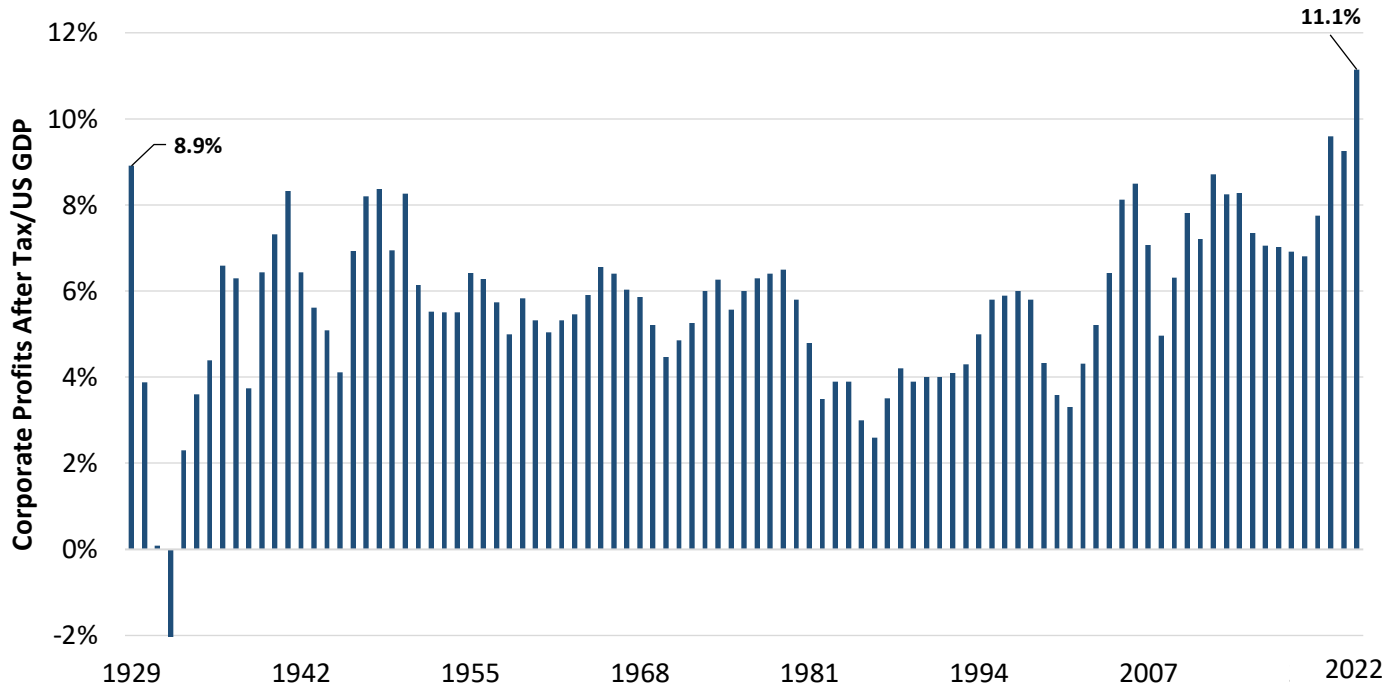
Source: Kailash Capital Research, LLC, St. Louis Fed

¹¹ IBID, p.13

¹² IBID, p. 7

“...another powerful factor was also at work in the United States: a rising GDP share of corporate earnings...The earnings share of GDP rose by 80% from 1995 to 2021 to 12.3 percent – **the highest share in a century**. The earnings share grew **despite the fact that the stock of corporate capital, as is common, closely tracked GDP**. [Causes included] rising automation and a **decline in labor bargaining power** in some sectors, including from **globalization, offshoring**, and shifts in production to less unionized states. **Changes in corporate tax rates** may also have played a role.”¹³

Corporate Profits After Tax/Total US GDP



Source: Kailash Capital, St. Louis Fed, Fortune Magazine; Data from 12/31/1929 - 7/31/2023

And so there you have it. From McKinsey’s extensive research on the evolution and state of the global balance sheet. **The good news is we are living in a moment of extraordinary wealth.** The trouble is that much of this wealth rests on unsustainably high profit margins sitting on some of the highest multiples in history.

The trouble is further exacerbated by the record levels of inequality this dynamic has created. We are not macroeconomic forecasters here at KCR, but we do understand the human desire to “know” what is coming. On this front, McKinsey lays out four possible future scenarios.

One of the most appealing parts of their research sits in the arithmetic clarity of its design and the near decade-long nature of their thinking. For disciplined investors with longer horizons, the appeal here is obvious. McKinsey’s efforts focus on “what” rather than pretending to know “when” and highlight how investors’ short-term focus may undermine the long-term prospects for preserving and growing wealth.

*“Many players still emphasize short-term financial indicators such as the latest inflation readings, an interest rate decision by the US Federal Reserve or Bank of Japan, and the reaction to any of these in the financial markets. **Longer-term structural shifts generally attract less attention.** ...*

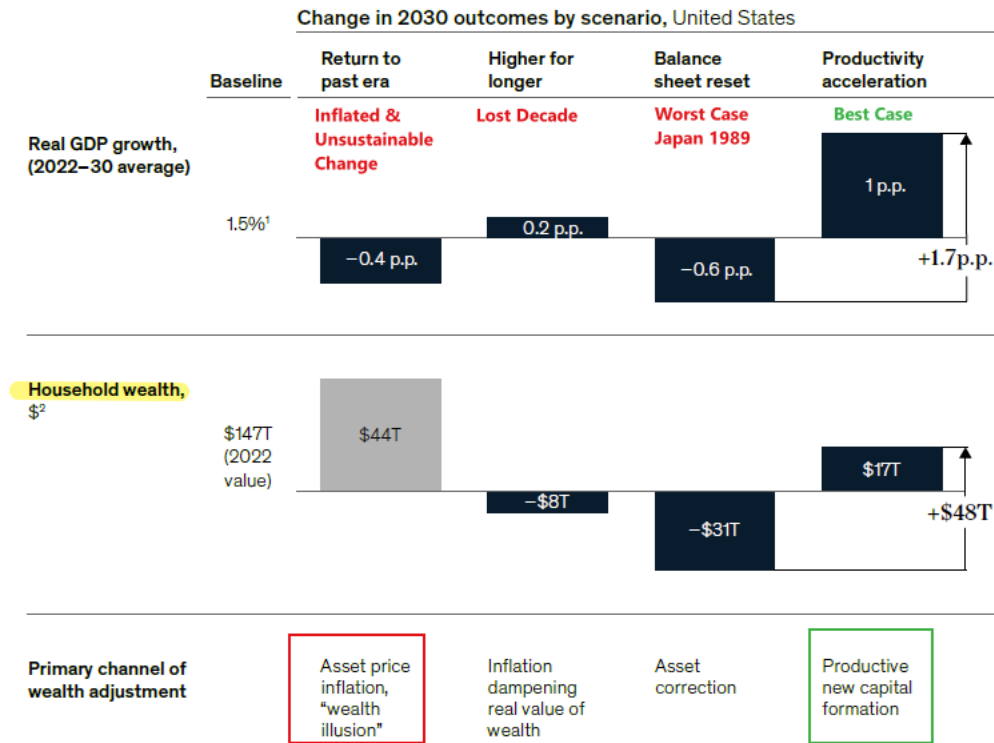
*How can investors and asset managers develop foresight and adjust asset portfolios? **‘Everything will be fine if you take a ten-year perspective’ may apply less than in the past, whether for asset prices, financing conditions, or economic parameters.**”¹⁴*

¹³ IBID, p. 12

¹⁴ IBID, page 32

McKinsey’s Four Paths for the Future of Household Wealth in the United States:

... [McKinsey modeled] four economic scenarios. ... Three potential scenarios are far from ideal – two are ‘pick your poison’ and the third a double dose. ... The worst case would look like Japan after its real estate and equity bubble burst in the 1990s with drawn-out deleveraging and a sharp contraction in asset prices. ... the most desirable outcome is to accelerate productivity so that economic growth catches up with the balance sheet.”¹⁵



The left-most scenario, “Return to past era,” with its \$44T increase in household wealth might look appealing. But as McKinsey explains, “...this scenario may appear attractive because wealth continues to grow. But that growth comes at the expense of real economic output, accentuates inequality, and continues to raise the risk of financial stress and future corrections. ... The balance sheet continues its secular expansion relative to GDP, but, as before, remains vulnerable to future shocks and disruptions.”¹⁶

The most desirable scenario McKinsey provides is the right-most one, “Productivity acceleration.” In this scenario, “New investment materially accelerates productivity growth and GDP growth...compared with the past decade. Faced with tight labor markets, firms accelerate investment in and adoption of automation technology, fostering productivity growth. ... Thanks to rapid GDP growth, the size of the balance sheet overall as a multiple of GDP declines slightly. The total real market value of equity grows only modestly more slowly than in the past, but it declines relative to accelerating GDP. ... The value of real estate (adjusted for inflation) broadly stagnates, and, therefore, declines relative to GDP. ... Real household wealth grows by a cumulative \$16 trillion.”¹⁷

¹⁵ IBID, p. iv
¹⁶ IBID, p. 25
¹⁷ IBID, p. 28

Conclusions from McKinsey & KCR:

KCR would like to be very clear: in the interests of verbal and optical efficiency we have shortchanged the McKinsey work. We cannot recommend it strongly enough. Our team merely felt that their work, spanning three years, did a remarkable job documenting and explaining the difficult moment for asset markets globally, but particularly in the US.

Given the surfeit of analytical excellence, choosing what to quote around which chart was no easy task. We ask our readers and anyone who reads the McKinsey work for forgiveness if they feel we failed in this endeavor. We chose the quote below as the “closer” as it sums up both the predicament created by our past actions as well as posing what might be the most important question to realigning asset values with economic growth in the healthiest manner possible.

“Decision makers have become used to a balance sheet, both debt and asset values, that outgrew GDP for decades, but the next decade could see the world heading in a materially different direction. ... Monetary and fiscal policy makers face a predicament: fail to tighten enough, and inflation stays uncomfortably high; tighten too much, and wealth and the financial system face stress. Without faster GDP growth, the line between these outcomes may be very thin. ...

*Reshaping the financial system to focus capital allocation toward new, productive capital formation could help. **What could shift the relative attractiveness of financing new businesses and projects in energy or infrastructure versus financing existing asset transactions like mortgages for existing homes at ever-rising prices?**”¹⁸*

For KCR readers who have felt that the 2020 meme-mania and the explosion in supersized tech stocks priced for perpetual perfection are alarming, you are not alone. For those looking at McKinsey’s four paths forward and thinking none of this looks particularly appealing, you are, once again, not alone. **There is good news however: this data is at the aggregate level.**

As our research has documented, for investors willing to embrace idiosyncratic risk and invest with an active manager, the value and quality spreads in US equities are at or beyond the extremes last seen at the peak of the dot.com bubble. As we have highlighted, this is particularly true in high-quality dividend stocks, value stocks, and, most importantly, mid- and small-cap stocks.

We understand the media has become a virtual mouthpiece for the index-fund complex. With over half the market now allocating capital based on market cap alone and that share growing by the month, “cheap beta” has become the biggest equity bubble in our lifetimes. Adding things like profitability, valuation, and capital allocation to the process of stock selection has historically done a remarkable job of protecting investor capital.

We went through our list of clients and pulled out all the mutual fund products that existed since 1999, that we could find. Below, we show the performance of these products from the dot.com peak to the trough and then full-cycle vs. the benchmarks.

The chart below shows:

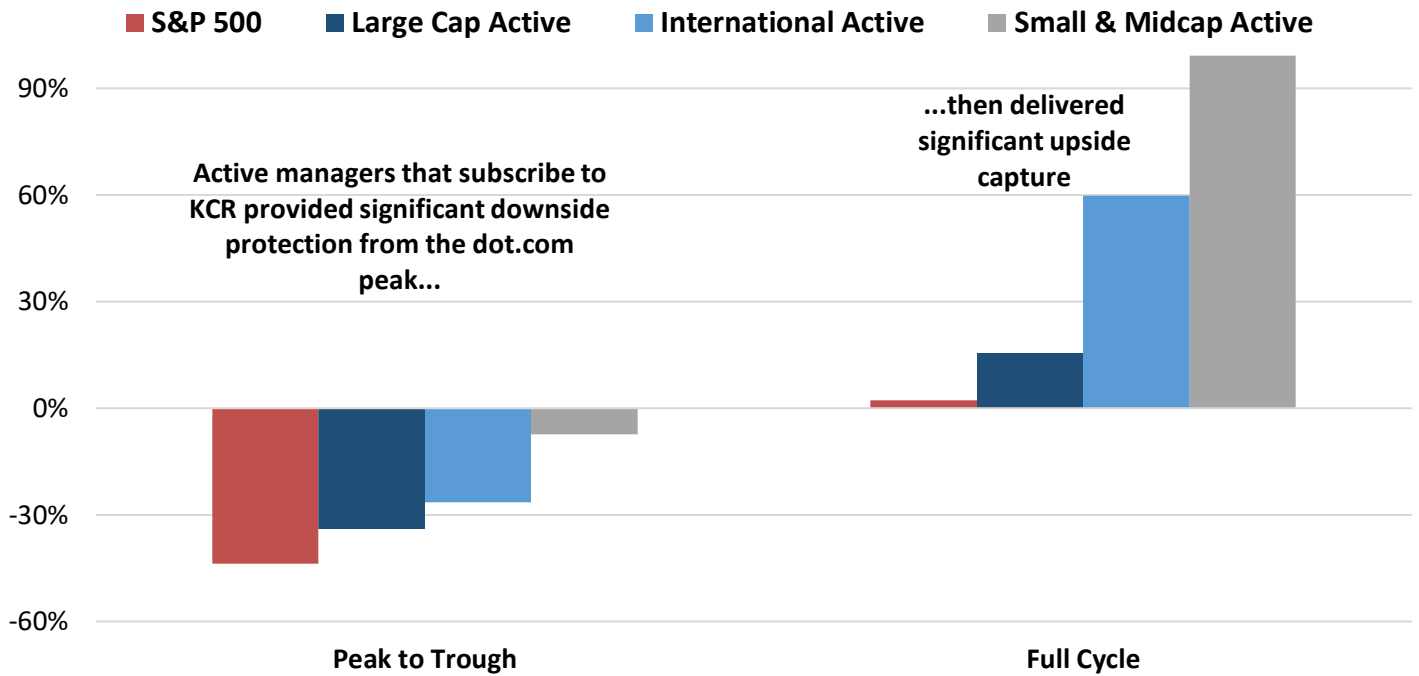
- **Red Bar:** S&P 500 Index Returns
- **Navy-Blue Bar:** returns to active large cap mutual funds run by KCR’s enterprise subscribers
- **Light-Blue Bar:** returns to active international mutual funds run by KCR’s enterprise subscribers
- **Gray Bar:** returns to active small & mid cap mutual funds run by KCR’s enterprise subscribers

Considering the ruthless panning the active management community takes, we find the results below compelling evidence for active managers. Even Larry Fink, “[The Pope of Wall Street](#)”¹⁹ has taken a liking to the idea....

¹⁸ IBID, pages 28-31

¹⁹ Title courtesy of [Grant’s Interest Rate Observer](#), a “must read” publication in our view

Performance of Active Managers in the Dot.Com Mania



Source: Kailash Capital Research, LLC, Bloomberg; Data from 3/31/2000 - 10/31/2006; *Active managers consist of KCR clients only

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